Bill 69 – *Prompt Payment Act,* 2013

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Submitted to: Standing Committee on Regulations and Private Bills

Submitted by: The Ontario Bar Association, Construction and Infrastructure Law Section

ONTARIO BAR ASSOCIATION
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Introduction

The Ontario Bar Association ("OBA") appreciates the opportunity to provide comment to the Standing Committee on Regulations and Private Bills respecting Bill 69, *An Act respecting payments made under contracts and subcontracts in the construction industry*, 2013 ("Bill 69" or "the Act").

The OBA

Established in 1907, the OBA is the largest voluntary legal association in Ontario and represents over 16,000 lawyers, judges, law professors and law students. In addition to providing legal education for its members, the OBA is pleased to analyze and assist the legislature with a number of legislative and policy initiatives each year - both in the interest of the profession and in the interest of the public.

This submission was prepared by the OBA's Construction and Infrastructure Law Section ("the Section"), which has over 450 members comprised of the leading barristers and solicitors involved in construction law issues. Members of the Section represent a broad cross-section of industry stakeholders, including owners, general contractors, sub-contractors and suppliers, lenders and insurers, government and homeowners.

Brief Summary of Bill 69

Among other things, Part I of the Act binds the Crown and amends all contracts entered into after the Act comes into force to comply with the Act.

Part II of the Act entitles contractors and subcontractors to receive progress payments and to suspend work or terminate a contract if such payments are not made. It also provides that payments can only be withheld if the payer notifies the payee that a payment application is disapproved or amended within 10 days after it is submitted. Limits are imposed on the amount that can be withheld.

Part III of the Act requires owners to provide contractors with certain financial information before entering into a contract. It also entitles subcontractors to receive certain financial information.

Part IV of the Act authorizes the Lieutenant Governor in Council to make various regulations, including regulations that exempt contracts or subcontracts from the application of the Act.

Commentary

Part I – General

The Act deems every contract and subcontract related to an improvement to be amended in so far as is necessary to be in conformity with the Act (s.3), but the Act does not apply to any contract or subcontract prescribed by the regulations (s.2(2)).

While we recognize the objective of the Act is to protect payees, we also recognize that the Act is a departure from the current industry practices and norms and submit that it would significantly curtail contractual freedom of contracting parties on terms – payment, holdbacks and disclosure – that are highly negotiated in the construction industry.

In addition, we question whether it is appropriate or necessary for the Act to apply so broadly to every contract and subcontract related to an improvement in order to achieve the purported objectives of the Act. Many different types of improvements and construction projects are structured in ways in which industry practice makes it difficult to fit within the payment and disclosure regime imposed by the Act. This is particularly so on both very large and very small or residential improvements, on improvements financed by third parties and on public infrastructure works, among others.

It remains to be seen whether the contemplated regulations will provide appropriate exemptions that reflect the diversity of industry payment and disclosure practices for a wide variety of construction projects and contracts.

Part II – Payments

(a) Holdbacks

The Act obliges a payer to pay the value of a holdback within one day after the day the payer is no longer required to retain the holdback under the *Construction Lien Act* (the "CLA") (s.4(2)). The Act also prohibits holdbacks other than those permitted or required under the Act or the CLA (s.4(3)).

While we recognize the dilemma faced by contractors and subcontractors at the end of the lien preservation period and whether they will need to file liens to protect their holdback or trust that payers will release the statutory holdback after the lien period has ended and all liens expired, we also recognize that it is industry practice for payers and payees to reconcile and set-off claims, outstanding balances and deficiencies at the end of a project at the time of the release of holdback. This standard industry practice would be prohibited by the Act.

We also recognize that it is industry practice and quite common for contracts to provide for large final milestone payments, reserve accounts, deficiency holdbacks and other completion and cash flow security that would be prohibited by the Act. The impact of this prohibition upon the choice of contractors by owners and developers or of sub-contractors by general contractors is not clear. There is a concern that owners, developers and general contractors for example may either require more financial security from small and mid-sized contractors (by way of bonds or letters of credit) or simply minimize perceived risks by choosing familiar and larger contractors with strong financial resources and balance sheets. This in turn, arguably, could increase project costs, reduce market competition, or both. It is not clear how the obligation to pay holdbacks within a specified time period, or to make progress payments within a specified time period under section 6, can be reconciled with section 17(3) of the CLA which expressly permits set-offs, as well as common law rights of set-off available to contracting parties in all industries.

It is also not clear how section 12(2) of the Act, which permits the payer to disapprove or amend an application for payment, is reconciled with section 4(3), which provides for an absolute obligation that is not restricted to approved payments.

The CLA establishes a comprehensive holdback regime for improvements in order to protect payees and provide a balance between the interests of project participants. It would seem prudent, therefore, and less confusing to stakeholders to amend the CLA directly, rather than enact a second statute covering much of the same subject matter. This approach would also avoid the risk of there being inconsistencies between the two statutes.

(b) Payments

The Act obliges payers to either make progress payments within statutorily defined time periods of (a) at least 31 days after the first day that services or materials were supplied to the improvement, if the contract or subcontract provides for progress payments, or (b) within 20 days after the day the payee submits its application for payment, in the case of a contractor, and within the later of 10 days after the certificate has been issued by a payment certifier and 30 days after the payee submits its application, in the case of a subcontractor, if the contract or subcontract does not provide for progress payments.

As noted above, the payment provisions curtail the common law and the freedom of contracting parties to negotiate and settle on contract terms. There are many different payment terms and many different types of projects accepted by industry practice, and it is not clear how these are addressed by the Act or whether they will be. Financing arrangements, P3 infrastructure projects, milestone payments, landlord improvement allowances, phased projects, cross-defaults on multiple projects between developers and builders, and small projects with single sum final payments are just some of the types of payment structures and project types where payment timing and structures are established in ways which would be difficult for construction parties to conform to

the Act. While these may be addressed in exemptions in the regulations under section 2(2) of the Act, it is not clear whether regulations will be able to adequately account for the breadth and diversity of payment structures and processes that are common in the industry.

We also note that payment structures are often designed to reflect certain allocations of project risk and the realities of cash flow on the project or in the owner's business, with payment timing designed to recognize this. While most contracts would comply with the payment structure contemplated by the Act, contractual flexibility is lost. The impact of mandating payment structures on the construction industry is not clear and may result in increased project costs as owners and developers require additional performance security from contractors, and contractors, in turn, require it from subcontractors.

(c) Pay When Paid

While section 9 purports to provide payees relief on payment obligations to subcontractors if the payee itself is not paid (pay when paid), the Act actually requires that payee to first suspend work or terminate the contract or subcontract before benefiting from this relief. It is not clear why this should be the case as it seems this will encourage the escalation of disputes and require payees to shut projects down or lien the project, rather than direct parties toward private and summary resolution of disputes. It is also not clear why pay when paid relief would not also be made available to project parties relying upon third party financing or payments.

It is equally unclear that the timeline and mechanics of section 9 will facilitate or encourage the summary resolution of disputes. The timing appears to be very limited in light of the payment regime imposed by section 8(2) of the Act.

(d) Final Payment

The Act imposes an obligation for a payer to make the final payment in accordance with the timing set out in section 11. However, it appears that the time mandated in section 11(4) requires the final payment to be made prior to the end of the lien preservation period. This conflicts with the finishing holdback regime established in the CLA.

(e) Approval of Applications

The Act deems a payment application to be approved by a payee 10 days after it is submitted by the payee unless, before the 10th day, the payer provides the payee with written notice that all or part of the application is being disapproved or amended (s.12).

It seems that there are a number of practical difficulties with this provision. The timing is very limited and there is concern that it does not provide payers – both owners and contractors – with sufficient time to adequately verify the work after an application for payment has been received.

This is particularly so for large, complex or remote projects and those requiring verification by third parties (including, for example, municipal inspectors).

There also seems to be a possibility for a gap in time between when a subcontractor's application could be deemed approved and when a contractor's application could be disapproved or amended in section 12(1).

In disapproving or amending an application, a payer is required to provide a written notice with "full particulars" (s.12(1)(b)). It is not clear what information a payer must provide to comply with this obligation, or who determines the adequacy of this notice, or whether there is an ability of the payer to cure or rectify their notice if the initial notice is found to be inadequate.

Part III – Right to Information

The Act obliges an owner to provide the contractor with financial information prescribed by regulations for the purpose of demonstrating the financial ability of the owner to make payments for work (s.14(1)).

It is not clear what type of information will satisfy an owner's disclosure obligation. The Act contemplates regulations, but these have not been prepared at this time.

The information, by its nature, will be highly confidential and proprietary to the owner. It may also include third parties if the owner is relying upon cash flow from its operations (customer receivables), lenders or landlords. It will also be very personal in the case of individuals and residential improvements and may conflict with objectives of privacy law regimes.

The Act attempts to provide some protection to owners in section 14(6) by requiring that disclosed information be kept confidential and not used for any other purpose. However, it is not clear that confidentiality of such sensitive and proprietary information can be preserved. Claims for breaches of confidentiality are challenging to prove because of the evidentiary difficulty of identifying the source of information leaks and demonstrating specific damage that results. In addition, there is little to no ability to prevent the use of the information by contractors competitively, such as on future bids.

The Act requires ongoing disclosure by the owner, at the contractor's request, and requires payers which are also payees to provide notices to all payees of the receipt of payment. There is a concern that these disclosure obligations will result in undue administrative burdens, particularly on contractors and particularly on large projects. The Act requires that all payees be notified, regardless of whether the payment relates to work performed by a payee. This may result in increased project costs and possibly delays.

In addition, the Act makes disclosing parties liable for all damages suffered as a result of the failure to disclose as required or for any misstatements of information. There is concern that this presents a very great financial penalty that is too open ended.

Finally, section 39 of the CLA addresses financial disclosure obligations of owners. It would seem to be prudent, therefore, and less confusing to amend the CLA directly, rather than by way of a second statute covering much of the same subject matter.

Conclusion

Once again, the OBA appreciates the opportunity to provide comments on Bill 69 to the Standing Committee on Regulations and Private Bills.