THE EQUITABLE DOCTRINE OF MARSHALLING IN CONSTRUCTION LIEN ACTIONS

© 2004 by Harvey J. Kirsh
Construction and Infrastructure Group
Osler, Hoskin & Harcourt LLP

"Boilerplate" construction lien pleadings in Ontario typically include a claim for priority over the security held by the lender who financed construction. The nature of the priority claim is partly dependent on whether it can be established that the security is a "building mortgage", and additionally whether the security is "prior" or "subsequent". Deciding whether and how to advance the priority claim requires an analysis of the sequence of registration of competing property instruments, the dates and amounts of loan advances, and the value of the premises at the time the lien arose. Another important factor, not often considered, is whether the security also encumbers <u>*other*</u> lands, property interests or assets of the owner/ debtor. The answer to that inquiry may cause the lien claimant to attempt to invoke the equitable doctrine of "marshalling" as an additional or alternative attack on the lender's security.

What is "marshalling" ?

Marshalling is an equitable doctrine which applies to protect a "junior creditor", who has recourse to only one fund of a debtor, from the actions of a "senior creditor", who has access to more than one fund of the same debtor[1]. Furthermore, *Falconbridge on Mortgages* comments that a court will generally not interfere with the rights of a senior creditor against any or all of the funds; but if he should resort to the one fund against which the junior creditor has rights, then, in appropriate circumstances, the court will subrogate the junior creditor to the rights of the senior creditor in the other funds.

Canadian courts have held that the following conditions must prevail in order for equity to step in and for the doctrine of marshalling to apply:

---

[1] See, for example, *Steacy (Re)*, (1971) 39 O.L.R. 548 (H.C.J.); *Victoria & Grey Trust Co. v. Brewer et al*, [1970] 3 O.R. 704, 14 D.L.R. (3d) 28 (H.C.J.); *Brown v. Canadian Imperial Bank of Commerce et al*, (1985), 50 O.R. 420, citing *16 Halsbury's Laws of England, 4th ed.* at 962. Also see *Aldrich v. Cooper*, (1803) All E. R. 51, 8 Ves. 382.

(a) there must be two competing creditors' claims, with the senior creditor having access to both of the debtor's funds and the junior creditor having access only to one. The intention of the doctrine is to regulate the rights of creditors amongst themselves, without interfering with the paramount rights of the senior creditor to pursue his remedy against either fund[2];

(b) there must be a single common debtor[3];

(c) the two funds must be at the debtor's disposal[4];

(d) the two funds must be in existence when the question of marshalling arises[5];

(e) the invocation of the doctrine of marshalling is dependent upon a timely claim by the junior creditor; otherwise it may be lost through waiver or laches[6]; and

(f) the doctrine, whose object is to achieve fairness, will not be applied to the prejudice of third parties[7].

Is the Doctrine of Marshalling Applicable in Construction Lien Actions in Ontario ?

In Canada, the doctrine of marshalling has typically been applied to the competing security interests of mortgage lenders, and to the administration of assets and estates (both bankruptcy and testamentary). The parameters of the doctrine, insofar as lien claims are concerned, have not been entirely defined. One writer recently commented that "*(e)quity gives* [the doctrine] *its*

---

[2] *Re Allison*, [1998] OJ. No. 820, 38 O.R. (3d(337 (C.A.)

[3] *Fiatallis North America, Inc et al v Pigott Construction Limited et al*, (1992) 31 A.C.W.S. (3d) 266

[4] *ibid*. Also see *C.I.B.C. Mortgage Corp. v. Branch et al*, [1999] B.C.J. No. 503 (per Levine J., B.C.S.C.)

[5] *ibid*

[6] *Surrey Metro Savings Credit Union v. Chestnut Hill Homes Inc.*, [1997] B.C.J. No. 241 (Drost J., in Chambers); *Granville Savings and Mortgage Corporation v. Bob Co. Holdings Ltd. et al*, [1996] B.C.J. No. 1056

[7] *Nova Scotia Savings & Loan v. O'Hara et al*, (1979) 7 R.P.R 281

flexibility, adaptability and utility. Equity also gives it its uncertainty and lack of clear boundaries"[8].

There is a thin line of judicial authority in British Columbia to the effect that a lien claimant may not obtain the benefit of the marshalling doctrine[9]; but, in those cases, there were many distinguishing facts, not all the requisite criteria were met, and the lien claims under review were never perfected.

In Ontario, there does not appear to be any clear authority that the doctrine of marshalling is (or is not) applicable in construction lien proceedings. Having said that:

(a) subsection 51(a) of the *Construction Lien Act* provides jurisdiction to the court to try the lien action, "*in order to dispose completely of the action and to adjust the rights and liabilities of the persons appearing before it . . .*";

(b) subsection 51(b) of the *Act* provides jurisdiction to the court to "*adjust the rights and liabilities of, and give all necessary relief to, all parties to the action*";

(c) subsection 58(4) of the *Act* provides that a master, to whom a reference has been directed, "*has all the jurisdiction, powers and authority of the court to try and completely dispose of the action and all matters and questions arising in connection with the action . . .*"; and

(d) the *Courts of Justice Act*, which applies to proceedings under the *Construction Lien Act*, confirms that the Superior Court "*may grant equitable relief*"; that it "*has all the jurisdiction, power and authority historically exercised by courts of common law and equity in England and Ontario*"; that "*(c)ourts shall administer concurrently all rules of equity and the common law*";

---

[8] Bruce MacDougall, "*Marshalling and the Personal Property Security Act: Doing unto Others*", 28 U.B.C. Law Review 91

[9] See *Hirsch v. 467145 B.C. Ltd.*, [1996] B.C.J. No. 1901 at para. 15 (S. C. Master in Chambers); but see *Williamson v. Loonstra*, (1973), 34 D.L.R. (3d) 275 (B.C.S.C.)

and that "*(w)here a rule of equity conflicts with a rule of the common law, the rule of equity prevails*".

A recent Ontario decision[10] describes the claim of an unpaid contractor who had supplied electrical services to a private school. The school had borrowed money from its bank, and had provided the bank with collateral security. Although the electrical contractor was an *unsecured* creditor, it sought to amend its pleading so as to pursue a claim requiring the school's bank to marshal its security. Master Polika permitted the amendment, holding that "*the marshalling claim comes within the four corners of the proposition*". If the doctrine could potentially be applied in a case involving an unsecured creditor, why not in a case involving a secured lien claimant ?

It should be noted, however, that, if the doctrine is applicable in the context of construction lien actions, it may only be available to contractors, who have privity of contract with an owner, and not to subcontractors, who do not. The suggested rationale is that one of the criteria for marshalling to apply is that there must be a "single common debtor"[11].

It is submitted that, so long as there is no impairment or prejudice or delay to the rights of the senior creditor, lien claimants who enjoy privity of contract with an owner, *qua* junior creditors, should be entitled, in appropriate circumstances, to invoke the equitable marshalling doctrine, and should be entitled to full rights of subrogation.

---

[10] *Nortown Electrical Contractors Associates v. Or Haemet Sephardic School*, [2000] O.J. No. 4112

[11] The doctrine of marshalling, one might argue, may possibly be applicable to the claims of subcontractors as well, since the "single common debtor", namely the owner, is directly indebted to the subcontractors to the extent of the statutory and notice holdbacks