Canadian College of Construction Lawyers

LEGAL UPDATE

L.U. #158

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LU #158 [2020]

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V. Payment of Contractors and Subcontractors
Jurisdiction:
Alberta
Author:
Shauna N. Finlay, Partner, Reynolds Mirth Richards and Farmer, LLP

Shauna N. Finlay

The Anti-Deprivation Rule Applies in Canada

Chandos Construction Ltd. v. Deloitte Restructuring Inc., 2020 SCC 25

This decision dealt with the applicability of the "anti-deprivation" rule in Canada. While the anti-deprivation rule has been the subject of recent decisions of the UK Supreme Court, it is the first decision of Canada's Supreme Court on this old common law rule.

The anti-deprivation rule renders void any provision in an agreement which provides that upon insolvency, value is removed that would otherwise have been available to the insolvent party's creditors under the applicable statutory regime.

The issue arose when a contractor sought to enforce a clause in a construction subcontract that was triggered by the subcontractor's insolvency. The clause allowed the contractor to hold back an additional ten percent (10%) of the value of the subcontract if the subcontractor failed to complete its work (including where such failure was due to the insolvency of the subcontractor). When the subcontractor went bankrupt, the contractor argued that it was entitled to set off the cost to complete the work and an additional 10% of the value of the subcontract against any payments due to the bankrupt estate. The bankruptcy trustee of the subcontractor argued that the clause violated the anti-deprivation rule and so was void or unenforceable. Ultimately, the Supreme Court agreed.

The Facts

Chandos Construction ("Chandos") subcontracted Capital Steel Inc. ("Capital Steel") to provide steel for a condominium project. Capital Steel assigned itself into bankruptcy prior to completing the subcontract. The subcontract included the following clause (the "Chandos Clause") which Chandos purported to enforce:

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> *In the event the Subcontractor commits any act of insolvency, bankruptcy, winding up or other distribution of assets, or permits a receiver of the Subcontractor's business to be appointed, or ceases to carry on business or closes down its operations, then in any such events:*
>
> *...*
>
> *(d) the Subcontractor shall forfeit 10% of the within Subcontract Agreement price to the Contractor as a fee for the inconvenience of completing the work using alternative means and/or for monitoring the work during the warranty period.*

Deloitte, in its position as trustee in bankruptcy, argued that this clause was void by virtue of the anti-deprivation rule (and, in the alternative, that it was not enforceable by virtue of being an illegal penalty).

Lower Court Decisions

The Chambers Justice held that the Chandos Clause was not an attempt to avoid the application of bankruptcy laws (and nor was it an illegal penalty) and thus, it was not void. In analysing the issue this way and considering the *bona fides* of the parties intent, rather than the *effect* of the particular clause, the Chambers Justice was informed by a decision on the anti-deprivation rule from the UK Supreme Court, namely *Belmont Park Investments Pty Ltd. v. BNY Corporate Trustee Services Ltd.* [2011] UKSC 38, [2012] 1 All ER 505, [2012] 1 AC 383. In that case, the UK Supreme Court found that while the anti-deprivation rule was still an important part of the common law, it should be applied in a common sense manner that prevents its application to *bona fide* commercial transactions which do not have, as their predominant purpose, the deprivation of the property of a bankrupt.

The trustee appealed. In the Alberta Court of Appeal, the majority reversed the Chambers decision holding that the Chandos Clause offended the anti-deprivation rule. The majority rejected the intent-based test from *Belmont*, and instead found that the application of the rule required one to consider the *effect* of the clause ("Did it result in value being diverted from an insolvent party's creditors that otherwise would have been available, contrary to the applicable statutory scheme?").

In an extensive dissent, the minority argued that the anti-deprivation rule

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was not part of Canadian common law. The dissent further posited that an intent-based test was appropriate considering the importance of freedom of contract and the ability of parties to fashion their own remedies to a breach.

In keeping with this approach, the minority also referred to a line of cases from the UK Supreme Court that found that liquidated damages clauses are not limited to a genuine pre-estimate of damages. The minority argued that if a liquidated damages clause had a reasonable commercial basis and was not extravagant, exorbitant or unconscionable, then it was not a prohibited penalty clause. On this basis, the minority would have upheld the clause in question.

Chandos appealed to the Supreme Court of Canada.

What the SCC found

The SCC denied the appeal (8-1), with Justice Rowe writing the majority decision and Justice Coté dissenting. Both decisions accepted that the anti-deprivation rule was a part of the common law of Canada. Justice Rowe, writing for the majority, confirmed the rule is to be applied based on the effect a clause would have, regardless of the intent of the parties. The majority noted that an effects-based test was consistent with provisions in the *Bankruptcy and Insolvency Act* and with the *pari passu* rule, in that one looks to the effect of the transaction, as opposed to the intent of the parties or the commercial purpose. The majority also found that this approach created commercial certainty because one could readily determine the effect of a clause, as opposed to the difficulty of ascertaining the intent of the parties in drafting the clause. In this case specifically, Justice Rowe found that because the effect of the clause was to create a debt to Chandos that would not exist but for the insolvency, it was clearly caught by the anti-deprivation rule. As the application of the anti-deprivation rule rendered the clause void, Justice Rowe declined to address the issue as to whether the Chandos Clause offended the penalty rule.

In her dissent, Justice Coté sought to apply the rule using the intent -based test, requiring one to consider if the provision serves a *bona fide* commercial purpose. She stated that she would have found that the provision did serve a *bona fide* commercial purpose.

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Key Points

The Supreme Court confirmed the test for applying anti-deprivation rule as follows:

i) Is the relevant clause triggered by an event of insolvency or bankruptcy?
ii) And if so, is the effect to remove value from the insolvent's estate that would otherwise be available for distribution to creditors?

The anti-deprivation rule supports one of the principles of the statutory insolvency regime which is to maximize the global recovery for all creditors in accordance with the priorities set out in the *Bankruptcy and Insolvency Act*.

The Supreme Court also addressed examples where the rule may not apply. The Court found that the anti-deprivation rule may *not* apply to contractual provisions that remove property but not value from a bankrupt estate. It may not apply where the contractual provision is triggered by an event other than an insolvency or bankruptcy. Further, the Supreme Court noted that parties are free to protect themselves from the effects of an insolvent counter party by taking security, acquiring insurance or requiring third party guarantees.

The Supreme Court also confirmed that the law of set-off does not save debts triggered only by insolvency or bankruptcy. In this case, the 10% forfeiture was triggered solely by the insolvency. Therefore, it could not be set-off against amount owing by Chandos to the bankrupt estate of Capital Steel.

Construction contracts often include provisions that contain consequences arising from the insolvency of a party. It is worth reviewing such provisions in light of the *Chandos* decision to determine if such provisions can be recast to avoid the imposition of the anti-deprivation rule.

Let it Snow: Roof Collapse Leaves Landlord Liable for Breach of Implied Term in Lease

Canpar L.P. v. 3258042 Nova Scotia Limited,
2020 NSSC 274

LU #158 [2020]

Primary Topic:
I. General
Jurisdiction:
Nova Scotia
Authors:
John Kulik, Partner, and Melanie Gillis, Lawyer, McInnes Cooper

CanLii Reference:
2020 NSSC 274

NOVA SCOTIA

John Kulik, Q.C.

Melanie Gillis

The case of *Transport Canpar L.P. v. 3258042 Nova Scotia Limited*, 2020 NSSC 274 concerned a roof that collapsed due to an accumulation of snow in the winter of 2015. That winter was one of the worst Nova Scotia has ever seen and played a starring role in the facts of this case. As Justice Coughlan described it, between January 26 and February 22, 2015, Nova Scotia received 1.3 metres of snow as well as a healthy dose of rain[1], most of which immediately froze when it landed. Unsurprisingly, roof collapses abounded with an inevitable *flurry* of litigation (pun intended).

In this case, a commercial tenant sued its landlord for both breach of the parties' lease agreement and for negligence in failing to maintain the property when the roof of the subject property collapsed from a snow overload.

Background Facts

The facts underlying this case were atypical in several respects. First, the designer, builder, and supplier of the roof were all unknown. Therefore, unlike most construction matters - which often involve multiple parties - this case involved just the landlord and the tenant. Also atypical about this case was the fact that there were no construction plans to speak of, and in particular, no as-built drawings. Finally, there was no record of when the roof was in fact built, and therefore no definitive proof of which iteration of the *National Building Code of Canada* ("Code") would apply.

All the court had to go on was: 1. the terms of the lease agreement; 2. a range of ten years within which the roof was presumed to have been constructed; and 3. two opposing experts who provided conflicting opinions on both the structural integrity of the roof and the cause of loss. The experts relied almost exclusively on the observations of another engineer who had attended the site soon after the collapse.

Issues

The central issue was what the landlord ought to have done differently, given that they did not design the roof and had no knowledge of its as-built condition at the time they leased it to the tenant.

[1] *Transport Canpar L.P. v. 3258042 Nova Scotia Limited,* 2020 NSSC 274 at para. 52

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Reasoning

The issues at trial gave rise to *perfect storm* (sorry!) of legal issues that engaged principles of construction law, contract law, and the legal principles underpinning commercial lease arrangements.

Ultimately, Justice Coughlan found that there was an implied term in the lease that the building was designed and constructed in accordance with the *National Building Code of Canada* ("Code"). He further found that that the roof was not compliant with the snow load requirements under the Code, that the landlord breached the implied term of the lease, and that this breach caused the roof collapse. Coughlan J also went on to find that the landlord was negligent in failing to monitor the snow load on the roof.

In support of his reasoning, Justice Coughlan cited *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd*., [1999] 1 SCR 619 ("MJB") (*famous for other reasons*), which sets out the 'officious bystander test' for proving implied terms in contracts:

> 27. ...The general principles for finding an implied contractual term were outlined by this Court in Canadian Pacific Hotels Ltd. v. Bank of Montreal, 1987 CanLII 55 (SCC), [1987] 1 S.C.R. 711 (S.C.C.). Le Dain J., for the majority, held that terms may be implied in a contract: (1) based on custom or usage; (2) as the legal incidents of a particular class or kind of contract; or (3) based on the presumed intention of the parties where the implied term must be necessary "to give business efficacy to a contract or as otherwise meeting the 'officious bystander' test as a term which the parties would say, if questioned, that they had obviously assumed" (p.775).

Justice Coughlan applied the test and held that there was an implied term in the lease here that the building was designed and constructed in accordance with the Building Code. Specifically, he held that it "would make no commercial sense" to not imply the term, and that it was "necessary to give business efficiency to the lease".

However, Justice Coughlan did not end the inquiry there. He went on to decide whether the landlord, who had no hand in the design or construction of the property and had made no repairs or alterations, was still responsible for its Code compliance. Once again, he found against the landlord, and held that they ought to have retained an engineer to conduct an inspection at the time of purchase to determine the structural soundness of the building. Having failed to do so, he held that they should bear the risk.

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Also interesting is the fact that Coughlan J made this determination in the face of an exclusionary clause in favour of the landlord, which stated that the landlord would not be liable for any loss caused by "...smoke, steam, water, ice, rain, snow, or fumes which may leak, issue or flow into through or from the Premises..." (para. 81). Justice Coughlan disposed of this issue by citing *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways),* 2010 SCC 4, and adopting a strict and narrow interpretation of the exclusionary clause. Specifically, he held that the damage did not arise from the "use, operation, or occupation" of the property, and therefore the exclusionary clause did not apply.

Coughlan J went on to find that, in the event there was no contractual liability, that the landlord was negligent for failing to monitor and clear the snow.

Significance

The decision places a duty on landlords to ensure buildings are Code-compliant prior to leasing, even when they were not involved in the construction and there are no as-built drawings available. In addition, it suggests that exclusionary clauses in the context of commercial lease agreements dealing with construction-related failures will be given an extremely narrow and strict interpretation. In short, it places all of the risk relating to past construction on the landlord. This suggests that, in cases were there are no construction plans or as-built drawings with which to confirm whether a building is Code-compliant, **the wording of exclusionary clauses should be given particularly close attention,** to ensure that the parties have a firm understanding of how this category of risk will be allocated, and that flow-through mitigation strategies (such as the price of rent, and the insurance coverage each party retains) are adjusted accordingly.

Ensuring Coverage: When an Additional Insured is Not Insured at All

Sky Clean Energy Ltd. v. Economical Mutual Insurance Company,
2020 ON CA 558

LU #158 [2020]

Primary Topic:
XII. Insurance
Jurisdiction:
Ontario
Authors:
Howard Krupat, Partner and Patricia Chehade, Student at Law, DLA Piper (Canada) LLP

CanLii Reference:
2020 ON CA 558

ONTARIO

Howard Krupat

Patricia Chehade

It is not unusual in a construction contract for a project owner ("**Owner**") to be named as an "Additional Insured" on a Contractor General Liability ("**CGL**") insurance policy. The benefit to the Owner is the added protection against potential claims that may arise from the work performed by the contractor.

In *Sky Clean Energy Ltd v Economical Mutual Insurance Company*, a decision issued on September 9, 2020, the Ontario Court of Appeal considered whether the Owner's liability for remediation costs and loss of revenue due to the failure of the equipment installed by its contractor triggered the additional insured provision in the CGL policy. As explained below, a central issue in the dispute was the interpretation of the phrase "arising out of operations".

Factual Background

Sky Clean Energy Ltd. ("**Sky**") is a developer of solar energy projects. Marnoch Electrical Services Inc. ("**Marnoch**") is an electrical contracting company. Sky and Marnoch entered into two CCDC 2 stipulated price construction contracts, pursuant to which Marnoch agreed to install a rooftop solar power system at two different locations (the **"Contracts"**). Sky would design, select, and supply the equipment and Marnoch would install it. Pursuant to a separate agreement, Sky then agreed to sell each of these projects to Fireflight Solar Limited Partnership (**"Firelight"**).

Marnoch also agreed in the Contracts to name Sky as an additional insured under Marnoch's CGL policy and placed its CGL policy with Economical Mutual Insurance Company ("**Economical**"). The Economical policy provided that Sky, as an Additional Insured, was covered on the following basis:

> This insurance applies to those stated on the Declaration as "Additional Insureds" but only with respect to liability arising out of the operations of the Named Insured.

The "Named Insured" was Marnoch.

Once construction commenced, Marnoch noticed that the transformer delivered by Sky's original supplier to the first project site did not conform to the contractual specifications. Due to time constraints, Sky sought Marnoch's assistance in sourcing replacement transformers and provided Marnoch with the requisite technical information. Marnoch identified a supplier, Marcus Transformers of Canada Ltd. **("Marcus")** who could deliver the equipment within Sky's required time frame. Sky approved and accepted the replacement transformers for both sites. The Contracts were revised to reflect that Marnoch would supply and install the transformers manufactured by Marcus.

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When the supplied solar systems were energized, Marnoch noted problems with the transformers and suggested that the system be shut down pending further explanation. However, concerned with the loss of revenue, Sky decided to leave the equipment running for observation, formally took control of the facilities and later finalized its sale to Firelight.

The transformers subsequently failed at both locations, thereby igniting a fire and forcing both solar systems to be shut down. Sky elected to indemnify Firelight for remediation costs and loss of revenue and to seek recovery from Marnoch and Economical.

Sky first commenced an arbitration against Marnoch based on their contractual indemnity clause and on warranties given by Marnoch.

Arbitration between Sky and Marnoch

The arbitrator dismissed Sky's claim and found that Sky's liability was incurred as a result of its own negligence. It was Sky who selected the transformers and it did not rely on Marnoch's expertise in so doing. As such, Marnoch's role was limited to simply implementing Sky's choice. Interestingly, the arbitrator concluded that Marnoch's limited role in procuring the equipment meant that Marcus was not a supplier of Marnoch under the terms of the Contracts and that Marnoch could not be held responsible for any negligence by Marcus - even if that occurred.

Specifically, the arbitrator stated that "Sky cannot hold Marnoch responsible or liable for the consequences of [its] own decisions." Sky unsuccessfully appealed the arbitration award to the Superior Court.

Sky's action against Economical

Sky then commenced an action against Economical under the CGL policy. The parties agreed that the arbitrator's finding of facts would be binding on the trial judge.

Sky argued that it was covered under the Additional Insured Endorsement on the basis that the fire arose out of Marnoch's operations, thereby putting within the wording of the Endorsement. Sky also argued that the fire would not have occurred "but for" Marnoch's installation of the transformers. The trial judge observed that although the failure of the transformers was the cause of the fire, Marnoch did not cause them. Citing the case law that was presented for the test to be met in applying the "arising out of" phrase that is common in insurance policies, the trial judge concluded that the connection between Marnoch and the fire was merely incidental. Although the fire would not have occurred 'but for" the installation of the transformers, this is not the applicable test when it comes to interpreting the critical language of

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the insurance policy - the application of "arising out of" requires a higher standard.

It was also found that there was insufficient proximity between Sky's decision on which transformers should be used, and Marnoch's installation of the transformers to find that the fire arose out of Marnoch's operations

Finally, even if Sky's claim fell within the grant of coverage of the Additional Insured Endorsement, it was not entitled to coverage because it breached a condition of the policy that prohibited it from admitting liability and paying Fireflight the remediation cost without the insurer's consent.

Sky's appeal to the Ontario Court of Appeal

Applying traditional contract interpretation case law, the Ontario Court of Appeal noted that the interpretation of a provision within a standard form insurance policy is a question of law and therefore reviewed the issue on a correctness standard.

The Court of Appeal largely agreed with the B.C Court of Appeal's decision in *Vernon Vipers Hockey Club v. Canadian Recreation Excellence Vernon Corp*. In *Vernon*, the court held that "arising out of" requires more that a "but for" connection between the liability of the additional insured and the operations of the contractor. In other words, while the "but for" test is necessary, there must also be an unbroken link between the actions of the contractor and the liability that was incurred. As noted by the trial judge, the connection cannot be merely incidental.

The Court of Appeal therefore upheld the trial level decision, noting that the scope of Marnoch's operations did not include the selection of the transformers that were used. Again, Marnoch's installation of the transformers was incidental to the fires and did not establish the "unbroken chain of causation" that was required to fall within the "arising out of" language contained within the Endorsement to the CGL policy.

There were also arguments about the extent to which the CGL policy was consistent with the insurance requirements of the Contracts, which were revised as compared to the standard CCDC form. However, it was found that in the dispute between Economical and Sky, the policy language would be determinative. Accordingly, the discrepancy between the language of the Contracts and the language of the CGL policy is not a focal point of this summary.

Sky's appeal was dismissed, with costs.

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Commentary

Taken in the context of the specific wording of the insurance policy at issue, the specific facts of this case were determinative of the applicability of the Additional Insured Endorsement. In essence, to establish Marnoch's liability, the *manner* of installation of the transformers would have to be the cause of the fires. As described above, that is not what was found. It was therefore concluded that the incident did not arise out of Marnoch's operations and that the Additional Insured endorsement did not apply to provide coverage for Sky.

It is common in negotiating construction contracts to be satisfied that appropriate insurance has been obtained upon the basis of the categories of the insurance procured. However, any party relying upon an "Additional Insured" endorsement would be well advised to consider both: (i) whether the language of the policy is consistent with the language of the underlying contract (whether it is a CCDC contract or otherwise); and (ii) the scope of the coverage actually obtained.

In this case, it would appear that the Additional Insured logically concluded sufficient coverage would be available on the basis of the category of coverage procured. However, the heavily litigated phrase "arising out of" means that courts will pay careful attention to the scope of the work actually performed by the Named Insured and whether there is a sufficient nexus to that work and the event forming the basis of the insurance claim to trigger coverage.

It is also interesting to note that Sky's argument that the trial judge failed to consider the language of the insurance clause provided in the Contracts was of no use when it came to determining the insurer's liability under the language of the policy itself, notwithstanding that this discrepancy is a matter that could be argued between the parties themselves.

The inevitable conclusion from these observations is that parties relying upon such insurance provisions would be well advised to carefully consider the policy wording itself in the context of the scope of work prescribed by the underlying contract.

Lien Claimants, Mortgagees and Appeal routes – *Dal Bianco v. Deem Management Services Limited et al*

Dal Bianco v. Deem Management Services Limited et al
2020 ONCA 585

LU #158 [2020]

Primary Topic:
IX. Construction and Builders' Liens
Secondary Topic:
V. Payment of Contractors and Subcontractors
Jurisdiction:
Ontario
Authors:
Brendan Bowles, Partner and Brandon Keshen, Student at Law, Glaholt Bowles LLP

CanLii Reference:
2020 ONCA 585

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Brendan D. Bowles

Brandon Keshen

On September 18, 2020, the Ontario Court of Appeal released their decision in *Dal Bianco v. Deem Management Services Limited et al.*, 2020 ONCA 585. In brief, the lower court held that construction lien claimants had priority over a mortgagee in the sale proceeds of an insolvent debtor's property under section 78 of the Construction Act (the "***Act***"). The mortgagee appealed. On appeal, the parties moved for directions from the Court of Appeal on which appellate court had jurisdiction. Jurisdictional issues were present in this appeal because of the overlap between the priority dispute under the *Act* and the receivership process under the *Bankruptcy and Insolvency Act* ("***BIA***"). Both statutes set out distinct appeal routes.

The court ruled that because the impugned order was made in part reliance on the *BIA*, federal paramountcy rules in favour of federal legislation. As a result, under the *BIA*, the Court of Appeal, had appellate jurisdiction.

In addition to the procedural component, this decision further reinforces the protection of lien claimants as the overall purpose of the *Act*. This decision reflects the courts' propensity to underpin the protection of lien claimants as a guiding principle.

Background and Facts

Deem Management Services Limited ("**Deem**") was the registered owner of a parcel of land in Waterloo, Ontario (the "**Real Property**"). Mr. Dal Bianco, the owner and sole director of Deem, incorporated Uptown Inc. ("**Uptown**") to plan and develop the vacant portion of the Real Property into a senior's residence (the "**Project**").

Shortly into construction, the Project became insolvent and the trades were notified by Mr. Dal Bianco to cease construction activities. The trades liened. In addition to construction liens, various mortgages were registered against title to the Real Property, three of which were registered by Mr. Dal Bianco personally.

Pursuant to section 293(1) of the *Bankruptcy and Insolvency Act* ("***BIA***"), the Ontario Superior Court appointed a Receiver over the property in connection with the Project (the "**Property**"). The Receiver liquidated the Property, and payments were made to the first and second ranking mortgages from the proceeds of sale. However, $5M remained in trust and was to be disbursed to the remaining secured parties. A dispute arose as to whether the lien claimants or Mr. Dal Bianco, as third ranking mortgagee, held priority to the remaining funds.

Priority Motion in the Ontario Superior Court of Justice

The motion judge relied on section 78 of the *Act* to grant priority in favour of the construction lien claimants.

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Lien Claimants, Mortgagees and Appeal routes – *Dal Bianco v. Deem Management Services Limited et al*

In granting the motion, C. Gilmore J. noted that the intention of the *Act*, and thus the intention of section 78, is to protect lien claimants by granting them priority status over mortgages that are registered on title after construction liens have been registered. However, the *Act* carves out certain exceptions that, if proven, would shift the *Act*'s priority regime in favour of mortgagees. Therefore, the issue on this motion, as is the issue in most priority disputes, is whether the facts demonstrate that a section 78 exception exists.

C. Gilmore J. relied on the principle set out in the Ontario Court of Appeal's decision in *Boehmers v. 794561 Ontario Inc.*[1] to confirm that the onus to persuade the court that a section 78 exception is triggered rests on the mortgagee, not the lien claimant.

To satisfy their burden of proof, Mr. Dal Bianco relied on sections 78(6) and 78(2) of the *Act*, respectively, to argue that:

1) The third mortgage was a "subsequent mortgage" under the *Act* and because funds were advanced under the subsequent mortgage, Mr. Dal Bianco as the third ranking mortgagee, therefore had priority over those funds; and,

2) The third mortgage was a "building mortgage" under the *Act* and therefore held priority over the lien claimants to the extent of any deficiency in the holdbacks.

A) The s. 78(6) Subsequent Mortgage Argument

Section 78(6) of the *Act* outlines an exception that covers a mortgage registered after construction has commenced on a project and thus after lien rights have arisen. For a mortgagee to gain priority over lien claimants under this exception, the *Act* sets out that the funds lent must satisfy the following three conditions:

1) The funds must be advanced "in respect of that mortgage";

2) There must not be any preserved or perfected liens at the time of the advance; and

3) At the time of the advance, the mortgagee must not have received written notice of a claim for lien.

Conditions two and three were satisfied in this case.

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[1] 1995 CarswellOnt 244, 122 D.L.R. (4th), aff'g *Jade-Kennedy Development Corp., Re,* 2016 CarswellOnt 19127, 2016 ONSC 7125.

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With respect to the first condition, Dal Bianco took the position that the entirety of funds advanced under the Project "benefitted the project" and therefore were advanced "in respect of" the third mortgage. The court disagreed. The court referred to the case of *XDG Ltd. v. 1099606 Ontario Ltd*.[2] to highlight the distinction between "amounts secured" and "amounts advanced". In *XDG*, the financial arrangement in question involved advances made under a credit agreement, whose amounts were later secured by registration of a mortgage. The court in *XDG* held that because the mortgage was registered on title to secure a prior indebtedness and was not registered to secure advances made under that mortgage, the lien claimants' priority was not affected. The court also referred to the decision in *Jade-Kennedy Development Corp., Re*[3] to confirm the absence of case law supporting the notion that section 78(6) required the proceeds of an advance to create a "benefit" to the borrower.

Ultimately, the motion court held that Mr. Dal Bianco's third mortgage was not a "subsequent mortgage" under the *Act* and therefore did not trigger an exception that would disturb the *Act*'s priority regime. **Importantly**, Mr. Dal Bianco had already made the advances to finance the Project at the time when the construction liens arose, and then subsequently registered the mortgages on title. The court held that nowhere in the *Act* does it contain an exception that allows for lenders to lend funds for an improvement and then gain priority over lien claimants by subsequently securing their loans with registered mortgages. The court noted that allowing mortgagees to maneuver in this manner to gain priority runs counter to the *Act*'s overall purpose, which is to protect lien claimants.

B) The S. 78(2) Building Mortgage Argument

Mr. Dal Bianco further argued that the third mortgage is a "building mortgage" in accordance with section 78(2) of the *Act*. The court disagreed. Noting that "building mortgage" is not a defined term under the *Act*, the court undertook a closer inspection of the initial wording of section 78(2): "...intention to secure the financing of an improvement ...". The court characterized this language as a future intention on the part of the mortgagee to secure the financing of an improvement. Thus, for a charge to qualify as a "building mortgage" under the *Act*, a lender must first register a mortgage and then advance the funds under that mortgage. Mr. Dal Bianco did the reverse: he advanced funds and thereafter registered the mortgage on title – a sequence of events that proved fatal to his argument.

Mr. Dal Bianco appealed.

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[2] 2002 CarswellOnt 4535, [2002] O.J. No. 5307.
[3] 2016 CarswellOnt 19127, 2016 ONSC 7125.

Lien Claimants, Mortgagees and Appeal routes – *Dal Bianco v. Deem Management Services Limited et al*

Dal Bianco v. Deem Management Services Limited et al
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LU #158 [2020]

Primary Topic:
IX. Construction and Builders' Liens
Secondary Topic:
V. Payment of Contractors and Subcontractors
Jurisdiction:
Ontario
Authors:
Brendan Bowles, Partner and Brandon Keshen, Student at Law, Glaholt Bowles LLP

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First Motion in the Ontario Court of Appeal

On appeal, a dispute arose over the correct appeal route. Mr. Dal Bianco filed a motion to a single judge of the Court of Appeal seeking directions on whether the Court of Appeal or the Divisional Court had appellate jurisdiction over the lower court's order.

The *BIA* and the *Act* both set out different appeal routes: Under section 71(1) of the *Act*, an appeal lies to the Divisional Court; and under section 193 of the *BIA*, an appeal lies to the Court of Appeal.

M. Jamal J.A. held that, as a single judge, he lacked jurisdiction to decide the motion. In support of his disposition, he relied on the Ontario Court of Appeal case of *Ontario (Provincial Police) v. Assessment Direct Inc.*[4] where the Court of Appeal in that case held that "a single judge has no power to decide whether an appeal is within the jurisdiction of this court." The motion was adjourned to be heard by a panel.

Second Motion in the Ontario Court of Appeal

This time around, a panel of the Ontario Court of Appeal noted that the key to identifying the correct appeal route is to focus the analysis on the order under appeal. Specifically, the court confirmed that the question to be asked when a receiver has been appointed under section 193 of the *BIA* is "whether the order under appeal is one granted in reliance on jurisdiction under the *BIA*. Where it is, the appeal provisions of that statute are applicable."[5]

In this case, the impugned order was granted in part reliance on the *BIA*. The court held that styling a motion under a receivership or other bankruptcy and insolvency proceeding is not sufficient to access the appeal route under the *BIA*. However, the impugned order in this case was more than styled under the *BIA*. Rather, the substance of the order was borne out and made pursuant to the *BIA*'s receivership process. Thus, because the *BIA* is federal legislation and the *Act* is provincial legislation, the court deferred to the principle of federal paramountcy to settle the conflict in favour of the *BIA*. Accordingly, the Court of Appeal was the correct appeal route.

Key Takeaways

The case is important to construction stakeholders for both procedural and substantive reasons. First, as a matter of process the higher court's deci-

[4] 2017 CarswellOnt 19624, 2017 ONCA 986.
[5] Business Development Bank of Canada v. Astoria Organic Matters Ltd., 2019 CarswellOnt 5177, 2019 ONCA 269.

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sion clarifies that the *BIA*'s appeal route takes precedence over that of the *Act*'s when the order under appeal was granted in reliance on the *BIA*. Given the financial threat COVID-19 poses to construction projects and the likelihood of projects becoming insolvent as a result thereof, knowing the appropriate appeal route in the event of a bankruptcy and insolvency proceeding is useful for parties appealing orders.

Second, for construction financiers, the lower court's decision confirms that, as a rule, when claiming priority over lien claimants, it is prudent practice for secured lenders to register the charge *prior* to advancing the funds. Failing to adhere to this sequence and then moving to gain priority over lien claimants is a futile strategy, in blatant contradiction of the overall purpose of the *Act*. The merits of the appeal itself remain to be determined by the Court of Appeal. Earlier this year the Court of Appeal released a decision in *Urbancorp Cumberland 2GP Inc. (Re)*, 2020 ONCA 197, that in our view reflected an increased willingness on the part of the Court of Appeal to protect the rights of Ontario lien claimants in an insolvency. We therefore await the Court of Appeal's disposition as to the merits of the appeal with interest.

Contact the Legal Update Committee:

c/o **Brendan D. Bowles**
Glaholt Bowles LLP
Construction Lawyers
141 Adelaide St W, #800
Toronto, Ontario, M5H 3L5
Phone: (416) 368-8280
Fax: (416) 368-3467
E-mail: bb@glaholt.com

Legal Update Newsletter Design and Desktop Publishing:
Nicholas J. Dasios

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