Bill 142, *Construction Lien Amendment Act, 2017*

Date: August 15, 2017

Submitted to: Ministry of the Attorney General

Submitted by: Ontario Bar Association

ONTARIO BAR ASSOCIATION
A Branch of the Canadian Bar Association

L'ASSOCIATION DU BARREAU DE L'ONTARIO
Une division de l'Association du Barreau canadien

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Introduction

The Ontario Bar Association ("**OBA**") appreciates the opportunity to provide comment to the Ministry of the Attorney General regarding Bill 142, the *Construction Lien Amendment Act, 2017* ("**Bill 142**" or "**the Amendment Act**") which proposes many changes to the *Construction Lien Act* (the "**Act**").

The Act governs and regulates the construction sector and its participants like few other statutes. It has functioned reasonably well since its replacement of the Mechanics Lien Act in 1983; however, a number of significant developments in the construction industry have resulted in the need for its review and modernization.

In February of 2015, the Ministry of the Attorney General and the Ministry of Economic Development, Employment and Infrastructure (the "**Ministries**") initiated an expert review (the "**Expert Review**") which culminated in a report "Striking the Balance: An Expert Review of Ontario's Construction Lien Act" in April 2016 (the "**Expert Review Report**") which the Ministries subsequently released to the public. The OBA provided a number of submissions and held a number of meetings with the Expert Review and has been intimately involved in the process for review and reform of the Act, including making prior submissions regarding Bill 69, the *Prompt Payment Act*.

Following the recommendations of the Expert Review Report, the Ministry of the Attorney General ("**MAG**") introduced Bill 142 which passed first reading in the Ontario Legislature on May 31, 2017.

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 Construction Lien Act Amendments Committee of the OBA's Construction and Infrastructure Law Section ("the **Section**"), with input from the OBA's Insolvency and Alternative Dispute Resolution sections. Collectively, these groups have over 1000 members, including many 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.

The OBA applauds the efforts of the Ministries and the Review to review and modernize the Act. The time is well overdue. This represents a historic opportunity to modernize a critical piece of legislation in the construction industry.

1. Prompt Payment

The Amendment Act proposes a prompt payment regime in order to accelerate the flow of funds on construction projects. The OBA supports any measure that will reduce disputes and improve relations on projects, including improving the flow of funds.

We have collected the following technical and conceptual comments on the prompt payment provisions:

1.1 Several concerns have been relayed to us by our members relating to the connection between a contractor's proper invoice submitted to the owner, and a subcontractor's invoice submitted to the contractor. This is particularly concerning where the payment terms or structure of the contract between the owner and contractor are different than the terms or structure between the contractor and subcontractor. It seems possible for a subcontractor to adjudicate a disputed invoice before the contractor is entitled to payment. The prompt payment rules also require a contractor or subcontractor to commence adjudication in order to avoid being required to pay which undermines the principle of allowing "pay when paid" clauses in contracts as recommended in the Expert Review Report and by its authors, Bruce Reynolds and Sharon Vogel.

1.2 The underpinning of Bill 142 is that parties retain freedom of contract to agree to invoicing arrangements. However, ss. 6.4(1)-(3) and ss. 6.5(1)-(3) intrude into the payment relationship in a way that leads to confusion, and which will likely lead to litigation. The problem is that Bill 142 presumes a connection between a contractor's invoices and a subcontractor's invoice that may not exist in every case. For illustrative purposes, imagine a project where the contractor's prime contract with the owner has a different milestone schedule than the contractor's subcontract with the subcontractor (extremely common on engineering, procurement and construction contracts, and in public private partnerships (PPPs)). The owner's payment to the contractor will be for attainment of a milestone, without any specific reference to specific subcontractors or suppliers. The prescriptive terms of these clauses do not seem to allow for that arrangement. To the contrary, if the owner holds back some amount from the milestone, s. 6.4(3)(2) says that the contractor is to distribute the funds ratably among all subscontractors, which will be in violation of the contractor's milestone agreements with its subcontractors.

1.3 If an owner has not paid a contractor, the timing for payments to subcontractors is tied to the date on which the contractor submits a proper invoice to the owner under s. 6.4(4). As noted above, if the contractor's payments are structured on a milestone payment or payment schedule that is different than that of the subcontractor, then it seems as though the subcontractor does not benefit from the

prompt payment provisions of the Amendment Act until the contractor's payment arrangements with the owner are triggered by the contractor's submission of its "proper invoice".

1.4 This may have been deliberate in order to avoid squeezing the contractor, but as a result of the proper invoice being the sole trigger for the timing of payments to subcontractors, if a contractor simply does not submit a proper invoice – either because it decides not to, it agrees with an owner request not to, or it submits improper invoices – then it seems that the prompt payment regime timing simply does not get triggered with no remedy for subcontractors. Under s. 6.4(1), the timing for the contractor to pay the subcontractor is tied to the date of receipt of payment from the owner (s. 6.4(1)), but the owner does not have to pay if it has not received a proper invoice. Under s. 6.4(4), the timing for the contractor to pay subcontractors or dispute a non-payment when the owner has not paid is also tied to the submission of a proper invoice. Under s. 6.7, interest is only calculated from the date a payment was due under s. 6.1 which only occurs if a proper invoice is submitted. While s. 6.2(1) does require that a proper invoice "shall be given", it does not specify that the contractor must do so, and no consequences set out for the failure to do so.

1.5 Our understanding following the release of the Expert Review Report was that the panel recommended that a payor could suspend its payment obligation by simply initiating the dispute resolution process under the applicable contract. By contrast, Bill 142 requires the much more formal step of adjudication, which essentially eviscerates contractual dispute resolution processes, including senior management meetings and dispute resolution boards ("DRBs"). The OBA recognizes that this is a "softer" step than requiring a suspension of work or a claim, as was contemplated in Bill 69, the *Prompt Payment Act*, but if part of the intent of Bill 142 to is to avoid or expedite disputes, we would suggest permitting a reasonable time for parties to use their own informal, private, agreed to dispute resolution processes rather than forcing every late payment into a formal adjudication process, and possibly over-taxing the system.

1.6 Under Bill 142, for improvements that are under an alternative financing and procurement ("AFP") or PPP project structure, government "owners" (the Crown, municipalities and broader public sector organizations ("BPSOs")) are not considered "owners" with respect to (amongst other things) prompt payment and adjudication. Bill 142 seems to assume that on AFP projects, the authority or government owner does not make progress payments. However, this is not the case for many recent AFP projects where the special purpose entity ("SPE") does not finance the entire project prior to substantial performance. On these projects, government owners make some progress payments during the build phase of the project. Even though the government owner progress payments are in addition to

funds borrowed by the SPE, if the government owners are not subject to the prompt payment and adjudication regimes, then the SPE, the contractor and all Subcontractors are left without any prompt payment remedy if the government owner fails to make its payments when due. Prompt payment and adjudication will only work if all entities making payments in respect of a construction project are subject to the new regime.

1.7 Pursuant to s. 1.1(2) of the Act as amended, the Crown, municipality or BPSO is not considered the owner if it enters into an agreement with a SPE that requires the entity to finance the improvement. It would be helpful if the Amendment Act clarified what is meant by "finance" in this case, or specifically that the intention is capture third-party financing. Many construction contracts require that some financing be provided, such as carrying costs while a dispute is settled or between milestone payments, to finance the vacating of liens by posting security in court, or the interim payment of permits or fines. These are clearly not meant to be captured by this new clause but could be. Secondly, it is not clear if "finance" is meant to capture indirect financing through equity contributions by the equity owners of the special purpose entity. Finally, since SPE is not defined, it seems as though the exception in this clause could be avoided if the entity that contracts with the Crown, municipality or BPSO is an existing entity and not an entity created specifically for the particular improvement. While that would invariably be the case for an Infrastructure Ontario-type AFP project, and the general intent of this clause seems clear, the use of undefined terms combined with is broad application seems to open the clause up to vagueness that could lead to disputes.

1.8 Proposed ss. 6.4(3) and 6.5(3) each contemplate situations in which there is a short payment and one or more subcontractors are implicated in a dispute. The sections provide that if there are multiple subcontractors implicated, then they shall be paid on a rateable basis. It is not clear how this is to be determined. In our view, this turns on the meaning of "rateable basis," and we note that on any given project, many different types of payment structures could be involved. In such situations, it is not clear how to compare these different payment structures. For instance, a project could include completion payments that include all profit and overhead for a project, advanced payments or deposits for orders that could be later discounted or cancelled, or payments based on milestones or a schedule that may not reflect true costs and where profit and overhead are paid out later. This lack of clarity could lead to inequitable results.

1.9 In the owner's notice of non-payment under s. 6.3(2) or a contractor's notice of non-payment under s. 6.4(6), we question whether failing to detail "all" of the reasons for a non-payment precludes the payor from raising other reasons at a later stage. There could very well be multiple reasons for a non-payment and the use of the word "all" implies that the payor may not present any other reasons for

non-payment at a later stage in the dispute, including in response to claims made by the payee. This point should be clarified.

2. Adjudication

The proposed legislation appears to make for a workable adjudicative model. We have, however, identified the following concerns for consideration.

2.1 Concerning section 13.8, to minimize the risk of inconsistent results consideration should be given to permitting both "concurrent" and "consecutive" adjudication of same or related-matters disputes by a single adjudicator.

2.2 We recommend that section 13.9(3) of the Act be revised to permit the parties to agree to an adjudicator at the time the contract is formed. In our view, this is an appropriate time and a similar procedure is already in place for many contracts with DRB panels.

2.3 With respect to section 13.9(4), clarity is required on whether the 4 days permitted runs from when the Notice of Adjudication is given to the Respondent, or from when the Notice is given to the Adjudicator. In any event, four days from receipt by the Respondent is likely insufficient time to allow the Claimant and Respondent to discuss and agree on an adjudicator and then the adjudicator to confirm that they are available and willing.

2.4 Paragraph 5 of section 13.12(1) permits an adjudicator to obtain assistance from a "merchant, accountant, actuary, building contractor, architect, engineer or other person ...." Consideration should be given to adding "quantity surveyor" to this list of consultants, as quantity surveyors have replaced other experts as payment certifiers on most major projects, and the immunity granted to the adjudicator and his or her employees under s. 13.21 be extended to include these consultants.

2.5 Section 13.12(3) permits the adjudicator to obtain the assistance of a consultant, and direct payment to the consultant from one or both parties without the parties' consent. Bill 142 should include some control over the adjudicator's retainer of third parties, such as a statement that the amount spent on third parties should be proportional to the amount in dispute. Under Bill 142 as currently drafted, there are no accountability mechanisms for an adjudicator that does not take proportionality into account.

2.6 Section 13.16 should note that it is subject to both sections 13.12(3) and section 13.17.

2.7 Section 34(10) suspends the expiry of a lien that is in adjudication. However, the suspension to 45 days after the adjudicator receives documents may only be one

day after the adjudication decision if the decision is 30 + 14 days = 44 days; and, the suspension doesn't extend longer than 45 days and would not be helpful if the parties agreed to a longer adjudication timeframe under s. 13.13(2)(b). In such cases, the lien period should just be extended to 10 days past the adjudication decision, so that the lien can be registered if a payment is not made as ordered by the adjudicator.

2.8 Clarification is required as to when the two-year limitation period related to disputed invoices is to commence. Recent Ontario Court of Appeal decisions, including *ETR Concession Company Limited v. Day*,[1] and *Presidential MSH Corporation v. Marr Foster & Co. LLP*,[2] would suggest that the triggering event is the receipt of the adjudicator's decision. However, it would be of assistance if Bill 142 could clarify whether that is indeed the intent, or whether the triggering event is an earlier date, such as when the owner first notifies the contractor that the invoice is disputed.

2.9 It appears that adjudication is intended to apply to payment disputes, being triggered by the delivery of a proper invoice and a notice of dispute. However, often in payment disputes, particularly for extra or changed work, issues related negligence on the part of the project architect or engineer are raised. Clarification is required as to how the adjudication process will be affected when allegations of design professionals' negligence are raised, whether the design professional must participate in the adjudication, and how the adjudicator's decision may subsequently be used in any litigation between the contractor, owner and design professional.

2.10 Under Bill 142, for improvements that are under an AFP/PPP project structure, the Crown, municipalities and BPSOs are not considered owners and the adjudication provisions do not apply to them. This creates the very real possibility of adjudication decisions resulting in costs to the private sector "owner" (Project Co), or expansions of scope of work, for which it will not have any recourse or remedy with the Crown, municipality or BPSO. This will be unintended stranded risk with Project Co and will result in higher costs on AFP/PPP projects.

[1] 2016 ONCA 709.
[2] 2017 ONCA 325.

3. Definitions

We have the following comments with respect to the definitions proposed by the new legislation:

3.1 Section 2(11) repeals and replaces the definition of "price" with a direct cost component, and a contract or subcontract price component.

3.2 Section 2(16) introduces a new definition of "direct costs". The new definition excludes "loss of profit" and "head office overhead", and includes "costs resulting from seasonal conditions."

3.3 It is suggested that "loss of profit" should not be excluded from the direct costs, since it is a direct damage, albeit one that is difficult to directly quantify. Adding loss of productivity to the list of items that do not form part of the definition of price is also internally inconsistent with including season shift costs, which are a subset of lack of productivity costs.

3.4 Similarly, "head office overhead" costs are direct costs and consideration should be given to its inclusion in the definition. As an example, if a contractor only performed one project in one calendar year, all the head office costs, i.e. non-project costs of the company, would be fully captured in the price for that job. However, if the project ran over by one full calendar year, the original price of the job would be insufficient to cover the head office costs.

3.5 As noted above, included in the definition of direct costs is "costs resulting from seasonal conditions". Given that seasonal shift is just one aspect of impact costs, it would assist to include any additional costs of the work (e.g. trade stacking) resulting from the extension be included in "price".

4. Holdbacks

We have the following comment on Holdbacks:

4.1 Section 24(2) of the Act is being modified by deleting "services and materials" and substituting "services or materials". It seems like this should stay as an "and", not an "or". One should retain 90% of all services and materials provided, not 90% of one or the other.

5. Procedures

We have the following comments related to the procedure of lien actions and the removal of liens from title.

5.1 The Amendment Act refers to a lien being "satisfied, discharged or otherwise provided for". Clarity is required on when it would be appropriate to include "vacated" in that list.

5.2 Paragraph 1 of section 35(1) of the Amendment Act refers to "willfully exaggerated" lien amounts. We question whether "willful" exaggeration is necessary, and if there is a possibility to reduce the lien under section 35(2) in instances of "good faith" exaggeration. Deleting the word "willful" may remove the seeming contradiction.

6. Design Professionals

We have the following comment regarding design professionals:

6.1 Section 12(2) of Bill 142 amends s. 14 of the Act to specifically state that s. 14(1) applies to architects. It is unclear why only architects have been specifically added. It would be helpful to either remove the reference to architects or extend the clarification to engineers, designers, planners, landscape architects and design professionals who also provide lienable services.

7. Bonding

7.1 Bill 142 introduces a mandatory requirement for payment and performance bonds for "public contracts". It is not clear how this bonding requirement is to be applied on public contracts for property or facility operations and maintenance, especially if the contract includes capital repairs. Often such contracts will pay a fixed amount each month to the contractor that covers all improvement work, whether or not any construction or capital repair work is actually performed. This is typical of large public facilities management contracts. It is also typical for the operations phase of AFP/PPP projects. It is not clear how the amount of the bonds would be calculated, or when they need to be obtained. It may be worthwhile to consider using regulations to exempt operations and maintenance contracts, or at least clarify how the bonding rules apply.

Conclusion

Once again, the OBA appreciates the opportunity to provide input and assistance to the Office of the Attorney General regarding Bill 142.