IMPROVEMENTS BY TENANTS: — WHO IS LIENABLE?

E. MIRTH, Q.C.*

The author discusses recent developments in the area of mechanics' liens as a result of a trilogy of Supreme Court of Canada decisions. These decisions increase the potential for landlords to be subject to mechanics' liens in respect of improvements undertaken by tenants.

I. SUMMARY

Recent developments in mechanics' lien law in Canada offer a serious new twist to financing and other arrangements for improvements constructed for tenants. In three recent decisions involving complex transactions Canada's Supreme Court has found a landlord to be subject to the duties of an owner in respect of improvements constructed by or for a tenant. The cases are:

1. *Northern Electric Company Ltd.* v. *The Manufacturers Life Insurance Company*;[1]
2. *Phoenix Assurance Company of Canada* v. *Bird Construction Company Ltd.*;[2]
3. *Ken Gordon Excavating Ltd.* v. *Edstan Construction Ltd.*[3]

An earlier decision in the Alberta Court of Queen's Bench reached similar conclusions in respect of a conventional sales participation space lease in a shopping centre: *Suss Woodcraft Ltd.* v. *Abby Glen Property Corp.*[4] The court found such liability without finding any arrangement between the landlord and the tenant for the landlord to pay for the improvements. That raises the possibility that in every typical commercial landlord and tenant situation today the landlord may have direct mechanics' lien responsibility.

II. BACKGROUND MECHANICS' LIEN POINTS

To understand the impact of these cases, some brief review of the basic concepts in mechanics' liens statutes is needed. Such statutes exist in all the common law provinces in Canada[5] and appear to emanate from the United States out of early Roman law.[6] The Civil Codes of the State of Louisiana and the Province of Quebec, which are based on Roman law, also contain provisions for workmen's liens against land.[7] The English common law had

* Partner, Reynolds, Mirth & Cote Barristers & Solicitors Edmonton, Alberta. [This paper was originally presented at a joint ALI/ABA and Legal Education Society of British Columbia seminar on commercial leases in July, 1986.]

1. [1977] 2 S.C.R. 762, 79 D.L.R. (3d) 336.
2. [1984] 2 S.C.R. 199.
3. [1984] 2 S.C.R. 280.
4. [1975] 5 W.W.R. 57.
5. See D. Macklem and D. Bristow, *Mechanics' Liens in Canada* (4th Ed.) 1.
6. *Id.* at 1.
7. *Id.* at 1.

no similar concept and the mechanics' lien as a result is entirely a creature of statute.[8] All American states have mechanics' lien statutes.[9]

Generally speaking, the object of the various statutes is to prevent owners of land from getting the benefit of buildings constructed on the lands without paying for them.[10] In all common law provinces, the statute gives the person who does work or supplies materials a lien upon the land. In some provinces,[11] the statute also gives that person a lien upon the monies paid by the owner of the land to the contractor with whom the owner contracts (the "prime contractor") by imposing a trust on such monies.

In all the provinces, the statutes seek to ensure payment of lienholders' claims by requiring the owner to retain out of all payments made under the prime contract a percentage of the value (normally based on contract price) of work done. Lien claims are also a lien upon such holdback funds. If the owner complies with the holdback obligations and makes what he has held back available to lien claimants then if liens are registered (or notified), the liens on land will be discharged and the owner's obligations will be satisfied. In a sense, therefore, the "active ingredient" in all mechanics' lien statutes is the holdback obligation imposed upon an owner.[12] Some provinces[13] extend the holdback obligation down the construction chain, while some provide only for an owner's holdback.[14]

But if there is nothing at all payable by an owner in respect of work done there is (or more correctly was previously) no holdback obligation and no lien right (we ignore situations where something might have been payable but for some failure or default, for which special statutory rules were adopted.)[15] Where no payment[16] is ever contemplated there is nothing to which a lien can attach and there can be no lien against the estate of the

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8. *Shuttleworth* v. *Seymour* (1914) 7 Sask. L.R. 74, 6 W.W.R. 1100 (C.A.); *Johnson* v. *Crew* (1836) 5 U.C.O.B. O.S. 200 (C.A.); *Fitzgerald* v. *Apperley* [1926] 2 W.W.R. 689 (Sask. C.A.); *Clarke* v. *Williams* [1939] 3 W.W.R. 481 (B.C. Co. Ct.); *Cross* v. *Brooks* (1958) 26 W.W.R. 15 (B.C.C.A.); *Granby Const. & Equip. Ltd.* v. *Player* (1964) 49 D.L.R. (2d) 658; *Read* v. *Whitney* (1919) 45 O.L.R. 377 (C.A.); *Clarkson Co. Ltd.* v. *Ace Lbr. Ltd.*, [1963] S.C.R. 110; *Hett* v. *Samoth Realty Projects Ltd.* (1977) 76 D.L.R. (3d) 362 (Alta. C.A.).

9. This statement is drawn from Osborne, Nelson & Whitman, *Real Estate Finance Law*, (1979), 735. The writer defers to the American panelist as to the accuracy of this statement.

10. *Hickey* v. *Stalker* (1923) 53 O.L.R. 414 (C.A.); *Earl F. Wakefield Co.* v. *Oil City Petroleums (Leduc) Ltd.* [1958] S.C.R. 361; *affd.* (1959) 29 W.W.R. 638 (P.C.); *Scratch* v. *Anderson* [1917] 1 W.W.R. 1340 (Alta. C.A.).

11. Ontario, New Brunswick, Manitoba, Saskatchewan, British Columbia, and (*in part only*) Alberta (see on the latter Alta., 1985, c. 14, s. 16.1, which provides a trust only on monies paid by an owner after issue of a substantial performance certificate).

12. The Alberta statute, for example, provides that an owner is not liable under the statute for more than the holdback (i.e., the mandatory holdback or the actual holdback if greater amounts are withheld): Builder's Lien Act, R.S.A. 1980, c. B-12, s. 15(5) and s. 16.4 of said Act as am. S.A. 1985, c. 14.

13. Ontario, Saskatchewan, Nova Scotia, Manitoba, British Columbia and Newfoundland.

14. Prince Edward Island, Alberta and New Brunswick.

15. Described briefly in Macklem and Bristow, *supra* n. 5 at 118-119.

16. As distinct from payment in kind or by some other form of consideration, for which a holdback obligation based on value may apply: see s. 19 of the Alberta statute, R.S.A. 1980, c. B-12, (both before and after 1985 amendments).

owner.[17] Further, once in the past Canada's Supreme Court apparently held that the holdback obligation did not apply even where a consideration was payable, but there was no separation of the consideration between building work and other items contracted for that were not building work: *S. Morgan Smith Co.* v. *Sissiboo Pulp & Paper Co.*[18]

The holdback obligation in all provinces expires after a period of time following prime contract completion.[19] If it expires and no liens have been registered[20] the owner may validly end his holdback obligation by payment and all liens become discharged[21] (that is, they no longer exist). This concept also points to the holdback obligation as the main ingredient in the statutes.

III. APPARENT PRIOR RULES WHEN APPLIED TO LEASES

As noted above, the principles of the various mechanics' liens statutes would leave a landlord who gives no consideration that equates to payment, in respect of fixed improvements constructed by or for a tenant, free of responsibility and lien attachment. A landlord who leases bare ground to a tenant who builds a building for his own use, a landlord who leases unfinished office space to a tenant who installs his own partitions and other improvements, and a landlord who leases unfinished space in a shopping centre to a retail tenant who completes his own storefront and partitions, would all be able largely[22] to disregard the impact of mechanics' lien law. While a tenant's interest as lessee could be liened for the work, the landlord's estate would not be at risk[23] and the landlord would have no "holdback" obligation.

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17. *Kosobuski* v. *Extension Mining Co. Ltd.* (1929) 64 O.L.R. 8 (C.A.); *Turner Valley Supply Co. Ltd.* v. *Scott* [1940] 3 W.W.R. 529, reversing [1940] 2 W.W.R. 478 (Alta. C.A.); *Can. Cutting and Coring (Toronto) Ltd.* v. *Howson* [1968] 2 O.R. 449 (M.C.); *Jack Greedy Ltd.* v. *Shields* (1981) 10 A.C.W.S. (2d) 473 (Ont. M.C.); *Cobble Construction Ltd.* v. *Elder* (1982) 36 O.R. (2d) 712 (M.C.); *Revelstoke Co. Ltd.* v. *Simper* (1978) 6 Alta. L.R. (2d) 252. *See also River Valley Store Fixtures Ltd.* v. *Camper-Villa-Inn Ltd.* [1977] 1 W.W.R. 659 (Man. Co. Ct.); *Burton* v. *Hookwith* (1919) 45 O.L.R. 348 (C.A.); *Farrell* v. *Gallagher* (1911) 23 O.L.R. 130; *McManus* v. *Rothschild* (1911) 25 O.L.R. 138 (C.A.); *Rice Lewis & Son Ltd.* v. *George Rathbone Ltd.* (1913) 27 O.L.R. 630 (C.A.); *Travis* v. *Brechenridge-Lund Lbr. & Coal Co.* (1910) 43 S.C.R. 59, reversing 10 W.L.R. 392; *Ne Page* v. *Pinner* (1915) 8 W.W.R. 322 (B.C.C.A.); and *Wilks* v. *Leduc* [1917] 1 W.W.R. 4 (Man. C.A.).

18. (1904) 35 S.C.R. 93. This case may not apply any longer in light of provisions like Alberta's section 19, *supra* n. 16, which says that the value of the work is to be used for holdback calculation where the price is not payable in money.

19. The periods vary from province to province: see Macklem and Bristow, *supra* n. 5, at 117-118. They also run variously from the moment of full completion and the moment of substantial completion. In theory in Alberta, before 1985 statute amendments, the mandatory holdback period of 35 days after substantial completion of the prime contract (*but see, contra, Glenway Supply (Alta.) Ltd.* v. *Knobloch* [1972] 6 W.W.R. 513 (Alta. C.A.). Since the 1985 amendments the period has (for post-June 30, 1985 prime contracts) changed to 45 days from full completion or from issuance of a certificate of substantial performance.

20. Or, in some provinces, notified to an owner.

21. See s. 18 of the Alberta statute, *supra* n. 16, (both before and after the 1985 amendments).

22. The prudent landlord will concern himself about lien claims on the leasehold estate as well, but the concerns and solutions are not the same as those of an owner with direct lien liability.

23. Subject to what is said below regarding notices to a landlord under provisions like Alberta's s. 12, *supra* n. 16.

But if by the lease the landlord undertakes to construct and pay for the improvements for his own account and benefit, but for use by the tenant during the lease term, then all the provisions of the statutes would bear on the landlord's position. Obviously, a landlord who builds a building on his own land to suit a tenant is an owner who contracts for improvements within the statutes. He must hold back from the contractors he hires to do the job and he must deal as an owner with liens registered or notified. The same would be true of the landlord who installs for his own account permanent leasehold partitions in office space for use by a tenant. Those are clear cases.

Some situations are not so clear. For example, landlords often pay an "improvements allowance" to tenants as part of a leasing package. Sometimes a landlord will leave the tenant to install the improvements but will pay for them by way of a loan that becomes amortized in the rental over the lease term. In these situations it has been difficult[24] to discern whether the landlord has lien responsibility or not. A host of situations could fall into this "grey area", particularly in the context of the modern-day inventiveness of property owners in designing lease concepts.[25]

Before 1975 a landlord who did not himself undertake the work was probably free as long as he avoided any direct dealing with lien claimants.[26] For example, even though a landlord paid some accounts of an electrician hired by a tenant but there were no direct dealings between the landlord and the electrician, the landlord was not an "owner" with lien liability.[27] Where the tenant undertook renovations to standards established pursuant to the lease and the landlord took no part in the renovations, the landlord was not a lienable owner.[28] Even if the landlord had approval control over the tenant's construction plans and the right to supervise and even alter plans, the landlord was not liable for liens.[29]

24. Until the Supreme court decisions first above-noted.

25. Often today the leasing arrangements are quantified in terms of over-all costs during the lease term (lumping base rent, operating costs, tenant inducements and all other factors together in a global computation) or over-all yield during the lease term. Whether the various components in that global sum are inducements, rent adjustments, financing of construction costs or landlord's assumption of construction obligations is often difficult to identify.

26. *Gearing* v. *Robinson* (1900) 27 O.A.R. 364; *John A. Marshall Brick Co.* v. *York Farmers Colonization Co.* (1917) 54 S.C.R. 569, *affg.* 35 O.L.R. 542 (*sub nom. Marshall Brick Co.* v. *Irving*).

27. *Swalm* v. *Fairway Finance Ltd.* (1965) 52 W.W.R. 626 (Alta. Dist. Ct.).

28. *Dalgleish* v. *Prescott Arena Co. Ltd.* [1951] O.R. 121 (C.A.); See also *Hillcrest Contractors Ltd.* v. *McDonald* (No. 2) (1977) 2 Alta. L.R. (2d) 273; *Sandon Const. Ltd.* v. *Cafik* [1973] 2 O.R. 553 (C.A.).

29. *Stuart & Sinclair Ltd.* v. *Biltmore Park Estates Ltd.* [1931] O.R. 315 (C.A.). The result would be otherwise, however, if the landlord became active in the actual work, such as by way of ordering some of the work, paying in fact for some aspects of it, taking out the building permit and consulting on building progress: *Orr* v. *Robertson* 91915) 34 O.L.R. 147 (C.A.); see also the explanation of this case in *John A. Marshall Brick Co.* v. *York Farmers Colonization Co. supra* n. 26. See also *Eddy Co.* v. *Chamberlain* (1917) 45 N.B.R. 261 (C.A.); *Garing* v. *Hunt* (1895) 27 O.R. 149; *Pavich* v. *Tulameen Coal Mines Ltd.* [1936] 3 W.W.R. 593 (B.C.C.A.); *Limoges* v. *Scratch* (1910) 44 S.C.R. 86; *Nuspel* v. *Lem Foo* [1949] O.W.N. 476; *Partridge* v. *Dunham* [1932] 1 W.W.R. 99 (Man. C.A.); *Turner Valley Supply Co. Ltd.* v. *Scott* [1940] 3 W.W.R. 529 (Alta. C.A.); *Morgan* v. *Sunray Petroleum Corp.* [1941] 3 D.L.R. 747 (Alta. S.C.); *Webb* v. *Gage* (1902) 1 O.W.R. 327 (C.A.); *Johnson & Johnson Ltd.* v. *Butler* (1914), 7 W.W.R. 385 (Alta. S.C.). See also *City of Hamilton* v. *Cipriani* [1977] 1 S.C.R. 169.

The "old" law can be illustrated from five reported cases ranging from 1904 to 1940. Oddly enough, as is discussed more fully below, four of these cases were cited and applied by the Supreme Court in the *Phoenix Assurance* case. Brief summaries of the cases are as follows:

A. *THE S. MORGAN SMITH CO.* V. *THE SISSIBOO PULP & PAPER CO.*[30]

This case involved a complex transaction on a mining property that included the supply of equipment and the issue of shares and other security interests. The various terms of consideration for the transaction were not differentiated as between the various parts. The mining equipment was supplied at a time in the transaction when there was nothing whatever remaining payable by the person who the supplier of the equipment sought to charge as an "owner".

In a very brief judgment the Supreme Court of Canada held that there was no lien if there was nothing payable by the person who was sought to be charged as owner. Further, the court held that there also could be no lien where the payment by the alleged "owner" is for several different things including items that are not work or materials under the lien statute and there is no differentiation of the consideration between items of work and materials and other items.

B. *JOHN A. MARSHALL BRICK CO.* V. *THE YORK FARMERS COLONIZATION CO.*[31]

This was a 3 to 2 decision of the Supreme Court with the majority opinion given by Chief Justice Fitzpatrick and Justices Duff (as he then was) and Anglin. Dissenting judgments were given by Justices Davies and Brodeur.

The case appeared to resolve what was to that point a highly debated difference of opinion in the Courts as to whether or not the mere fact that A contracted with B to build an improvement made B liable to liens.[32]

The case involved an agreement for sale of lands between what appears to have been a sub-division developer and a builder. Under the arrangements between those parties, the builder purchased lots from the sub-division owner by agreement for sale. The vendor, in turn, financed the construction of houses on the lots, which houses were required to be built pursuant to plans prepared by the vendor. Under the sale contracts the purchaser covenanted with the vendor to build homes according to those plans.

The debate in the courts below had been on the question of whether the contractual undertaking to build given by the purchaser to the vendor was itself sufficient to make the vendor an owner for whom the construction was done within the definition of the liens' statute.

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30. (1904) 34 S.C.R. 93.

31. (1916) 54 S.C.R. 569.

32. In *Orr* v. *Robertson* 91915) 34 O.L.R. 147 the Ontario Court of Appeal had held that a lessee's contracting with lessor to build improvements was enough to make lessor liable for liens. This case was subsequently "explained" in *Marshall Brick*, *supra* n. 26, as being a case where there *was* direct dealing between the lessor and the lien claimants.

The majority in the Supreme Court held that contracting for the construction of a building would not itself render the vendor an owner. Unless the vendor had some direct dealings with the persons who were lien claimants, he would not be liable for liens.

The dissenting opinion suggested that the undertaking by contract was itself sufficient.

The majority opinion, and its description of the need for direct dealings, has subsequently been applied in numerous cases throughout the country. The following passage discussing the defined term "owner" in a lien statute is taken from the judgment of Mr. Justice Anglin (at page 581) and has been often quoted:[33]

> While it is difficult if not impossible to assign to each of the three words 'request', 'privity', 'consent', a meaning which will not to some extent overlap that of either of the others, after carefully reading all the authorities cited I accept as settled law the view enunciated in *Graham* v. *Williams* [8 O.R. 478], and approved in *Gearing* v. *Robinson* [27 Ont. App. R. 364], at page 371, that 'privity and consent' involves
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> > something in the nature of a direct dealing between the contractor and the persons whose interest is sought to be charged . . . mere knowledge of, or mere consent to, the work being done is not sufficient.
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> There is no evidence here of any direct dealing by the respondent company with the Purchaser's contractor such as is necessary to establish the 'privity' requisite to constitute the respondent company an 'owner' within the definition 'Mechanics' Lien Act'.

C. *KOSUBUSKI* V. *EXTENSION MINING CO.*[34]

This was another mining case. A person who held an option on a mining operation contracted in such option to perform certain mining obligations. In so performing, the optionee incurred lien obligations which the lien claimants sought to attach to the interest of the optionor.

The Ontario Court of Appeal referred to the *Sissiboo* [35] case in holding that because there was no money payable by the optionor to the optionee there could be no lien of the optionor's estate in the land.

The lien claimants were employed by the optionee, Extension Mines Corporation Ltd. for the purpose of pumping out or "dewatering" the mine and the lien claims were for wages for the services so performed.

Mr. Justice Orr made the following statements at page 11 and 12, some of which were in fact quoted with approval in the *Phoenix Assurance* case:[36]

> There was no contractual relationship whatever between the Ixion Mines Ltd. [the optionor] and the Plaintiffs, and it is impossible, in my judgment, that in regard to the relationship of the parties and the provisions of the Mechanic's Lien Act, for any lien to have attached against the estate of the owners for the wages claimed by the Plaintiffs.

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33. It is difficult to distinguish the facts and result in the *Marshall Brick*, *supra* n. 26 case from those in the *Edstan* case. While the latter bore a more complicated factual situation than the situation presented in the *Marshall Brick* case, in substance the facts were the same. It would almost seem that the Supreme Court in the *Edstan* case was overruling itself, or at least appeared to reverse the result of the *Marshall Brick* case. That fact is particularly curious when one notes that in the *Phoenix Assurance* case *Marshall Brick* was applied to exclude liability for the third-party tenant improvements (as is hereinafter outlined). The ratio of the new Supreme Court decisions becomes rather hard to identify as a result.

34. (1929) 64 O.L.R. 8.

35. *Supra* n. 30.

36. *Supra* n. 34 at 11.

> The work of dewatering the mine was to be performed by Ward as part of the consideration for the option granted to him by the appellants. The consideration passing to him for that work was complete, and nothing further could at any time thereafter become payable by them to him in respect thereof.
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> Section 10 of the Mechanic's Lien Act is as follows:—
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> 'save as herein otherwise provided where the lien is claimed by any person other than the contractor the amount which may be claimed in respect thereof shall be limited to the amount owing to the contractor or sub-contractor or other person for whom the work or service has been done or the materials placed or furnished.'
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> Ward was clearly a contractor for the dewatering of the mine; and, as no amount was ever or could be owing to him by the appellants thereunder, there was nothing upon which any lien for work done for him could attach. Nothing in the Act gives a sub-contractor (which term by paragraph (f) of s. 1 includes a wage earner) the right to recover, as against any person higher up the scale than the person with whom he himself contracted, more than the amount owing to such person by those above him, due regard being had, of course, to the obligation of the owner and each contractor and sub-contractor to protect possible lienholders under s. 11, by retaining, out of the contract price, the percentages specified in subsections 1 and 2, or a larger amount if notice in writing is given under subsection 4.

D. STUART SINCLAIR LTD. V. *BILTMORE PARK ESTATES* [37]

In this case a ground lessee agreed to build and operate a recreational club on lands owned by the lessor within a subdivision being developed by the lessor. If the lessee didn't build the club the lessor had the right to cancel the lease or to enforce the undertaking to build the clubhouse. The ground lease went on to provide that in the event of fire, loss proceeds of fire insurance coverage were payable to the lessor, although they had to be applied to the rebuilding of the clubhouse. Plans for the clubhouse had to be approved by the lessor and the construction and even purchase of equipment was to be subject to the lessor's approval as well. The lessor had the right to require changes in the plans for the clubhouse. Further, officers of the lessor were to be given the free use of a suite within the clubhouse. The lessor was given the function of selling shares in the club as agent for the club and for profit. The lessor had the right under the ground lease to supervise construction. The lessee club however signed the construction contract as "owner" with the prime contractor. The lessor was, on the brochures issued in the organization of the club, to put up its remaining lands as security for the undertaking of the club.

The majority of the Ontario Court of Appeal (Magee, J., dissenting) applied the *Marshall Brick* case, *supra* n. 26, and held that there was no lienability on the interest of the lessor.

E. *TURNER VALLEY SUPPLY* V. *SCOTT* [38]

In this case the Alberta Court of Appeal applied the *Marshall Brick* decision *supra* n. 26 to an oil and gas sublease. Under the terms of the sublease there was nothing payable by the lessor to the lessee. As a result, the Court ruled that no liens were available as against the estate of the lessor. There being no contract on which a holdback would be calculable and no holdback obligation there could be no liens. The Court referred to and applied the *Sissiboo* [39] case.

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37. [1931] O.R. 315.
38. [1940] 3 W.W.R. 529.
39. *Supra* n. 30.

From these cases it seems clear that at least until the 1940's[40] if there was nothing payable by a fee owner to a subordinate interest holder the fee owner would not be subject to liens arising under the interest holder. Further, for a landlord to be responsible for liens arising through his tenant the landlord had to have some direct or active involvement with the lien claimants. While pre-1923 cases need to be viewed with a special caution, they remain nonetheless relevant to the issue. (Prior to 1923 entire contracts in Ontario and elsewhere would avoid liens altogether if the contracts were not complete; and after that date, in Ontario at least, lien liability occurred whether the contract was entire or not. That change, however, bears nothing at all on the situation that applies where there is nothing ever payable by party A to party B and the law on that point had, until the above 3 Supreme Court of Canada decisions, been stable for some 60 years.)

IV. LIABILITY ON NOTICE

All the provinces' statutes allow a lien claimant doing work for a tenant to subject the fee simple owner (or landlord) to liability for his lien.[41] In Alberta the mechanism for that is found in section 12:

> 12(1) When the estate on which a lien attaches is a freehold estate for a life or lives or a leasehold estate then, if the person doing the work or furnishing the materials gives to the person holding the fee simple, or his agent, notice in writing of the work to be done or materials to be furnished, the lien also attaches to the estate in fee simple unless the person holding that estate, or his agent, within 5 days after the receipt of the notice, gives notice that he will not be responsible for the doing of the work or the furnishing of the materials.
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> (2) When the estate on which a lien attaches is leasehold, no forfeiture or cancellation of a lease, except for nonpayment of rent, is effective to deprive a lienholder of the benefit of the lien, but the lienholder may, in order to avoid forfeiture or termination of the lease for nonpayment of rent, pay any rent due or accruing due on the lease and continue the lease to its term and the sum so paid may be added to the claim of the lienholder.
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> (3) This section applies in respect of land other than minerals.

The notice can only cover work to be done, not work already done.[42] The notice must contain more than mere delivery of construction plans and other information to the landlord-owner.[43] In *Beyersbergen construction Ltd.* v. *Edmonton Centre Ltd.*[44] the Alberta Court of Appeal made it clear that the notice must make the landlord plainly aware that a lien attachment of his estate is intended:

> The sole question here is whether the notice in writing must expressly or by necessary implication inform the fee simple owner or his agent that the lienholder will claim a lien against the fee simple estate. In my opinion it must. The provision in the Mechanics' Lien Act of 1922 provided that if the owner had knowledge of the improvement, then, unless he disclaimed, he was liable. By changing the Act to make it necessary to give notice in writing of the work to be done it is clear the Legislature did not intend mere knowledge of

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40. Some of the other cases mentioned in the footnotes to this point would carry that thought into the modern day and indeed even past the 1977 *Manulife* decision.

41. Macklem and Bristow *supra* n. 5, at p. 33.

42. *Patsis* v. *75-89 Gosford Ltd.* [1973] 1 O.R. 629.

43. *Suss Woodcraft Ltd.* v. *Abbey Glen Property Corp.* [1975] 5 W.W.R. 57; *Hillcrest Contractors Ltd.* v. *McDonald supra* n. 28; *Beyersbergen Construction Ltd.* v. *Edmonton Centre Ltd.* (1977) 78 D.L.R. (3d) 122 (Alta. C.A.); *West Edmonton Mall Ltd.* v. *D.I. Retail Planning and Design Ltd.* (1982) 49 A.R. 241 (M.C.); *Cadillac Fairview Corp. Ltd.* v. *Apacon Contracting Ltd.* (1981) 38 A.R. 398 at 403.

44. *Supra* n. 43, at 124-125.

> the improvement to make the owner's property liable to a lien. The Ontario Court of Appeal in *Dalgleish* v. *Prescott Arena Co. Ltd. and Woodword*, [1951] O.R. 121 at p. 129, dealing with a similar provision said: 'mere knowledge that the work is being done is not enough to fix the owner with liability'.
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> In the case at bar although the owner had knowledge of the work being done it was necessary that the owner be given such information under the provisions of the lease and that consent be given. In receiving the plans and specifications it was pursuant to the lease and there is no necessary impliction that the only reason for giving such information was pursuant to s. 12 of the Act.
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> It may be that the notice in writing does not necessarily have to say that a lien will be claimed against the freehold interest, but the writing must give such notice if not expressly at least by necessary implication. Such was the opinion of D.C. McDonald, J. in *Suss Woodcraft Ltd.* v. *Abbey Glen Property Corp. and Zwaig* [1975] 5 W.W.R. 57, and Buchanan, C.J.D.C., in *Direct Lumber Co. Ltd.* v. *Meda* (1957) 23 W.W.R. 126.

What should be included in an effective notice might be drawn from the foregoing passage plus the requirements for notice by a lien claimant to an owner or contractor in those jurisdictions where liens can bind by notice (and not solely by registration, as is now the case in Alberta).[45] It would seem that a notice should contain the following:

(1) an indication that the contractor, subcontractor or supplier is supplying labour and materials to the tenant,
(2) a full description of the property,
(3) an indication that there will be an account owing,
(4) a statement that the contractor, subcontractor or supplier will be claiming a builder's lien against the fee simple interest and will consider registering such lien unless payment is made,
(5) the amount that the lien is or will be for, and
(6) an indication that the letter is notice pursuant to Section 12 of the Builders' Lien Act and that unless the holder of the fee simple gives a notice within 5 days of the receipt that he will not be responsible for the doing of the work or the furnishing of the material the estate of the fee simple will be responsible for the value of the improvements.

Of course, the landlord-owner can avoid lien liability under s. 12 by simply notifying the lien claimant (within the required 5 days) that the landlord will *not* be responsible. If that is done, the liens will attach no more than the leasehold estate.

V. LANDLORD AS OWNER

A landlord runs a much larger risk where he may be said to be an owner for whom or at whose request or with whose privity or consent work is done. This is where the recent Supreme Court of Canada cases impact seriously.

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45. Before 1970 a lien claimant could stop release of owner or contractor payments by notice. That still applies in some provinces, but not in Alberta since 1970. What was required for an effective notice, however, might be drawn from *Bird Construction Co. Ltd.* v. *Mountainview Construction Ltd.* (1969) 67 W.W.R. 515 (Alta.); and *Direct Lumber Co.* v. *Meda* (1957) 23 W.W.R. 126 (Alta. Dist. Ct.).

The various mechanics' lien statutes all define "owner" as a person who has requested, either directly or by implication that the work be done. In Alberta, the definition provides:[46]

> (g) owner means a person having an estate or interest in land at whose request, express or implied, and
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> (i) on whose credit,
>
> (ii) on whose behalf,
>
> (iii) with whose privity and consent, or
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> (iv) for whose direct benefit,
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> work is done on or material is furnished for an improvement to the land and includes all persons claiming under him whose rights are acquired after the commencement of the work or the furnishing of the material.

Many of the cases on landlord responsibility mentioned above focus on this kind of definition, which in itself (and in isolation from the rest of the statute) is quite broad. The words "for whose direct benefit" seem to encompass anyone who permits the work to be done and derives benefit therefrom. Any landlord who keeps the tenant's improvements after the lease expires and who contracts with the tenant for the tenant to install the improvements seems to fall within the definition. However, the section should be viewed in the context of the entire statute to be understood. When that is done and one has due regard for the character of the "active ingredient" in mechanics' lien statutes — the holdback requirements[47] — "owner" encompasses something less than the bare definition suggests. A bare land owner who *leaves* it to a Mcdonald's restaurant owner to design, build and occupy premises on the land for many years and who pays the restaurant owner nothing for the building construction, cannot be an owner with holdback obligations. Even though after lease expiry the restaurant building may revert to the landowner, there is nothing that can be identified as a construction contract or a payment obligation between the owner and the restauranteur in respect of which the "active ingredient" might operate.

VI. THE SURPEME COURT DECISIONS

With that background, what have the Supreme Court decisions done?

A. *MANUFACTURERS LIFE* CASE

The first decision was *Northern Electric Company Limited* v. *The Manufacturers Life Insurance Company* [48] in 1977. This case involved a conventional leaseback financing transaction of the variety that was quite common in Canada in the late 1960's and early 1970's. The financing was for new development of an apartment building. The developer sold the land for its reasonable value to the lender Manufacturers Life and took back from the lender a long-term lease under which the developer built an apartment building. Manufacturers Life, in turn, financed the building by way of a conventional mortgage on the leasehold estate. So there was a landlord, Manufacturers Life, who owned the fee simple, and a tenant, the

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46. RSA 1980, c. B-12, s. 1(g).

47. Or, in provinces with "trust fund" concepts, both the holdback obligation and the trust fund obligation.

48. [1977] 2 S.C.R. 762, 79 D.L.R. (3d) 336.

developer, who owned a leasehold title. The improvement constructed was a tenant's improvement contracted for by the tenant. There was no construction payment moving from Manufacturers Life to the developer. While Manufacturers Life did advance monies on the strength of construction progress, such advances were made under a conventional leasehold mortgage and as and by way of loan, not payment for work done.

When the developer went bankrupt, lien claimants sought to attach the interest of Manufacturers Life as owner/landlord. Northern Electric Company's claim to a lien was advanced as a test case in the matter. The trial judge held that Northern Electric Company Limited was entitled to a lien on Manufacturers' reversion in fee simple and that there was a joint venture involved in the construction project. He rejected the lien claim as against the mortgaged leasehold interest in the land. The Nova Scotia Court of Appeal reversed the trial decision, ruled that the developer and Manufacturers Life were not joint venturers and rejected the claim to lien against the interest of Manufacturers Life and the land. The Supreme Court of Canada restored the trial judge's decision in result.

In the Supreme Court of Canada, Martland J. (and Judson J.) dissented. That dissenting judgment travelled down the "old" trail of law as above outlined. It noted that there was no consideration payable by Manufacturers Life to the developer in respect of the building construction. While Manufacturers Life was an owner within the definition of "owner" under the applicable mechanics' liens statute, the developer did not do the work for Manufacturers Life but rather did it for itself as owner of the leasehold interest. The definition of "owner" was to be viewed in the context of the whole of the statute. After looking at other provisions of the statute, the minority opinion concluded that the developer was not a prime contractor of Manufacturers Life, that there were no payments which Manufacturers Life was required to make to the developer in respect of construction, and that Manufacturers Life had no lien responsibility.

The majority of the Court, however, focussed on the statutory definition of the term "owner"; and finding (as had the minority judges as well) that Manufacturers Life was an "owner" within that definition, held Manufacturers Life to be responsible for the lien claims. The majority did not assess the leaseback arrangement as a joint venture (as the trial judge had), but nonetheless came to the same end result. The majority emphasized the benefits Manufacturers Life got from the leaseback arrangement, and the degree of control which Manufacturers Life had over the appearance and form of the development. Under the terms of the arrangement, the design of the building was to be approved by Manufacturers Life, Manufacturers Life was entitled to make inspections, advances on the leasehold mortgage were to be on a progress basis, the building was to become the property of Manufacturers Life on lease expiry, and a share in the rental income from the building was to accrue to Manufacturers Life.

The majority decision was delivered by Laskin, CJC. He stressed the commitment letter between Manufacturers Life and the developer and concluded from it that the apartment building was in substance being constructed for Manufacturers Life and not for the developer. He said:[49]

49. *Id.* at 766 and 768.

> In view of some of the submissions to which I will refer later in these reasons, it is worth noting that nowhere in the letter of commitment is it stated that the construction of the apartment building is to be for Metropolitan [the developer]. The sequence of clauses in the letter is (1) an agreement by Metropolitan to sell its land to the respondent, the latter to lease the land back for an 80-year term; (2) an agreement by the respondent to grant a first mortgage on the leasehold interest; (3) a description of the land, and (4) 'it is agreed and understood that we [Metropolitan] will construct a six-storey apartment building with an aggregate of 125 suites . . '. If the apartment building was for anyone, it was for the respondent as owner of the land on which it was to be built. Metropolitan was as much a contractor for the construction as a beneficiary thereof.
>
> The result of the arrangement between Metropolitan and the respondent was to give the latter title to the land and building, full possession on the termination of the 80-year lease, and in the meantme the right to share in the profits from the apartment building as well as to receive monthly rent payments during the leasehold period. This was no mere mortgage investment by the respondent requiring it to reconvey the property on repayment of its loan but, rather, the financing, for its own benefit as owner, of a property development to be carried out for it by another who brought into it the land on which the development was to take place and who would stand to gain (apart from being paid for the land) from the revenues of the development over the period of its leasehold.

Later he added:[50]

> I would go further than the Nova Scotia Court of Appeal and further than my brother Martland in assessing whether the respondent is an "owner" under s. 1(d). In my opinion, the work herein can properly be said to have been done also on the respondent's behalf, if not also for its direct benefit. It may be said that it was also done on behalf of Metropolitan and for its direct benefit, but, if so, this does not preclude a similar finding in respect of the respondent, having regard to the arrangement between it and Metropolitan. The outright purchase by the respondent of the land on which the apartment building was to be built, the fact that title to the building would belong to the respondent no less than the title to the land, without any revestment right in Metropolitan, and the fact that, to the knowledge of the respondent, Metropolitan was to act as contractor on the project which was to proceed according to plans and specifications approved by the respondent and under the latter's financial control, are significant indications to me that the work was being done and the materials furnished more on behalf of the respondent than on behalf of Metropolitan, and more for its direct benefit than for the direct benefit of Metropolitan.

His Lordship then came to the "nub"[51] of the case in the application of sections 5 and 12 of the Nova Scotia Mechanics' Lien statute. Section 5 provided for the existence of liens as follows (paraphrasing mine):

> . . . any person who performs any work . . . in the making, [or] constructing, . . . of an erection, [or] building, . . . for any owner, contractor, or sub-contractor, shall by virtue thereof have a lien for the price of such work, service or materials upon the erection [or] building, . . . and the land occupied thereby or enjoyed therewith . . . limited however in amount to the sum justly due to the person entitled to the lien and to the sum justly owing (except as herein provided) by the owner.

Section 12, in turn, provided for the mandatory holdback obligation and imposed a 20 per cent holdback obligation on amounts up to $15,000.00 and a 15 per cent holdback obligation beyond that amount. Section 10 of the Act provided that a lien does not attach so as to make the owner liable for a sum greater than the sum payable by the owner to the contractor.

His Lordship then went on to say that once a person is an owner within the definition of "owner" in the statute, he is an owner for whom work is done under section 5:[52]

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50. *Id.* at 770.

51. As his Lordship described in *Id.* at 770.

52. *Id.* at 772.

> Section 5, so far as relevant, declares that a lien arises when a person performs work upon or furnishes material to be used in the construction of a building "for any owner, contractor or sub-contractor". It seems plain to me that once it is determined that the respondent is an owner within s. 1(d), as being a person at whose request and on whose behalf work is done or materials are furnished in respect of land in which that person has an estate or interest, it is also "any owner" under s. 5, as a person for whom the work is done or the materials are furnished in respect of the construction project. It is unnecessary, therefore, for me to decide whether the respondent is also within s. 5 as an "owner" by reason of work being done or materials being furnished at its request and with its privity and consent. I incline to the view that it is also within s. 5 on that basis, especially when Metropolitan, the developer, was also the general contractor for the construction project carried out under the letters of commitment between it and the respondent.

He also found that the developer was a "contractor" within the definition of that term under the Nova Scotia statute. Turning to section 12 of the statute (the holdback section), Chief Justice Laskin simply concluded that Manufacturers Life was the person primarily liable so far as the contract with the developer was concerned. He noted in that regard that it was not necessary for the Court to determine what would be the result for the holdback provisions if the developer had retained a third party to act as prime contractor for the project:[53]

> The question is simply whether the respondent is within the words the 'person primarily liable upon any contract' under or by virtue of which a lien may arise so as to oblige it to maintain a 15 per cent holdback for the prescribed period after completion or abandonment of the work or the furnishing of materials. There is no issue as to Metropolitan being primarily liable under the contracts with its sub-contractors, nor as to those being contracts under or by virtue of which a lien may arise. The respondent, *qua* its contract with Metropolitan, is, it seems to me, similarly the person primarily liable so far as that contract is concerned; and, as it contemplated construction of a building on land of which the respondent became the owner pursuant to that contract, it follows that the contract is one by virtue of which a lien may arise. This Court is not called on in this case to determine what application should be made of the holdback provision of The Mechanics' Lien Act if Metropolitan had not acted as the contractor for the project but had engaged someone else for that purpose.

Finally, the majority judgment dismissed any suggestion that the arrangement with the developer was largely a financing arrangement:[54]

> I cannot agree with the submission that Metropolitan was merely borrowing money to enable it to put up a building of its own, and that the respondent was not advancing money for the construction of a building for it by Metropolitan. The title position and the rent payment provisions are against any such submission. Whose building was it if not the respondent's, subject to possession and use by Metropolitan for a limited period, by way of being able to realize some pecuniary advantage from its original ownership of land and from its exertions as contractor? The letters of commitment are clear enough on this point since they associate the obligation to construct the building with the transfer to the respondent of the land upon which the builidng is to be constructed, and they provide that the construction will be paid for by the respondent. This is the substance of the overall arrangement, and the security aspect of the transaction, involving a mortgage of the leasehold, cannot be allowed to mask the substance. I am not at all persuaded that the true character of the transaction between the parties can be founded upon a consideration of only the mortgage of the leasehold, with its common place provision that any advances thereon are in the discretion of the mortgagee. This provision has no more reality against the entire arrangement than has the provision of the mortgage by which the mortgagor acknowledges receipt of the entire sum of the proposed loan as consideration for the mortgage.[55]

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53. *Id.* at 773-4.

54. *Id.* at 774.

55. These conclusions must have surprised the lender, who undoubtedly thought it was simply doing "participation financing". One wonders what evidence of the parties' intentions came out before the trial court and in the appeal transcripts.

The "nub" of the majority decision (to use the term the Chief Justice used) would appear to be that once a party can be characterized as an owner, within the definition of that term under the Act, he inevitably then becomes someone who has responsibility for liens under the other provisions of the Act.

It is interesting to note that the mortgage on the leasehold estate retained its priority position over liens and further that the majority judgment ruled[56] that the lien claimant was entitled to realize its lien claim out of the holdback fund which the respondent was obliged to keep available pursuant to section 12. The case was sent back to the trial judge to have the amount of the holdback determined. Subsequently, when that matter did come back to the trial judge, he ruled that the holdback was 15 per cent of the amount of the leasehold mortgage principal sum.[57]

B. *PHOENIX* CASE

The facts in the second case, *Phoenix Assurance Company of Canada and Phoenix Assurance Company Limited* v. *Bird Construction Company Limited*,[58] were considerably more complicated than those in *Manufacturers Life*. The *Phoenix* case differed significantly in 2 respects. First, the contract work was done by a single prime contractor retained by the party that was in the same position as the developer in *Manufacturers Life*. Secondly, the financing of the construction was done through a third party lender; unlike the situation in *Manufacturers Life*, here the landlord was *not* the lender.

In very brief form the following are the facts of the case:

Phoenix Assurance Company Limited, a United Kingdom company, and Phoenix Assurance Company of Canada, its wholly owned subsidiary, wished to establish a head office building in downtown Toronto, Ontario. The two Phoenix companies entered into an arrangement with Ownix Developments for the development of the building. Because Ownix lacked adequate financing to undertake the project by itself, an elaborate development scheme was put together. Ownix sold to the Canadian subsidiary vacant land in fee simple and received back from it a ground lease. Ownix then charged its leasehold interest in the lands and premises to Canada Trust and granted to the Phoenix (U.K.) parent company a lease of the land and building to take effect on completion of the building with rent being equal to the amount necessary to retire Ownix's mortgage with Canada Trust. The lease to Phoenix (U.K.), of course, contained that company's covenant to pay such rent. It was referred to in the documents as the "credit lease". The credit lease was assigned to Canada Trust as further security for its mortgage. Phoenix (U.K.) granted a sublease back to Ownix, with the rent under such sub-lease being equal to the payments made under the credit lease plus a share in the building's profits. Ownix leased space in part of the building to the Phoenix Canadian subsidiary and let the remainder of the building out to unrelated tenants. Ownix entered

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56. *Supra* n. 48, at 775.

57. *Northern Electric Company Limited* v. *Metro Projects* (1977) 1 R.P.R. 286 (N.S.).

58. [1984] 2 S.C.R. 199.

into a construction contract with Bird Construction Co. Ltd. for the construction of the building. Ownix then became insolvent, and Bird Construction filed lien claims against the interest of both Phoenix companies, Ownix and Canada Trust for money owing.

The Master in Chambers found a valid lien against the interest of Ownix only, but the Divisional Court on appeal awarded Bird Construction a lien against the interests of both Phoenix companies. The Court of Appeal upheld the Divisional Court but struck out that part of Bird's lien claim relating to improvements constructed for unrelated tenants. A further appeal to the Supreme Court of Canada failed.

The judgment of the Court was written by Estey J. Referring to its decision in the *Manufacturers Life* case, the Court ruled that the factual differences in the *Phoenix* case did not change the result. The construction work done by Bird Construction was done at the request of the Phoenix companies and they were, as a result, liable for liens. The lien was valid against all estates or intersts in the land whether or not each owner of such interest requested the work. The statutory pattern of the Act is not susceptible to different application and different results as between lien claimant and owners according to whether the owner actually entered into a contract, or operated through a development arrangement and intermediaries. Because both Phoenix and Ownix were owners and because Ownix made the request as Phoenix's agent, no question of privity arose. The fact that Phoenix was not required to retain a lien holdback did not preclude the enforceability of the lien. The lienholder's principal remedy was his right to resort to the interest in the land and the holdback was merely an ancilliary remedy. In result, the "active ingredient" of mechanics' lien statutes was reduced to a purely secondary role.

The lien for leasehold improvements constructed for unrelated tenants, however, was not enforceable against the Phoenix companies. In so ruling, the Court came very close to self-contradiction. The Court ruled that there was nothing in the nature of direct dealings between the Phoenix companies and the lien claimants in respect of such work. No privity existed between Bird Construction and the Phoenix companies and even though the tenants' improvements would ultimately revert to Phoenix, Phoenix could not be liable as an owner. Further, even if the Phoenix companies were considered an owner of the leasehold interest, no sum was "justly owing" by them in respect of such improvements. This result was reached although the arrangements between Ownix and Phoenix included payment to Phoenix of a share of profits from rents and the ability to approve the third-party tenants and their leases. Further, after the expiry of the leaseback to Ownix, the Canadian Phoenix subsidiary would become the owner of the whole property free of all encumbrances (the Canada Trust Mortgage by that time having been retired).

Curiously, there did not appear on the *first* part of the case to be much indication of any direct involvement between Phoenix and Bird or its subtrades either.

Estey J. noted that if the development arrangements were dissected into their minute parts, one might well conclude that the Phoenix companies did not extend the credit which resulted in the project being developed.

One might also conclude that technically the Phoenix companies did not request that any of the work be done or that materials be delivered and that they did not directly benefit from such work (except in respect of their own leasehold space improvements, as to which there was no contest before the Supreme Court).

However, looking at the overall arrangements between the parties His Lordship held that a different result applied. In essence, the Phoenix companies were developing the building for their purposes and Ownix contributed the land and its developmental and entrepreneurial abilities (as a project manager, in essence). In the end, Ownix would not own the land or the building; the Canadian Phoenix subsidiary would be the owner of the land. It was in the context of that factual background that the Court felt that the liability for liens had to be assessed. Because of the bankruptcy of Ownix, the Phoenix Canadian subsidiary ended up with the fee simple title to the lands subject only to responsibility to the Canada Trust Mortgage, for which Phoenix effectively was responsible in any event by virtue of the credit lease. Unless Bird Construction could establish a lien against the interest of Phoenix, it would be without effective recourse.

Referring to the *Manufacturers Life* case and the fact that in the *Phoenix* case the developer company Ownix was interposed between the contractor, Bird Construction and Phoenix (which was not the case in *Manufacturers Life*), the Court said that one must take an overall view of the complex arrangement. It then concluded that "it would be legalism in its purest form to conclude that either [Phoenix] company had not requested the work, in the sense of section 1 of the Act."[59] The interposition of Ownix between the Phoenix companies and the contractor, Bird Construction, was a difference with no legal consequence.

The position of Phoenix was equated to the position of the City of Hamilton in *Hamilton* v. *Cipriani* [60] where the Supreme Court of Canada had held that construction of a public work on city land through the Ontario Water Resources Commission was in fact done by the Commission as agent and general contractor for the City of Hamilton. The two factual situations were treated the same even though in the *Hamilton* case it was apparent from the decision that the work was in fact being done for the City on city lands and that the "agent", the Commission, had no real interest in the lands or in the public works *per se*.[61]

The factual distinction between the independent financing here through Canada Trustco (and the direct financing in the *Manufacturers Life* case) was overcome by the Court by the conclusion that in granting the credit lease the Phoenix companies became effective guarantors of the Canada Trustco Mortgage. Whether the landlord owner's financing of the project came by means of a simple mortgage or a simple guarantee of a mortgage did not matter. The substance remained the same because the credit of the Phoenix companies was employed to bring the project into being through

59. *Id.* at 215.

60. [1977] 1 S.C.R. 169, 67 D.L.R. (3d) 1.

61. Although the Commission had a right to become registered as owner of the lands, that was only as a security for repayment of the project costs by the City.

the credit lease. The substance of the transaction was then characterized as follows:[62]

> Phoenix, being the registered owner of the land, had an interest in the land within the meaning of s. 1. It was at the request of Phoenix that the work was done on the land by Bird. Divided up into each single step or function performed by the parties under the development agreement, it might be argued that Ownix, not Phoenix, requested Bird to construct the building. Ownix, through the performance of the development contract, caused the building to be built, which building, by the contract, became, in the fullness of time, the sole property of Phoenix. Additionally, Phoenix participated in the profits from the operation of the building until it vested completely in Phoenix in thirty-five years. In short, Ownix and Phoenix instituted this development project wherein a head office for PCDA [Phoenix Canada] was brought into being, all pursuant to the development contract between Ownix and Phoenix. As was the case in *Northern Electric*, *supra*, Phoenix was the entrepreneur, owner and financier. Ownix was the contractor for Phoenix; and Bird was engaged by Ownix on behalf of and as the agent for Phoenix. This was the substance which the form merely served.

The Court then looked at section 5 of the Ontario statute,[63] that was the equivalent section to section 5 in the *Manufacturers Life* case, which grants a lien to a person doing work on an improvement for an owner, contractor or sub-contractor. Estey J. said:[64]

> If, under s. 1(1), the Phoenix companies are included in the defined owners of this land (as I have concluded they are), then it is clear from s. 5(1) that Bird, by performing work on such land for "any owner", has an entitlement to a lien. There is no differentiation as between those persons coming within the statutory definition of "owner", nor indeed is the lien, by express terms, limited to the interest of the owner for whom the work in question is done. The narrow question which then arises is whether the term "any owner" includes as one of a group "the owner" in such a way as to permit or require that the lien shall burden only the interest of the "requesting owner" and not all "owners" within the definition. Here, the facts do not require an answer to the question. Phoenix has an interest in the land; Phoenix, in these circumstances, must be considered as a single entity; Phoenix, through Ownix, requested the work; Phoenix falls within the definition of "owner" and hence is in the group contemplated by the expression "any owner"; and the completion expenditures relate to, and certainly enhance the value of the interest of the owner, Phoenix, in the lands.

The matter of whether or not there was any sum "justly owing . . . by [Phoenix as] the owner" under section 5 was simply resolved on the basis that it didn't matter whether there was an identifiable contract sum payable by Phoenix:[65]

> On the facts it is clear that no money was owed by Phoenix to Bird. It is equally clear that moneys are owed by the insolvent Ownix to Bird. I have already concluded that Ownix and the Phoenix companies are all owners within the statutory definition. Section 5, expansively construed, would create lien rights in the supplier of materials or services against all estates or interests in the land whether or not each owner of such an interest was a so-called contracting owner. A more restrictive view would interpret "just owing . . . by the owner" as meaning the owner who had directly and in commercial reality requested the work to be done. The latter interpretation would produce a different result according to the otherwise inconsequential differences in contractual arrangements between the various participating entrepreneurs in a construction project of this size. The statutory pattern adopted in the Act by the legislature does not appear to be susceptible to different application and different results, as between lien claimant and owners of the project, according to whether the owner actually enters into a contract with a contractor or a series of subcontractors on the one hand, or whether the owner, through a development

62. *Supra* n. 58, 217-218.

63. It was dealing with the pre-1983 Ontario Mechanics' Lien statute, not the Construction Lien Act, 1983.

64. *Supra* n. 58, at 220.

65. *Id.* at 221-222.

> arrangement, brings about the same result with such intermediaries as development companies, project managers, and financing mechanisms, whether by agency relationship or otherwise.
>
> The question remains, however, whether the plain meaning of the terms in s. 5, when read in conjunction with s. 1(1)(d), requires that once the person is embraced by the Act as an owner under s. 1(1)(d) for any purpose, the lien claim runs against the interest of that person and all other owners, limited only by the amounts which are justly recoverable by the lien claimant for the work and services in question against the land and improvements in question. It may be that these sections, when read together, require privity of contract between the claimant and the owner of the interest or estate which is sought to bind by the lien. It is difficult to conceive how a supplier of work or materials could have a claim for a lien where no unilateral contract has arisen by the supply of the work or the services (aside from holdback considerations). This appears to be so because of the prerequisite "at the request" in s. 1(1)(d) and because s. 5, as was observed by Laskin C.J. in *Northern Electric*, *supra*, follows along the terminology of s. 1 and hence applies the same test to "any owner" and to "the owner". As I have already stated, it is not necessary to determine whether or not contractual privity is a condition precedent to lien entitlement because here Ownix and Phoenix are both owners, and Phoenix, like the mortgagee in *Northern Electric*, is the directing entrepreneur of the project, and hence Ownix is its instrument of accomplishment; its "agent" in the terminology of the law. Hence, the request of Ownix is the request of Phoenix (per s. 1(1)(d)) and is the agent and alter ego of Phoenix in the expression "the owner" as that term is used in s. 5(1) again excepting the situation arising out of the leaehold improvements for third party space tenants).

The Court then addressed the difficulty its decision posed for a person in the position of the Phoenix companies, and suggested, as a solution, requiring that the mortgage monies be advanced only in accordance with the Mechanics' Lien Act or some similar contractual procedure to produce the same result:[66]

> It is said that this will produce great hardship because the non-contracting owner will have no control over the funds flowing from the owner to the contractor, subcontractors, etc. for the purpose of effecting holdbacks and required by the Act, and consequently there would be a difference in exposure to liability as between various owners in the same project. This may well be the result, but such result would appear to be inevitable where the workings of commerce produce arrangements as complicated as those surrounding the financing, design, construction and operation of these head office premises. It therefore is not necessary to determine what the result would be if Phoenix were not in the position of the dominant entrepreneur in the enterprise and the principal of Ownix in the operations governed here by the Act; in the same way as was the insurance company in *Northern Electric*, *supra*. Any difficulties which may be raised on behalf of Phoenix as regards the obligation to effect holdbacks under s. 11 are fully answered by the observations of Laskin C.J. in *Cipriani*, *supra*, at pg. 174, which I quote later in these reasons. Furthermore, if Phoenix is, in fact and in law, a non-contracting owner, to use the somewhat inaccurate terminology employed in these proceedings, it could protect itself by proper contractual provision which more precisely spelled out the interrelationship between the developer Ownix, and the financing participant Phoenix, in this complex building development. For example, Phoenix could have protected itself in this regard by requiring, in the development agreement and in the financing agreements, that the moneys under the mortgage be advanced through Ownix only as required by The Mechanics' Lien Act, and for a trusteeship of the moneys held back from mortgage advances under these contractual arrangements. There are no doubt other and better contractual procedures for achieving the same result.

In dealing with the fact that there was no obligation on the part of the Phoenix companies to advance monies to Ownix or anyone else in respect of the construction of the building, the Court relied upon the decision in *Hamilton* v. *Cipriani* and cited in that regard the following passage from the judgment of Laskin, CJC:[67]

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66. *Id.* at 222-223.

67. *Supra* n. 60, at 174.

> Counsel for the appellant contending, as already noted, that there was no right or duty to maintain a holdback in this case, submitted in effect that this precluded enforcement of the lien. Counsel for the respondent contended that in the present case it was the City that was "the person primarily liable upon a contract . . . by virtue of which a lien may arise" within s. 11, and that the obligation thereunder to maintain a holdback does not depend on a fund being available out of which the holdback must be reserved. Whether this contention is correct or not on the facts of this case, I do not think that a valid claim of lien against an owner under s. 5 can be defeated by showing that the owner is not a "person primarily liable" under s. 11 and hence not obliged to maintain a holdback. The right to resort to the owner's interest in the affected land is the principal remedy; s. 11 provides merely an ancillary resort for realizing the lien claim.

While the language above cited would certainly support the position taken in both *Manufacturers Life* and *Phoenix Assurance*, the *Hamilton* case was not *in pari materia* with either of the later two cases. In *Hamilton* the project was being built for the City of Hamilton and not by the contracting party, the Ontario Water Resources Commission. Any interest in the land at all held by the Commission was purely by way of security for the repayment obligations that the City of Hamilton had to the Commission. The City remained the owner of the land, the project was built for the City as a city municipal work and the Commission was merely a financing agency for the cost of that project. The position of the Commission was essentially the same as the position of a mortgage lender. The only difference was that the Commission also acted as agent for the signing of the prime contract (which is not a position a mortgage lender normally would assume). To look at it another way, the arrangement did require the City to pay the Commission the full cost, albeit over a period of years.

In any event, the quotation taken from the *Hamilton* case is extended by *Phoenix Assurance* to produce the result that there is a liability for liens even though there may be no payment or other obligation whatever from which a holdback may be made. That is to say, the holdback element of lien legislation becomes a purely secondary and non-essential one and the lien on the land becomes the primary and necessary ingredient. It does not take much imagination to recognize how such redirection of mechanics' lien statute interpretation could be extended to disassociate lien rights broadly from the holdback concepts in the statutes, especially in those statutes that also have "trust" provisions.

As mentioned above, the Court did not render the Phoenix companies liable for unrelated tenant improvements' costs. This was so even though the Phoenix Canadian subsidiary would get the benefit of those leases on termination of the Ownix interest in the lands, shared profits under the Ownix leaseback and would get the benefit of the third party tenant improvements on the expiry of their respective lease terms. The different treatment of that work appears to come from the fact that there was no involvement by the Phoenix companies in the doing of the work in question. The Court spoke of the absence of privity of contract between Bird and Phoenix in relation to that work. The work was not "requested" by the Phoenix companies and they would not be an owner in respect of such work. Based on the *Marshall* case,[68] and *Sandon Construction Ltd.* v. *Cafik*,[69] the Court ruled that for the Phoenix companies to be responsible

68. *Supra* n. 26.

69. (1973) 34 D.L.R. (3d) 609 (Ont. C.A.).

as owner for third-party tenant improvements it would be necessary that there be something in the nature of a *direct dealing* between the Phoenix companies and the lien claimants. There was no such direct dealing in this particular case.

Would the situation have been different had the arrangements between the Phoenix companies and Ownix included some degree of control and direction on the part of the Phoenix companies in respect of the constructing third-party-tenant improvements? Where or what was the relevant evidence of direct involvement for the building itself? The design and planning of the building?

With respect to the unrelated tenant improvements, the Court's decision in *Phoenix Assurance* is rather confusing. Having made all the statements above quoted at length, the Court made the following two statements that seem quite inconsistent with the earlier portions of its rulings:[70]

> It should be noted that s. 7 of the Act establishes a procedure where the work is being performed for a tenant. Section 5 requires the contractor, in order to subject the fee simple interest or estate to the lien, to give notice to the owner of the fee of the work to be done. The owner may, within fifteen days thereafter, deny any responsibility. This section supports the interpretation of s. 5 which limits the right to claim a lien to those interests owned by the owner making the implied request under s. 5. In short, he who supplies work or materials in response to the express request in s. 1(1)(d) and the implied request in s. 5 may claim a lien against the estate or interest of the requesting owner.
>
> Section 5 places another impediment in the way of Bird when it attempts to reach past the third party tenants and to lien the interests of Phoenix in respect of improvements installed at the request and on the premises on the third party lessees, even assuming such work can be done without direct privity or privity by agency; namely, the absence of any liability in Phoenix to Bird. Thus there is no sum justly owing by "the owner". This closes any opening left to Bird even if s. 5 were construed so as to allow a claim against all owners if one of them requested the work in question. *Vide Canadian Cutting and Coring (Toronto) Ltd.* v. *Howson*, [1968] 2 O.R. 449; and *S. Morgan Smith Co.* v. *Sissiboo Pulp and Paper Co.* (1904) 35 S.C.R. 93, at pp. 96-97. Orde J.A., in discussing this requirement of the Act in the context of tiered contractors in *Kosobuski* v. *Extension Mining Co.* (1929), 64 O.L.R. 8, at p. 12, stated:
>
> > 'Nothing in the Act gives a subcontractor . . . the right to recover, as against any person higher up the scale than the person with whom he himself contracted, more than the amount owing to such person by those above him, due regard being had, of course, to the obligation of the owner and each contractor and subcontractor to protect possible lienholders under sec. 11, by retaining, out of the contract price, the percentages specified in subsections 1 and 2, or a larger amount if notice in writing is given under subsec. 4.'

The cases cited in the above passage are precisely the cases that are cited in the first part of this paper to support the proposition that before these recent Supreme Court cases, in order for a party to be liable to lien claimants there had to be something from which one could identify a holdback obligation. The two parts of this judgment accordingly seem to be at cross purposes.

C. *EDSTAN* CASE

The third decision[71] was also written by Estey J. Again the facts were somewhat complex. However, this time no leaseback arrangements were involved.

The project in question was a small housing project undertaken by the Ontario Housing Corporation (OHC), the Ontario Mortgage Corporation

70. *Supra* n. 58, at 228-229.

71. *Ken Gordon Excavating Ltd.* v. *Edstan Construction Ltd.* [1984] 2 S.C.R. 280.

(OMC), and Edstan Construction Limited. Edstan bought 25 lots from OHC subject to an interest-free second mortgage held by OHC. Edstan granted to OMC a mortgage to cover the cost of construction. OHC's second mortgage provided for payment of monies in respect of capital invested (designated as "primary principal"), and payment of capital profits (designated as the "remainder principal").

The project fell apart and Edstan went bankrupt right after the first draw on the OMC mortgage. The primary principal payable to OHC was paid out of that first draw and the balance was released to Edstan. After the project was abandoned, a second draw was made by OHC and paid directly to OMC. The property was thereafter sold through exercise of mortgagee's power of sale rights by OMC.

The Supreme Court held that OHC fell within the definition of owner under the applicable Ontario mechanics' liens statute and that the case was essentially the same as the prior *Phoenix*, *Northern Electric* and *Hamilton* cases.

The agreement under which the 25 lots were bought by Edstan required Edstan to pay what amounted to the cost to OHC of acquiring and developing the land. Ultimate purchasers of completed houses from Edstan had to pay the remainder principal, which was the difference between the said costs of acquisition and development and the agreed market value of the land. The said obligation on Edstan's part was secured by a second mortgage. The remainder principal would be paid by the ultimate home purchasers over some 33 years. The "primary principal", the acquisition and development costs, was repayable with interst on an amortized basis over the life of the second mortgage. The total land cost (including both primary principal and remainder principal) was $670,500.00 and the cost of the houses was $625,740.00. Of the latter, $594,453.00 was financed through the OMC mortgages. The OMC mortgages were set for amounts that covered not only the aforesaid $594,453.00 but also the primary principal sum for the avowed purposes of consolidating in one mortgage all payments which bore interest and called for repayment on a progressive basis. Advances on the OMC mortgage were to be made as authorized by Central Mortgage and Housing Corporation from time to time, although CMHC was not a party to any of the mortgage commitments or other basic agreements. It was presumed that Edstan's profit in the transaction was going to be the total of the equity input of the various purchasers plus the excess (if any) of the proceeds of the first mortgage over actual construction costs incurred by Edstan in building the houses. That at least was the plan. In fact Edstan failed because the agreements (under what the Court viewed as inadequate documentation by OHC and OMC) required Edstan to complete a large part of the house construction before it received reimbursement for the cost of construction. Edstan's bank line of credit and working capital were evidently insufficient to cover the cash flow shortfall that resulted.

All three lower Courts found that OHC fell within the definition of "owner" under the Mechanics' Liens Act. Estey J. had no difficulty in affirming that finding. He said:[72]

72. *Id.* at 292-293.

A short reference to the arrangements between Edstan and OHC is all that is required to find ample justification for this finding. The basic agreement between OHC and Edstan provided:

(a) For the maximum selling price for which Edstan may sell these houses;

(b) for the construction of these houses according to models, plans and specifications as approved by OHC;

(c) that the distribution of models throughout the twenty-five lots shall be as approved by the architect of OHC;

(d) no change in the plans may be effected without specific waiver by OHC;

(e) OHC reserves the right to include in any conveyance to Edstan any of the terms and conditions of the basic agreement with Edstan;

(f) Edstan may sell such houses when completed only to purchasers approved by OHC, and OHC has the 'unqualified right' to determine the method of selection of the purchasers and the advertising of the houses for sale;

(g) OHC may at any time elect to purchase any or all of the completed houses for the contract specified sale price;

(h) all sales contracts between Edstan and the purchasers shall be in the form of agreement prescribed by OHC;

(i) in the event of default of any clause in the basic agreement, OHC has the right to enter upon the lands in question for the purpose of remedying the default and charging any expense associated therewith to Edstan;

(j) OHC has the right to enter upon these lands at any time for a period of three years in order to inspect and repair grading, drainage, etc.

It is clear that OHC, as a Crown corporation, can qualify as an owner under the Act (s. 1(1)(d)). OHC has an interest or estate in these lands. By its arrangements and relationship with Edstan, OHC has a very extensive interest, in the broader sense of the word, but over and above all these considerations is the similarity of the relationship between OHC and Edstan to those relationships examined by this Court in *Northern Electric Co.* v. *Manufacturers Life Insurance Co.* [1977] 2 S.C.R. 762, *Hamilton [City of]* v. *Cipriani*, [1977] 1 S.C.R. 169, and *Phoenix, supra*. In each case the entrepreneur of the project, though with varying final positions or interests, was found to be an owner under the Act. OHC, on these authorities, clearly falls within the statutory definition of an owner, and in this, I am in respectful agreement with all the others below. The conclusion expressed by Rutherford, J. on this point summarizes the position taken by all the courts below:

> 'In light of the facts in the instant case, however, I do not think Ontario Housing can be heard to deny that its involvement in the Borden Farm project was sufficient to constitute it 'an owner'. Both before and after September 26, 1977, Ontario Housing had intimate knowledge of the project and took an active role in its progress. It directed Edstan as to what work was to be done and as to the specifications it was to meet. Moreover, the work was done on behalf of Ontario Housing in the sense that it was Ontario Housing's mandate to provide residential accomoodation of the variety Edstan contracted to build. It can also be said that the work was performed and the materials were furnished with the consent of Ontario Housing and for its direct benefit. For these reaons, I find myself in complete agreement with Judge Doyle's finding that Ontario Housing was an 'owner' within the meaning of s. 1(1)(d) of the Act.'

The Court went on to describe the nature of the transaction between OHC and Edstan, and concluded that it was in essence an agreement for purchase and sale of land. In result, it would have been an agreement that, rather than providing for any compensation moving from OHC to Edstan who contracted the construction work, provided for payment obligations moving from Edstan to OHC. Nonetheless, OHC was an owner responsible for liens arising out of the work contracted for by Edstan. Again, the liability for liens occurred without any need to identify a consideration in respect of or from which a form of holdback could be calculated. Again, the holdback aspect of the mechanics' liens statute was relegated to a secondary (and in this case quite insignificant) position. The fact of

ownership, implied request, and benefit, combined with active involvement in the direction of the construction process, produced a liability for liens.

VII. IMPACT OF CASES FOR LANDLORDS

Applying the new directions offered by these three Supreme Court decisions to standard commercial lease transactions, what is their potential impact?

In most commercial leases found today, the landlord keeps ownership of improvements, a considerable power to approve plans and specifications, in many cases even the specification of who will be the mechanical and electrical contractors used, a right to inspect the work as it is being done, and the right to direct changes where what is being done adversely impacts on the building or some other interest of the landlord. In shopping centre contexts there is often sharing in the gross receipts (or some other measure for sharing in sale receipts), which involves the landlord in benefits during the course of the tenant's term. Many leases also contain detailed stipulations as to quality and character of use (particularly in shopping centre leases). In all of these situations, the Supreme Court decisions generate the very real possibility that the landlord who contracts with the tenant to do the work according to plans and specifications approved by the Landlord may be an owner whose interest is attached by liens when the tenant fails to pay for the improvements or when the tenant's contractor fails. And an owner who has trust obligations where the lien statute imposes them.

The reality of this risk in the context of shopping centre leases was anticipated by D.C. MacDonald J. of the Alberta Court of Queen's Bench in 1975 before any of the Supreme Court cases.[73] That discussion was *obiter* in *Suss Woodcraft Ltd.* v. *Abbey Glen Property Corporation and Zwaig*.[74] In the case, a lien was disallowed because it was claimed by a company that was not registered in Alberta.[75]

The work related to improvements done for a small drapery shop in a large shopping centre. The tenant had agreed, under the terms of its lease agreement with the landlord owner, that the tenant would construct store fixtures for the interior of the premises. The lien claimant did the work under contract with the tenant. Before work on the tenant's premises was commenced, the landlord's project coordinator, Mr. Yacyk, issued a letter addressed to all tenants:[76]

> Please remember that you must have the following items in your possession before you can start constructing your store.
>
> 1. Approved final working drawings.
> 2. We require a copy of your contract with your outside contractor, with either a set of the final approved drawings attached to the contract, or an indication in the contract that these are in fact the plans to which the contract refers.

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73. Indeed, preceded even the *Hamilton* v. *Cipriani* case, *supra*, n. 60.

74. [1975] 5 W.W.R. 57.

75. A ruling which has subsequently been rendered obsolete by amendment to the Land Titles Act that allows a lien to be registered even by an unregistered company: S.A. 1982, c. 23, s. 2.

76. *Supra* n. 74 at 59.

3. Your outside contractor must file proof of liability and vehicular insurance to the extent of $500,000.00 and it must contain an endorsement in favour of Western Realty Projects Ltd. and Smith Bros. & Wilson.
4. A Building Permit.
5. Clearance from the on-site construction coordinator Mr. Yacuk [sic].

These requirements were communicated to the lien claimant by the tenant. The lien claimant left materials with the landlord's project coordinator, as a result, setting out the price of his construction contract with the tenant and particulars of liability insurance coverage and a cheque for the cost of the building permit for the store premises.

McDonald J. noted that under the lease, the landlord approved the plans which were provided to it by the contractor lien-claimant. There had been direct discussions between the landlord's representative and the contractor's representative. The lien claimant had paid the cost of the building permit to the landlord and the landlord's representative (Mr. Yacyk and his assistant) from time to time expressed concern with what the lien claimant was doing (giving instructions directly to him in respect of fireproofing and specifying that the general contractor was to cut the floor where the front doors to the premises were to be installed). Those facts, however, his Lordship held were not enough to constitute "something of the nature of a direct dealing".[77]

However, he did conclude that there was a "direct benefit" in favour of the landlord in respect of the work done for the tenant. The lease provided that all alterations became the property of the landlord on lease expiry. His Lordship noted, as well, the decision in the trial court in *Northern Electric Co. Ltd.* v. *Metropolitan Projects Ltd.* (which ultimately went to the Supreme Court of Canada as the *Manufacturers Life* case above cited), where O'Hearn J. found a direct benefit in the fact that the tenant paid not only a basic rent but a share in gross receipts as well as in the landlord's entitlement to the improvements on reversion. McDonald J. found the reasoning of O'Hearn J. correct. Adapting it to the case before him, he noted that the lease in question provided not only for rent but for rent equal to a specified percentage of gross sales over a certain level and that the improvements reverted to the landlord on lease expiry. He therefore found the landlord to be an "owner" within the meaning of that term under the Builders' Lien Act of Alberta. Had the lien claimant been registered in Alberta, he would have had a valid lien. His decision in that regard has subsequently been borne out to considerable degree by the Supreme Court in *Manufacturers Life*, *Phoenix Assurance* and *Edstan*, the first of which cases, of course, affirmed O'Hearn J.'s decision.

The Supreme Court decisions have subsequently been followed in cases in Alberta involving Alberta Housing Corporation: *Wimpey Western Ltd.* v. *The City of Edmonton* [78] and *Consolidated Gypsum Supply* v. *B.L.R. Construction Ltd.*[79] Both cases involved leases by the City of Edmonton to

77. The quote is from the words of Mr. Justice Grimmer in *Eddy Co.* v. *Chamberlain* (1917) 37 D.L.R. 711 at 713-14.

78. Unreported March 15, 1979, Alta. Dist. Ct. J.D. Edmonton, action 240845, *per* Stevenson D.C.J. While this decision did not cite the *Manulife* case, it cited passages from Macklem and Bristow, *Mechanics' Liens in Canada* (4th ed.) 31-33, that were discussed in *Manulife*.

79. (1984) 55 A.R. 340 *per* V.W.M. Smith, J. These were the facts stated in the *Wimpey* case; it is presumed they are the same in *Consolidated Gypsum*.

A.H.C. in respect of housing projects jointly financed by the City (10%), A.H.C. (40%) and Central Mortgage and Housing Corporation (50%), although it would appear that the city and C.M.H.C. essentially contributed as a subsidy to A.H.C.[80] The reversionary interest of the city as landlord, the lessee's covenant to build and the approval right of the City in respect of plans and specifications were sufficient to render the City liable as an owner.[81] While A.H.C., as an agent of the Crown, was free of the lien claims, the City's reversionary interest as fee owner was attached by liens.

On the other side of the coin is a decision of the Ontario Divisional Court handed down in the past year. In *Pinehurst Woodworking* v. *Rocco* [82] a more-or-less conventional variety of shopping centre lease appeared to be involved. The agreement to lease provided that most installations in the "shell" of the leased premises were to be paid for by the tenant, that the plans and specifications for all installations were subject to approval by the landlord, and that the landlord would pay an improvements allowance of $75.00 per square metre to the tenant.

The only items of work the landlord was responsible for was a basic building shell with perimeter of bare plaster board or concrete block, roughed-in utilities, a single telephone conduit, a heat pump for heating and cooking, a sprinkler main, and if required by the applicable building code, a rear door. Almost everything else, whether installed by the landlord or not, was to be paid for by the Tenant and most items were to be provided by the Tenant as its own expense, but with designs and other matters subject to approval by the landlord. Amongst other things the tenant was responsible for ceilings, floor coverings, partition walls, electrical controls, distribution wires and fixtures, distribution ducts, plumbing and plumbing fixtures, etc. The improvements reverted to the landlord on lease expiry.

A change was made in one aspect of the plans (involving an electrical transformer) at the request of the landlord to correct a lighting problem.

The tenant's contractor claimed a lien against the fee simple estate (as well as the leasehold estate) both by virtue of section 8 (a section like Alberta's section 12 discussed above), which provides for a landlord being responsible if he fails to respond to a notice from a contractor that work is being done for a tenant, and by virtue of the landlord being an "owner" for whom the tenant's work was done.

The contractor's claim under s. 8 failed because the court ruled that the mere delivery of plans and specifications for the improvements did not constitute a notice in writing under this section.

On the question of whether or not the tenant's improvement allowance plus involvement in plan approval and the direction of the need for replacement of the transformer made the landlord an "owner", the court held that those things did not do so. There must be something more for the landlord to be an "owner". The fact that the landlord obtained the benefit of the improvements on lease expiry was also considered not sufficient to qualify the landlord as an owner.

80. *Per* Smith, J. in *Consolidated Gypsum supra* at 343.

81. *Id.* at 342.

82. (1986) 38 R.P.R. 118 (Div. Ct. Ont.).

The court relied upon the "old" law to the effect that there must be some greater involvement by the landlord, including some direct dealing between the landlord and the lien claimants. Dealing with the *Phoenix Assurance* case and the case of *Hamilton* v. *Cipriani*, the court held that those decisions were exceptions to the general rule. They depended upon the "closeness or common ownership of particular owners and the entities found to be statutory owners." In *Pinehurst* there was no such close relationship between the landlord and the contractor and the Supreme Court decisions accordingly did not apply to the contractor's claim.

It is arguable that such distinguishing of the Supreme Court cases involved a distinction without any real difference. The *Pinehurst* case (in the Divisional Court of Ontario) is certainly consistent with what was the law before the Supreme Court decisions above mentioned; whether it correctly avoids those cases may have to await a decision of a higher Court. On the other hand, it would help rationalize the new Supreme Court rulings in *Manulife*, *Phoenix* and *Eastern* with the "old law" of *Sissibo* and *Marshall Brick* if one could characterize the new cases as special situations where the court simply concluded that the real developer in substance was the landlord (or subdivision developer in *Eastern*).

Unfortunately, the cases to date (other than *Pinehurst*) tend the other way and suggest that a new rule is created by the recent Supreme Court decisions. In *Roboak Developments Ltd.* v. *Lehndorff Corp.*,[83] mortgage lenders who took an active part in encouraging a builder to complete mortgaged homes were rendered subject to liens on the broad principles expressed in *Phoenix*. Recently in Alberta, a landlord[84] and a new-home purchaser[85] avoided liability for liens under the Supreme Court principle, only because they had the unusual situation of having *no* involvement in the doing or requesting of work. Notwithstanding the *Marshall Brick* case, subdivision developers (and lot sellers) who control building development requirements have also been subjected to liens arising out of their buyers' construction on the basis of the Supreme Court rulings.[86]

One last footnote on the case law development might be drawn from *Northern Electric Co. Ltd.* v. *Frank Warkentin Electric Ltd.*[87] The decision in that case was delivered by Dickson J.A. then of the Manitoba Court of Appeal. He did not sit on any of the three Supreme Court of Canada cases above summarized, although he was appointed to that Court shortly before the *Manufacturers Life* case was decided. The three decisions appear to reverse the judgment His Lordship rendered in the *Frank Warkentin* case.

The *Frank Warkentin* case was again one of a standard form of leaseback transaction. The developer, who wanted to develop an apartment complex on land, sold the land to the Canada Life Assurance Company, took back a

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83. (1986) 39 R.P.R. 191 (Ont. H. Ct.).

84. *Morguard Investments Ltd.* v. *Hamilton's Floor Covering Ltd.* (1986) 49 Alta. L.R. (2d) 88 (Q.B.).

85. *Royal Trust Corp.* v. *Bengert Const. Ltd.* (1986) 49 Alta. L.R. (2d) 79.

86. *Dixon Roof Truss and Building Components* v. *High Street Construction* (1983) 43 O.R. (2d) 691 (C.A.); *Muzzo Bros. Ltd.* v. *Cadillac Fairview Corp.* (1981) 34 O.R. (2d) 461 (S.C.).

87. (1972) 27 D.L.R. (3d) 519.

long-term lease pursuant to which he constructed the apartment project, and financed the construction through a mortgage from Canada Life. On the question of whether the interest of Canada Life as owner made it an owner within the Mechanics' Lien statute, Dickson J.A. said the following:[88]

> The question whether the interest of Canada Life as owner of the fee simple of Parcels B and C might be attached by mechanics' liens was raised. The answer depends on whether Canada Life can be said to be an "owner" within s. 2(d) of the Mechanics' Lien Act. There is ample authority to support the proposition that in order to make Canada Life an "owner", because work was done with its "privity or consent", there must be something in the nature of direct dealing between Canada Life and the lien claimant: *Gearing* v. *Robinson* (1900), 27 O.A.R. 364; *Marshall Brick Co.* v. *York Farmers Colonization Co.* (1917), 36 D.L.R. 420, 54 S.C.R. 569; *Partridge* v. *Dunham*, [1932] 1 D.L.R. 600, [1932] 1 W.W.R. 99, 40 Man. R. 165; and more recently *MacDonald-Rowe Woodworking Co. Ltd.* v. *MacDonald* (1963), 39 D.L.R. (2d) 63, 49 M.P.R. 91. There is no evidence in the case before us of any such direct dealing, nothing to suggest that Canada Life exercised control in any respect over any subcontractor, supplier, or workman.

One must ask, in the light of the Supreme Court decisions, what today is the relevance or effect of a direct dealing or the absence thereof? In none of the Supreme Court cases was there much discussion of the degree of direct involvement on the part of the fee owner with the persons who claimed liens. Indeed, all three seemed to treat the leasehold or other developer as the only person with whom some direct dealing was necessary (although this point became a little clouded by the decision in *Phoenix Assurance* in respect of the improvements constructed for third party tenants). In the *Suss Woodcraft* case the Court found owner liability even without any "direct dealing".

In the *Manufacturers Life* case, the factual situation would have been virtually identical to that in *Frank Warkentin* and again there would likely have been no significant evidence of direct dealings between Manufacturers Life and the lien claimants. While in *Frank Warkentin* the developer hired a general contractor to do the entire construction job (albeit a related company) and in *Manufacturers Life* the Court noted that the developer acted as its own prime contractor (or perhaps more correctly as Manufacturer's prime contractor), the distinction between those two factual situations has subsequently been relegated to insignificance by the *Phoenix Assurance* case.

With all of the foregoing, the approach taken by McDonald J. in *Suss Woodcraft* would appear today to be an approach that is supported by the interpretations placed on mechanics' lien statutes by the Supreme Court of Canada. If so, a "direct dealing" is not necessary for a landlord to be liable for liens, and non-existance of a holdback reference point (ie. landlord-tenant payment obligation) is not important.

VIII. SOME SPECIFIC EXAMPLES

With all of the foregoing in mind, it might be useful to conclude with a few examples of commercial leases and ask what is the potential lien exposure. The following examples can be found in practice in Alberta and probably elsewhere in Canada.

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88. *Id.* at 529.

A. GROUND LEASE

By a ground lease the landlord typically leases *land only* to the tenant, who develops a building for his own specific use or for sublease to third-party tenants. Typically, the ground lease will require the approval by the landlord of plans and specifications, will entitle the landlord to inspect the property from time to time during construction, will stipulate the standard or quality of work, and will permit inspection by a lessor's engineer. Typically also, there will be no financing offered by the landlord. Financing would be by independent third-party loan and would not involve the landlord at all. In this example there is clearly nothing that could be identified as a compensation going from the landlord to the tenant for the construction of the building, other than perhaps the benefit of the rental flow. On the other hand, when the lease terminates or expires the building becomes the property of the landlord and the landlord does have some limited involvement in the construction process through plan approval and inspections. Further, the lease will inevitably provide an undertaking by the tenant to build the building in question and will often include the requirement that it be built within set time limits and to certain standards. The lease likely provides as well that fire loss will be payable to the Landlord and will be applied to reconstruction unless the lease is terminated. And the *Wimpey* and *Consolidated Gypsum* cases would seem to support that result.

On balance, one would expect that this situation does not include much risk on the landlord's part of liability for the tenant's liens (other than liability that might occur under s. 12 of the Alberta Act if the landlord fails to respond to a notice under that section). On the other hand, if one were to apply the approach taken in the *Suss Woodcraft* case literally it *would* result in a lien responsibility on the landlord's part.

Perhaps in this example the landlord should protect himself by requiring the tenant to post some form of bond or other security for the performance of his obligations in respect of mechanics' liens.

B. HIGH RISE OFFICE LEASE FORM

Assuming a normal leasing market, one might expect this lease to include:

(1) Some payment by the landlord for tenant's improvements, including commonly a set tenant improvements allowance;
(2) Reversion of the improvements to the landlord on lease expiry or termination;
(3) Approval of tenant's plans before commencement of work;
(4) Inspection of plans by landlord's professionals (architect, engineer, etc.) prior to commencement of work;
(5) Possible requirement of mechanical and electrical work being completed by contractors selected by the landlord;
(6) Right to inspection during course of construction;
(7) Specific list of construction requirements for the mechanics of construction;

(8) Establishment of standards for quality of construction and even type of materials;

(9) Approval of the contractor hired to do the job.

With all of the above circumstances, the risk of lien liability on the part of the landlord would appear to be quite high. There is even some direct involvement potential in the fact that the landlord can select the contractor (or the mechanical and electrical contractor) and even require the landlord's contractor to be used.

In this situation, particularly if there is a payment made by the landlord to the tenant in the form of improvement allowances or some equivalent sum (even a rent-free period might be an equivalent sum), the landlord should protect himself against the possibility of mechanics' liens. Indeed, if the improvements allowance is sufficient to cover the cost of the improvements or a substantial portion of it, perhaps the landlord should simply assume the role of "owner" and make the holdback called for under the mechanics' liens legislation and look to the observance of trust obligations. Even if there is a significant tenant input required to cover the construction cost, the landlord can assume that role by requiring the tenant to deposit with him a sum sufficient to cover the mandatory percentage of the cost he is going to bear. At the very least some sort of lien bond or similar security would seem warranted.

C. SHOPPING CENTRE LEASE ON RETAIL PREMISES

This kind of tenancy probably has all of the relevant characteristics outlined above for the high-rise office lease. Further, it will likely include a potential for sharing in revenues from the premises on the part of the landlord. In this situation, and particularly in light of the *Suss Woodcraft* case, the risk of lien liability seems very high indeed. Again, some acceptance of an owner's role or some other mechanism or security device for the protection of the landlord against lien liability seems not only warranted but necessary.

IX. SPECIAL TRUST FUND CONCERNS

As mentioned in the opening summary in this paper, some jurisdictions include in their protection of subcontractors and others who have lien rights a concept of "trust fund". Ontario, New Brunswick, Saskatchewan, British Columbia and Manitoba all have such provisions.[89] Since 1985, Alberta has had a partial trust fund provision as well.[90] Essentially, the concept involves constituting as trust funds all monies received by the builder, contractor or subcontractor on account of the contract price, which trust is for the benefit of persons who have done work or supplied materials. The purpose was expressed in *Bank of Montreal* v. *Sidney* [91] as follows:

> Another object of the Act . . . is to prevent those entitled to protection from being victimized by unscrupulous or impecunious builders or contractors . . . As a further

89. See Macklem and Bristow, *supra* n. 5 at Chapter 9.

90. S.A. 1985, c. 14, s. 8.

91. [1955] O.W.N. 581 at 583.

> safeguard for the benefit of those the Act is designed to protect, all moneys received by the contractor from the person primarily liable are, by section 3, expressly said to be and to constitute a trust fund in his hands for the benefit of those other persons. Until those persons have been paid, he must not appropriate or convert any part of it to his own use or to any use authorized by the trust.

The Ontario and Saskatchewan statutes expressly provide also for the imposition of a trust on monies in the hands of owners.[92] Where a sum becomes payable by an owner to a contractor on a supervisor's (usually owner's architect or engineer) certificate, then, on issue of the certificate, the sum certified payable that is in the owner's hands (or subsequently received by him) constitutes a trust fund in his hands. Until the beneficiaries of the trust (the contractor, subcontractor, workmen, etc.) are paid in full, such trust monies may not be appropriated or converted by the owner to his own use (or any unauthorized use).

The impact of these concepts on landlords is difficult to assess. In the cases discussed above there are no monies payable by the landlord as owner. Yet, that absence did not impede lien responsibility in the Supreme Court's view. Should it any more impede trust responsibilities?

The question has implications not only for the landlord but for his lawyer. If the former does have a trust obligation and the latter either:

(a) fails adequately to conduct performance of or protection for that trust obligation, or

(b) himself handles payments without due regard for trust obligations,

will the lawyer himself also become embroiled through negligence claims or even breach of trust claims?

In provinces with trust concepts, especially in Ontario and Saskatchewan, it is prudent to include in the position of the landlord in all leases where he *may possibly* be said to be an "owner":

(a) at least evidence of entitlement to payment of trade and other accounts as a condition of release of any monies (including tenant improvements allowances), and

(b) perhaps in every case the *complete* handling of construction payment arrangements through the landlord's hands.

To date the practice impact of a partial trust has not become evident in procedures followed in Alberta, and the matter comes to be viewed as a result as rather new subject matter. From what can be seen in precedent lease forms from other provinces that have had a trust concept for some time, however, it is not clear that the matter has been fully developed in those jurisdictions either. Recognizing the relatively recent nature of the 1984 Supreme Court cases, perhaps *now* is the time for lawyers in all provinces to reassess their landlord - tenant practices.

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92. See Macklem and Bristow, *supra* n. 5 at 262-263.