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Thomas Heintzman is counsel at McCarthy Tétrault in Toronto. His practice specializes in litigation, arbitration and mediation relating to corporate disputes, shareholder's rights, securities law, broadcasting/telecommunications and class actions.

He has been counsel in many important actions, arbitrations, and appeals before all levels of courts in many Canadian provinces as well as the Supreme Court of Canada.

Thomas Heintzman is the author of Goldsmith & Heintzman on Canadian Building Contracts, 4<sup>th</sup> Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Goldsmith & Heintzman on Canadian Building Contracts has been cited in 183 judicial decisions including the two leading Supreme Court of Canada decisions on the law of tendering:

*M.J.B. Enterprises Ltd. v. Defence Construction (1951)*, [1999] 1 S.C.R. 619 and  
*Double N Earthmovers Ltd. v. Edmonton (City)*, 2007 SCC3, [2007] 1 S.C.R. 116-2007-01-25 Supreme Court of Canada

## **The Equitable Doctrine of Marshalling Applies to Construction Liens**

### **Construction Law - Construction liens - Marshalling**

The *Construction Lien Act* seems to be a world unto itself, unaffected by the general principles of law. But the recent decision of the Alberta Queen's Bench in *Gerrow v. Dorais* reminds us that a construction lien is one form of secured interest. The lien is therefore subject to the general principles of the law of mortgages and secured interests. The court held that a construction lien is subject to the age-old equitable principle of marshalling. This principle can be of great help to lien holders seeking to recover value from a highly mortgaged property.

The principle of marshalling applies if a creditor has security over two or more properties and there are creditors that have subsequent security over fewer properties. The prior secured creditor is required to recover its debt in a fashion which is least injurious to the subsequent encumbrancers. So, if the first mortgagee has security over two properties, and a subsequent

mortgagee has security over only one of those properties, the first mortgagee is required to recover the debt, to the extent possible, from the property which does not have a second mortgage, leaving the other property, to the extent possible, available to satisfy the second mortgage.

In *Gerrow v. Dorais*, the Alberta Court of Queen's Bench held that the principle of marshalling, developed long ago in relation to mortgages, applies to all secured indebtedness, not just mortgages. Accordingly, the Court held that the principle applied to construction liens. Lien holders are entitled to insist that a prior mortgagee must first satisfy the mortgage debt out of properties in which the lien holders hold no security. Only to the extent that the mortgage debt cannot be paid out of other secured property can the mortgagee look to the property upon which the lien holders have registered liens. In this fashion, value can be freed up for the lien holders even though the property is apparently highly mortgaged.

However, the Court held that the principle of apportionment must also be applied, in order to ensure fairness. Under this principle, the marshalling of the prior mortgages must be effected according to the value of the properties, especially when there are several layers of mortgages and a competition between second mortgages and lien holders. In this case, the lien holders objected to the application of the principle of apportionment as it meant that some of the recovery by the first mortgagee was apportioned to the land upon which they had registered liens. However, the Court held that the principle of apportionment –and marshalling– applied, thereby apparently eliminating or diminishing the lien holders' rights.

These equitable principles may appear arcane and confusing, but they are extremely important in sorting out the rights of lien holders in relation to other secured claims. The construction and building lien statutes do contain rules relating to priorities between liens and mortgages. But those rules are not a closed universe. There are other long-standing principles that may substantially affect priorities of lien holders. Marshalling and apportionment are just two of those principles.

See *Goldsmith and Heintzman, Canadian Building Contracts (4<sup>th</sup> ed.)*, Chapter 11, Part 2(h)

**Construction Law-Construction liens Marshalling:** *Gerrow v. Dorais*, 2010 ABQB 560

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