

Ontario government revamps Construction Lien Act: What you need to know about prompt payment, mandatory adjudication, and more

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Introduction

On May 31, 2017, the Ontario government introduced [Bill 142](#) [PDF] (the Bill) that, if passed, would significantly amend the *Construction Lien Act* to create a prompt payment regime, require the mandatory adjudication of certain construction disputes, and implement various additional amendments to modernize the Act. The Bill incorporates almost all of the 100 recommendations of an [in-depth report](#) commissioned by the government in 2015 which included a broad industry stakeholder consultation process spanning approximately 14 months.

Given the breadth of the proposed amendments, the goal of this Osler Update is to provide an overview of the following four core amendments:

- the new prompt payment regime
- the new mandatory adjudication regime
- clarifications regarding the Act's application to Alternative Financing and Procurement (AFP) projects; and
- technical amendments relating to holdback, liens, bonding, and trusts

This will be followed by in-depth looks at some of the commercial implications in forthcoming Osler Updates. However, given the balance inherent in the Bill between prescription and freedom of contract, it is clear to us that owners, contractors, design professionals, subcontractors, and other construction industry participants will have to modify and consider further reshaping their commercial agreements in consideration of the proposed

amendments.

Looking forward, Bill 142 was carried at first reading and will proceed to second reading and committee review when the legislature resumes again in early September. The government is then expected to move the Bill through the legislative process as quickly as possible in light of next year's provincial election on June 7, 2018.

Prompt payment

A new cascading prompt payment regime is intended to streamline the payment process throughout the construction pyramid by prescribing timelines for payment to contractors and subcontractors, while respecting the fundamental freedom of the parties to contract in respect of payment terms around a "proper invoice."

The concept of a proper invoice is key to understanding this inherent balance. The minimum requirements constituting a proper invoice are described in the Bill and include the expected basic information relating to the work, but also include any other information that may be prescribed by regulation as well as additional documents that are agreed upon in the contract, which could include statutory declarations or WSIB-related confirmations, for example. Note that any contract provision that makes submission of a proper invoice conditional upon prior payment certification or the owner's prior approval, will be of no force or effect; any such certification or approval would have to take place after submission of the proper invoice. The timing of a proper invoice is subject to a monthly requirement if a contract is silent, but we expect parties to consider the applicability of other payment terms including milestone payments relating to phases or other events. Subcontractors may request disclosure of whether such milestone payments are provided for under the contract.

Once an owner receives a proper invoice from the contractor, the timelines are prescribed; the owner is required to pay the amount payable no later than 28 days after receipt. However, the owner may refuse to pay all or a portion of the amount payable if the owner gives the contractor a notice of non-payment, specifying the amount that is not being paid and the reasons for non-payment, no later than 14 days after receiving the proper invoice. If an amount is not paid when due, mandatory interest will begin to accrue on the outstanding balance. These obligations are then cascaded down to the contractor and subcontractors, with tighter timelines.

A contractor is required to pay subcontractors within seven days of receipt of payment from the owner. Unless the contractor gives the subcontractor a notice of non-payment specifying the amount that is not being paid and the reasons for non-payment, the contractor is still required to pay each subcontractor the amount payable, even if the owner fails to pay all of a proper invoice to the contractor.

Similarly, a subcontractor (at any level) is then required to pay its subcontractors within seven days of receipt of payment, unless it serves a notice of non-payment upon its subcontractors.

Adjudication

The Bill features a new mandatory interim dispute resolution process (or "adjudication") intended to expedite the resolution of disputes and minimize payment and other disruptions to projects. The process provides quick decisions relating to disputes which are binding on an interim basis – i.e., they will remain binding unless the issue is ultimately referred to the courts or arbitration. The adjudication process is intended to apply to all contracts and

subcontracts entered into after the legislation comes into force.

The new process permits a party to submit a matter to adjudication provided that it is related to specific issues, including:

- value of services or materials
- payment, including change orders
- disputes that are the subject of a notice of non-payment
- set-off, and
- release of holdback

The new process also allows for parties to submit to adjudication other matters that may be set out in regulation or that the parties may agree to.

Matters must be heard by registered adjudicators approved by an approval authority to be designated by the government. Note that the parties cannot specify the name of an adjudicator in advance in the contract. Rather, the party that initiates an adjudication must propose an adjudicator, and the parties may either agree on an adjudicator or request that the approval authority appoint an adjudicator for the matter at issue.

However, consistent with the inherent balance in the Bill between prescription and freedom of contract, and consistent with other jurisdictions, parties are able to agree upon their own adjudication procedures in the contract or subcontract (particularly those who have developed custom adjudicative models) as long as those procedures comply with the new adjudication requirements in the Bill.

As currently described, the adjudication process proceeds by the initiating party providing the adjudicator with the contract (or subcontract) and the documents on which the initiating party intends to rely. The adjudicator has relatively broad powers and may conduct the adjudication in an inquisitorial manner, requesting documents and taking other actions deemed necessary. Subject to an extension, the adjudicator must render a written decision within 30 days of receiving the documents from the initiating party. Extensions are permitted, but only with the consent of the parties, and if the extension is requested by the adjudicator then it cannot exceed 14 days.

The adjudicator's decision cannot be appealed, although the subsequent determination of the matter by a court or arbitrator is not bound by the adjudicator's decision. A party required to pay money by the adjudicator's determination must make payment within 10 days, failing which the payee may suspend work. A party can also have the adjudicator's decision enforced by court order.

The adjudicator's fee is to be split between the parties and each party shall bear its own costs. The adjudicator may only make a costs award in situations where one party has acted in a manner related to the improvement that was frivolous, vexatious, constituted an abuse of process, or was not in good faith.

AFP/P3 projects

One important reason to modernize the Act has been to recognize the emergence of the public-private partnership project delivery model, known in Ontario as "Alternative Financing and Procurement" or AFP. The use of AFPs has grown significantly over the last decade, in Ontario and in other jurisdictions in Canada, and now involves a growing proportion of the construction industry. However, in Ontario there has been confusion in the application of the

Act to such structures, including who is an “owner,” which level of contract should be considered to be the “contract” for holdback purposes, and other commercial issues exacerbated by the large scale and longer timelines of projects of this magnitude. As a result, several provisions in Bill 142 clarify these issues and provide welcome flexibility for AFP procurement and project structures.

In addition to acknowledging the AFP model, the Bill expressly clarifies that the special purpose entity who undertakes the project on behalf of the public sector sponsor (typically known as Project Co) is deemed to be the “owner” in place of the Crown, municipality or broader public sector organization on whose behalf the project is undertaken, and that the agreement between Project Co and the contractor is deemed to be the “contract” in respect of the improvement. Those deeming provisions are, however, limited to certain sections of the Act, including the prompt payment and mandatory adjudication requirements, as well as the rules governing the certification or declaration of substantial performance. For all other parts of the Act, the Crown, municipality or broader public sector organization would continue to be considered the owner.

These clarifications generally reflect typical practice in the AFP community to date and should be welcomed by industry.

Another welcome change relates to bundled and phased projects. Some AFP projects, such as Infrastructure Ontario’s OPP Modernization project for the construction of 18 OPP separate detachments and other facilities across the province, as an example, have procured separate project sites under a single bundled agreement, one rationale for which is to take advantage of economies of scale. In this type of scenario, if the contract between Project Co and the contractor related to a bundle of projects on separate non-adjointing sites, the new provisions of the Bill would allow the parties to consider each such site to be administered as if it were a separate improvement under a separate contract, facilitating holdback release on a site-by-site basis. In addition, new provisions allow parties to agree to the release of basic holdback on a phased basis relating to a given improvement. Note that the concept of a phase is not defined in the Bill, but will need to be well-defined in the underlying contract.

Technical amendments

There are a number of proposed amendments to the Act, beyond the change of the statute’s short title to the “*Construction Act*” that we believe the construction industry should take note of due to their commercial implications. A few of these are briefly mentioned below:

Practices relating to holdback

- In lieu of cash funds, holdback may now be maintained in the form of a letter of credit, demand repayment bond or other prescribed form, which validates some commercial arrangements that are already being used in the industry.
- Release of basic and finishing holdback will now be mandatory once the requirements for the release under the Act are satisfied. However, a payer may withhold some or all of the amount to be paid if the payer publishes the notice required by the regulations, in the manner to be prescribed.
- In addition to phased and segmented holdback release, holdback may also be partially released on an annual basis provided the contract provides for this, the contract price exceeds an amount to be prescribed, and no liens have been registered that have not been

vacated or discharged.

Timing relating to liens

- The 45-day deadline for preserving liens will be extended to 60 days. This will impact the timing of various payments including release of holdback and financial milestones including certain construction loan advances.
- The 45-day deadline for perfecting liens will be extended to 90 days from the last day on which the lien could have been preserved.
- Termination of the contract will be added to completion and abandonment as events which trigger the clock for the preservation of liens.

New mandatory surety bonding on Ontario public contracts

- All contractors performing work under a “public contract” – i.e., a contract respecting an improvement with the Ontario Crown, a municipality or other broader public sector entity – will be required to provide a labour and material payment bond and a performance bond, each for at least 50% of the contract price. For our American readers, Ontario is essentially now adopting the *Miller Act* approach to Ontario public projects. However, note that the Act does not apply to federally governed projects located in Ontario.

Trust accounting

- The trust provisions will be amended such that trustees under the Act must deposit trust funds into a bank account in the trustee’s name and must keep separate written records in respect of each trust for which it is responsible. Multiple trust funds may be kept in a single account, such that a dedicated trust bank account for each project is not required.

Next steps

Stay tuned and visit our [new Canada Prompt Payment hub](#) for further information regarding other prompt payment initiatives at the federal level and in other provinces, as well as Osler Updates providing a deeper analysis of selected elements of the Bill and analysis of the accompanying regulation(s), which are being worked on over the summer, as and when they are issued.