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BUILDERS'/MECHANICS' LIEN ACTS:

INTERACTION WITH ARBITRATION PROCEDURES

PRELIMINARY DISCUSSION PAPER FOR POSSIBLE LEGISLATIVE REFORM

Canadian Bar Association
Construction Section

INTRODUCTION

The recent amendments to the standard Canadian construction contract (CCDC2-94) which add new arbitration provisions are designed to promote more cost effective and expeditious resolution of construction disputes than has traditionally been available through the litigation process. This step forward in the alternative resolution of construction disputes offers the potential for circumventing the traditional problems arising out of protracted litigation in the construction context. This paper considers whether amendment of provincial lien legislation should be considered for the purpose of facilitating the use of arbitration under the CCDC2-94 form or under other forms of construction contracts.

BENEFITS OF ARBITRATION

The potential benefits of the alternative dispute resolution process have been emphasized by many writers in recent years. These include:

1. speedier resolution;
2. less cost;
3. more flexibility in procedures/evidence;
4. privacy;
5. preservation of commercial relationships;
6. ability to utilize expertise of arbitrators on technical issues.

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G.F. Henderson in an address on arbitration on November 6, 1992 stated:

> There is a growing interest in the use of arbitration as a dispute resolution mechanism. This interest is growing amongst businessmen who are becoming increasingly concerned about delays and costs in the court system... The advantages of arbitration are well known. It is a mechanism that enables disputes to be resolved more quickly at a minimum of cost. It is conducted in the spirit of confidence rather than confrontation and is flexible in that it can be adapted to the particular requirements of the subject matter of the dispute.

ISSUES

Many consider the new CCDC2-94 general condition GC 8 as a tangible step to taking advantage of the potential benefits of arbitration in the construction industry. There are a number of problems which will arise as the inclusion of mandatory arbitration clauses in construction contracts becomes more common. Principle concerns include the following:

CONCERN #1

Those agreeing to take advantage of the benefits offered by such clauses as GC 8 of the CCDC contract should not be faced with the requirement to undertake two procedural courses of action to exercise their contractual rights. Currently, where the contract provides that liens may not be enforced until the amounts of the claim have been submitted to arbitration, the lien must be filed and perfected within the times prescribed by the relevant lien Act as if this contractual arbitration provision did not exist: Macklem and Bristow, *Construction Builders' and Mechanics' Liens in Canada (6th Ed.) (Carswell, Toronto: 1990)* at p.6-74.

In Nova Scotia, for example, s. 26 of the *Mechanics' Lien Act* R.S.N.S. 1989, c.277 provides, *inter alia,* that every lien that has been registered shall absolutely cease to exist on the expiry of ninety days after the work or service has been completed or materials furnished or placed unless in the meantime an action is commenced to realize the claim, and a certificate [of lis pendens] is registered.

Similar provisions exist in the various Canadian lien Acts: e.g. *Builders Lien Act* R.S.B.C. 1979, c. 40, ss. 25,26; *Builders' Lien Act* R.S.A. 1980, c. B-12, s-32; *Construction Lien Act* R.S.O. 1990, c. C.30, s.36(3).

GC 8.3 of the CCDC form expressly reserves the lien claimants right to have resort to the security of the Act:

> **GC 8.3 RETENTION OF RIGHTS**
>
> 8.3.1 It is agreed that no act by either party shall be construed as a renunciation or waiver of any rights or recourses, provided the party has given the notices required under Part 8 of the General Conditions - DISPUTE RESOLUTION and has carried out the instructions as provided in paragraph 8.1.3.
>
> 8.3.2 Nothing in Part 8 of the General Conditions - DISPUTE RESOLUTION shall be construed in any way to limit a party from asserting any statutory right to a lien under applicable lien legislation of the jurisdiction of the Place of the Work and the assertion of such right by initiating judicial proceedings is not to be construed as a waiver of any right that party may have under paragraph 8.2.6 to proceed by way of arbitration to adjudicate the merits of the claim upon which such a lien is based.

It would appear to be counter-productive to require a party to take formal steps to prosecute a lien action at the same time that the underlying dispute is to be dealt with by way of arbitration. As it currently stands no prudent contractor would voluntarily refrain from perfecting his lien claim under the applicable lien legislation in the hopes that the arbitration procedures would be sufficient to protect his rights of recovery. The agreement to take advantage of arbitration is not intended to constitute a waiver of lien rights.

The strict requirements of lien legislation must be observed of course in order to maintain the statutory charge against the land or the security provided in lieu of the land. These requirements include specified time periods within which

a lien must be registered and an action must be commenced. Without any statutory provisions clearly protecting the security provided by the lien while the arbitration process takes place, it could be said that the legislative scheme is by default requiring duplicitous procedures, which is inconsistent with a fundamental purpose of the new ADR provisions, i.e. to promote the quick and inexpensive resolution of disputes.

Conversely, the absence of such protective legislation opens up the door to arguments by lien claimants (seeking for tactical or other reasons to avoid their prior agreement to arbitrate) that they should not be compelled to proceed to arbitration as such may prejudice their statutory lien.

Recent cases that have addressed the conflicts between arbitration provisions and mechanics lien rights have involved disputes regarding the applicability of arbitrations governed by International Commercial Arbitration rules. These cases are nonetheless illustrative of the problems that may arise in the inter-provincial or provincial context.

In *Kvaerner Enviropower Inc. v. Tanar Industries Ltd.* (1994), 17 C.L.R. 70, the Alberta Court of Queen's Bench dealt with whether or not an action to enforce lien rights under the Alberta *Builders' Lien Act* should be stayed pending an arbitration under the *International Commercial Arbitration Act,* S.A. 1986, c. 1-6.6 ("ICAA"). The case arose out of a project in Whitecourt, Alberta. The subcontract between the U.S.-based general contractor Kvaerner Enviropower Inc. ("Kvaerner") and Tanar Industries Ltd. ("Tanar") provided that "Any controversy between [Kvaerner] and [Tanar] shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association..."

Tanar failed to pay certain of its subcontractors and suppliers. These subs and suppliers were paid out by Tanar's bonding company which took an assignment of their lien rights. Subsequently, both Tanar and the bonding company filed lien claims and commenced action under the *Builders' Lien Act.* Kvaerner applied to stay these lien actions. The Court found that Kvaerner was within the terms of the contract reference to arbitration and the applicable provisions of the ICAA, and proceeded to deal with the lien claimants' arguments that they should be permitted to proceed with the lien actions. First, it was

argued that the subcontract expressly preserved the lien rights under the *Builders' Lien Act.* The Court held that the fact that the contract provided that the amount owing between them would be decided by arbitration did not deprive Tanar of its lien rights.

Secondly, Tanar argued that to allow the arbitration would be to make many of the provisions of *Builders' Lien Act* inapplicable to the extent that the agreement to arbitrate should be considered void, relying on a decision of the Saskatchewan Court of Queen's bench in *BWV Investments Ltd. v. SaskFerco Products Inc.,* [1993] 4 W.W.R. 533. [this decision was later overturned by the Saskatchewan Court of Appeal, see (1994), 17 C.L.R. (2d) 165.] Tanar relied upon s. 3 of the *Builders' Lien Act* which stated:

> 3. An agreement by any person that this Act does not apply or that the remedies provided by it are not to be available for his benefit is against public policy and void.

[It should be noted that similar provisions exist in the mechanics' lien legislation of the other provinces: see, for example, s. 4 of the *Construction Lien Act, 1983, S.O.* 1983, c.6, which is of similar scope to Alberta's s. 3, and also provisions which are limited in effect to the protection of workers and do not invalidate all agreements to waive the rights under the legislation, e.g. s. 9 of the *Builders' Lien Act,* R.S.B.C. 1979, c. 40; s. 3 of the *Mechanics' Lien Act,* R.S.N. 1990, c.M-3; and s. 4 of the *Mechanics' Lien Act* R.S.N.S. 1989, c. 277].

Justice Dea, in rejecting Tanar's argument, stated at p. 79:

> Arbitration of the part of the price of the work or material furnished in respect to an improvement that remains due to a lien holder is not contrary to the letter or to the spirit of the BLA. Public policy supports arbitration of disputes as shown by the International Convention and the Arbitration Act of Alberta. Many if not most construction contracts call for arbitration of disputes notwithstanding that the BLA applies to work and materials provided under construction contracts.

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Similar issues confronted the Ontario Court of Appeal in *Automatic Systems Inc v. Bracknell Corp.* (1994), 12 B.L.R. (2d) 132. Automatic Systems Inc. ("ASI") engaged Bracknell as subcontractor to work on the manufacture and installation of a conveyor system for Chrysler Canada's Bramalea assembly plant. ASI's standard subcontract provided that "Unresolved Claims" between ASI and the subcontractor were to be settled by arbitration. Absent any other procedure in the Prime Contract or other agreement between the parties, the arbitration was to be in accordance with the rules of the American Arbitration Association, and the arbitration was to be conducted in Kansas City, Missouri.

Bracknell filed a lien under the Ontario *Construction Lien Act.* ASI applied for a stay of the lien actions so that the disputes could be determined by arbitration.

At the Ontario High Court level, Feldman, J. framed the issue before the Court as follows:

> Can parties to a subcontract on an Ontario commercial project agree to arbitrate disputes where the International Commercial Arbitration Act ("ICCA ") applies, or does such an agreement amount to contracting out of the Construction Lien Act ("CLA"), making the agreement void under s.4 of the CLA?

The lower Court held that s. 4 (similar in terms to s. 3 of the Alberta Act cited above and considered in *Kvaerner, supra),* had as its main purpose the protection of contractors, subcontractors and workmen with less bargaining power or sophistication from being forced to give up their lien rights under the CLA to obtain work. The Court found that this protection was broad in scope, and the effect of s. 4 was to relieve the subcontractor of its agreement to submit disputes to arbitration.

The Ontario Court of Appeal disagreed, holding that there was no statutory impediment in the CLA which precluded the arbitration from proceeding. Importantly, the Court stressed that there were strong public policy reasons to sustain commercial arbitration clauses:

> Legislation similar to the ICAA, adopting the Model Law [as adopted by the United Nations Commission on International Trade Law on June 21, 19851 was enacted by the other provinces, providing for a uniform and universally consistent method of recognizing and enforcing commercial arbitration agreements between contracting parties in Canada and other parties adhering to the Convention. The purpose of the United Nations Conventions and the legislation adopting them is to ensure that the method of resolving disputes, in the forum and according to the rules chosen by the parties, is respected. Canadian Courts have recognized that predictability in the enforcement of dispute resolution provisions is an indispensable precondition to any international business transaction and facilitates and encourages the pursuit of freer trade on an international scale. Kaverit Steel & Crane Ltd. v. Kone Corp. (1992), 87 D.L.R, (4th) 129 (Alta C.A.) at p. 139.

It is apparent that the Court considered the policy reasons in favour of upholding arbitration clauses in the international context would also apply in the interprovincial context. Justice Austin stated at p. 144:

> As a matter of principle, it is difficult to see why, in the context of the CLA, any distinction should be drawn between domestic and international arbitration or, for that matter, between domestic and interprovincial arbitration. Having regard to international comity, and to the strong commitment made by the Legislature of this Province to the policy of international commercial arbitration through the adoption of the ICAA and the Model Law, it should, in my view, require very clear language to preclude it.

In *BWV Investments Ltd v. Saskferco Products Inc.* (1994), 17 C.L.R. (2d) 165, the Saskatchewan Court of Appeal arrived at a similar conclusion in considering yet another case involving a dispute as to whether the underlying contract dispute would be governed by the provincial lien legislation or whether the arbitration procedure contained within the contract would be reconciled with the lien procedures. The Court conducted a rather extensive review of decisions in other jurisdictions that considered the interaction between international arbitration and the domestic law of the jurisdiction. In upholding the arbitration

agreement, Justice Gerwing stated at p. 182:

> In the domestic arbitration context, a decision of the British Columbia Supreme Court has recognized that arbitration is not inconsistent with the builders' lien legislation. Relying on Defazio, the court in Sandbar Construction [(1992), 66 B.C.L.R. (2d) 225, 50 C.L.R. 74] stated that the quantum of monies owing under the contract could be determined by arbitration, and enforced by an action in contract, without abrogating the purposes of the builders' lien legislation. Rather, the arbitral award would "set the outside parameters of the sum that may be secured by a builder's lien" (at p. 84).
>
> In my opinion these cases represent the correct view of builders' lien legislation. While it is true the BLA makes provision for determining the quantum owing by and to parties involved in a construction project, the purposes underlying the legislation do not suggest that this is an exclusive mechanism to determine quantum. In the face of a dispute regarding quantum, the issue is customarily determined by an ordinary action in contract. While an action such as the present one is typically called a "builders' lien action", there is nothing about the action that makes it unique to builder's lien matters aside from the nominal procedural rules that are set out in the legislation. However, these procedural entitlements are expressly restricted to actions taken under that legislation: see s. 86 of the BLA. There is nothing in the BLA that expressly or impliedly abrogates the right to use the mechanisms available prior to the passing of the Act for the determination of quantum in contracts where liens have arisen. In light of the general law, their, a builders' lien action is not the only route to a determination of quantum in relation to contracts where liens have arisen.

The Court overturned the lower Court and ordered that the matters in dispute between the parties to arbitration are stayed pending the outcome of the arbitration.

These recent cases evidence a clear judicial policy in favour of maintaining the parties' rights to have certain issues determined by arbitration while at the same time preserving the security of a mechanics lien. The Courts were nonetheless faced with interpreting legislation which lacked clear direction on the interaction between the lien procedures and the arbitration process. It should also be noted that these cases generally dealt with relatively straight forward lien situations, for example, involving one contractor's claim against a lien fund posted to secure that claim. Undoubtedly, in the absence of any legislative response, the potential exists for substantial litigation in such situations where there are multiple parties competing for a single fund, some of whose contracts contain arbitration clauses and some without.

CONCERN #2

It is undesirable that those who provide work and materials under construction contracts be uncertain as to the necessary procedures to protect their contractual rights, and in particular that they be confronted with the contradictory requirements of proceeding to arbitration and prosecuting lien actions. For example, in contracts which do not effectively state that the arbitration clause is to apply notwithstanding the lien action, the defendant in the lien action is risks a finding that if he appears to defend (e.g. by filing a defence), he may be taken to have waived arbitration.

Related to this concern to avoid uncertainty in the law is the principle that parties should be held to agreements freely entered into in the commercial market place. The Courts have reserved the judicial discretion to relieve parties of onerous terms in unconscionable circumstances, however, otherwise there is no current judicial trend to permit parties to avoid their express contractual obligations. In the cases cited above, the lien claimants sought to circumvent the arbitration provisions. If the lien legislation had been clear as to the procedural implications of the arbitration provisions on the lien actions, the grounds upon which the claimants could attempt to avoid the arbitration process would have been substantially more limited.

CONCERN #3

As matters presently stand, and as is reflected in the case law cited above, where lien actions are initiated to preserve technical lien rights, either the lien claimant or the owner are required to take steps to obtain a stay of the Court proceedings.

Macklem and Bristow state as follows at p. 3-19:

> The proper procedure is for the defendant to bring a motion to stay the lien proceedings until arbitration has occurred: Art Plastering v. Oliver and Excelsior Const. Co., [1945] 0.W.N. 41 (H.C). However, the Court in Great West Elec. Ltd. v. Housing Guild, [1947] 2 W.W.R. 1023 (B.C. Co. Ct.), refused an application by a defendant for a stay of the mechanics' lien proceedings, where his contract contained an arbitration clause, holding that such a clause did not amount to a waiver of the Plaintiffs right to enforce his mechanics' lien. In Pigott Const. Co. v. Fathers of Confederation Memorial Citizens Foundation (1965), 51 D.L.R. (2d) 367 (P.E.I.S.C.), where the plaintiff applied for an order staying its own mechanics' lien action until the arbitrators had given their decision, it was held that the plaintiff had not waived its right to arbitration by commencing an action, and a stay of proceedings was granted. See also Lonmar Plumbing & Heating Ltd. v. Representative Holdings (1986), 1 D.L.R. (3d) 591 (Sask.Q.B.); Parsons & Whitemore Pulp-mills Inc. v. Foundation Co. (I 970), 73 W.W.R. 300 (Sask.CA.); Fathers of Confederation Bldgs. Trust v. Pigott Const. Co. (1974), 44 D.L.R. (3d) 265 (P.E.I.S.C).

and further at p. 7-16.3

> While the general rule is that the enforcement of the mechanics' lien must await the outcome of arbitration if the contract contains an arbitration clause, it was held in Great West Elec. Ltd. v. Housing Guild Ltd., [19471 2 W.W.R. 1023 (B. C Co. Ct.). that the claimant might enforce his lien despite the arbitration clause. Similarly, in Art Plastering Co. v. Oliver, [1945] 0. W. N. 41 (H. C),

the Court took the position that, if an action were commenced, the defendant might either waive the right to arbitration by entering a defence in the action or, alternatively, move for a stay of proceeding pending arbitration or for an outright dismissal of the action. If the defendant does neither, but appears at the trial, it would seem that he will be taken to have waived this provision in the contract. See Can. Sand etc. Co. v. Poole (1907), 10 O. W.R. 1041; Pigott Const. Co. v. Fathers of Confederation Memorial Citizens Foundation (No. 2) (1965), 51 D.L.R. (2d) 367 (P.E.I.S.C.); Grannan Plumbing & Heating Ltd v. Rimpson Const. Ltd. (1979), 24 N.B.R. (2d) 238 (C.A.).

The issue as to the effect of the arbitration clause can in itself involve expensive litigation, where one party wishes to circumvent the agreement to arbitrate by resort to the Court proceedings. An apt illustration is provided by the *Automatic Systems Inc* case cited above. ASI not only had to proceed through an application and an appeal with respect to the arbitration issue with its subcontractor Bracknell, it also was required to bring two applications and an appeal to establish its right to arbitrate disputes with a second subcontractor, E S. Fox Limited. (see *Automatic Systems Inc v. E.S. Fox Ltd.* (1994) 12 B.L.R. (2d) 125 (Ont. Ct. Justice); (1994) 12 B.L.R.(2d) 148 (Ont. C.A.); and [1995] O.J. No. 461(Ont. Ct. Justice).

It is recognized that in the normal course, a Court will grant a stay of proceedings under the relevant *Arbitration Act.* However, the requirement to take steps to obtain a stay when the issue between the parties is in arbitration seems to add unnecessary cost. Further, one of the benefits of the ADR process is that it tends to unburden the Courts. To require unnecessary applications for a remedy that in practice is automatic wastes the Court's valuable time.

CONCLUSION

These considerations appear to justify further study regarding possible legislative amendment which would obviate the potential for the lien process to complicate the parties' desire to proceed by arbitration, while at the same time preserving the security offered by the statutory lien. Mechanics' lien legislation is technical by nature, and there are various differences between the Canadian

provinces as to the technical requirements. More detailed study would be required to determine whether a common approach to this issue is possible, and whether there are inherent complications arising out of the class action nature of lien claims which could complicate the use of legislative amendment to facilitate the ADR process in this context.

It is submitted that there are compelling reasons to explore a uniform approach to this issue across Canada:

(a) as noted at the outset, the standard Canadian construction contract now places increased emphasis on the arbitration of disputes. It is desirable that those engaged in the construction industry, whether contractors, developers, or consultants, be able to move easily from one jurisdiction to another, i.e. without being exposed to divergent provincial legislative or judicial approaches.

(b) there are similar- although not identical -builders' lien Acts and arbitration Acts in every province and the issues discussed above exist in every province. Again, a uniform response would be useful.

(c) the ULC already adopted a *Uniform Arbitration Act* several years ago. As indicated above, continued uncertainty regarding the interaction of the lien legislation can only impede the implementation of the policies supporting the use of arbitration already adopted by the ULC.

The Construction Section recommends that the Uniform Law Conference adopt this issue as a subject for its next working year and that a Working Group of the ULC be struck to recommend legislative options and to draft legislative solutions.