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Proposed changes to the Construction Lien Act: What do they mean for the construction industry?

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The long-awaited report (the Report) on potential amendments to the *Construction Lien Act* (the CLA), which was commissioned by the Ontario Ministry of the Attorney General (the Ministry[1]), has now been released. Among other things, the Report recommends the following:

- the adoption of a prompt payment regime requiring payment within 28 days of submission of a proper invoice (subject to specific set-off notices)
- mandatory speedy adjudication of construction disputes, wherein a decision will be rendered within 30 days
- mandatory holdback release (subject to specific set-off notices), with permissible phased release of holdback on lengthy or segmented projects

The current CLA was enacted in 1983 and has not undergone a holistic review since its enactment, until now. Significant lobbying efforts by the construction industry, together with developments in the industry that include the increasing popularity of public-private partnerships, necessitated a critical appraisal of the effectiveness of the CLA in achieving its policy objectives within the modern context.

The Report was preceded by the attempted passage of Bill 69, the *Prompt Payment Act, 2013* (Bill 69), which had resulted from the prompt payment movement in Ontario and other jurisdictions. While Bill 69 was not passed, the province decided that a broader review of the CLA was warranted. Extensive consultation with industry stakeholders followed, and culminated in the Report.

Issues considered by the Report

The Report was undertaken with the intent to perform a thorough and comprehensive assessment of the CLA, which was reflected in the breadth and scope of the substantive issues examined.

The Report divided these issues into distinct chapters addressing: (1) lienability; (2) preservation, perfection and expiry of liens; (3) holdback and substantial performance; (4) summary procedure; (5) construction trusts; (6) promptness of payment; (7) adjudication; (8) surety bonds; (9) technical amendments; and (10) industry education and periodic review. The Report generated 100 individual recommendations.

This Osler Update will focus on the three key chapters of the Report: promptness of payment,

mandatory adjudication, and holdback and substantial performance. The remaining seven chapters of the Report are significant in their own right, including recommendations such as mandatory surety bonding for all public projects regardless of size, and lengthening the time periods to preserve and perfect liens.

In fact, as a result of the breadth and scope of all of these issues, when considered together, the Report recommends replacing the CLA, which primarily focuses on liens and trusts, with new legislation suggestively titled the "*Construction Act: An Act respecting Security of Payment and Efficient Dispute Resolution in the Construction Industry.*"

Prompt payment

The Report recommends the enactment of a default statutory regime for prompt payment. The elements of the prompt payment regime are outlined below.

To which types of contracts would prompt payment apply?

- The statutory prompt payment regime would apply to all construction contracts at all levels of the construction pyramid, in both the public and private sectors. Parties would be free to draft their own contractual payment provisions, provided they are consistent with the statutory regime. The mandatory provisions would be implied by law into any contracts that do not contain equivalent provisions.

What is the trigger for payment and what is the payment period?

The Report recommends the following:

- Between the owner and the general contractor, payment must be made within 28 days of the submission of a "proper invoice" as described below.
- Between the general contractor and the subcontractor, payment must be made within a further seven days from the date of the owner's payment (with an extra seven days added for each level down the construction pyramid).
- Payment obligations will be triggered by the delivery of a proper invoice, which means a properly documented invoice. Proper information and documentation would be defined by the contract, or by the legislation by default.
- Certification of payment by the payment certifier, if applicable, would *follow* submission of a proper invoice, and cannot be a precondition to the starting of the clock for payment.
- Parties would have the freedom to negotiate the payment cycle, but a monthly payment cycle would be implied if they fail to do so.
- Milestone-based payment mechanisms are permissible, but must be disclosed to subcontractors during the bidding stage.

On what basis can payment be withheld, and when?

- Payers would be allowed to withhold disputed amounts (but not undisputed amounts) by delivering a "Notice of Intention to Withhold Payment," setting out the amount being withheld and the reasons for the withholding within seven days of receipt of a proper

invoice.

- Payers would be allowed to set off all outstanding debts, claims or damages, but only relating to the contract at issue, and not relating to other projects as is the case under the current CLA.
- Essentially, the new approach would require payers to "get on with it" – in other words, to evaluate the payment application quickly, and either pay or assert a well-defined, specific set-off claim.

What remedies would be available in the event of non-payment?

- Late payments would attract mandatory non-waivable interest at a rate that is the greater of the contractual rate and the pre-judgment interest rate in the *Courts of Justice Act*.
- The payee's right to suspend work would arise if the payment dispute has been adjudicated and the payer refuses or fails to comply with the adjudicator's direction to pay.

Adjudication

The Report proposes the implementation of mandatory adjudication as a dispute resolution mechanism applicable to all construction contracts at all levels of the construction pyramid, in both the public and private sectors. In this regime, the parties would be free to negotiate contractual provisions in respect of adjudication so long as they are consistent with the statutory regime. Otherwise, the default statutory adjudication scheme (to be set out in a regulation to the CLA) would apply. The Report also recommends the creation of a single authority tasked with certifying, training and administering the appointment of adjudicators. Some of the additional elements of the adjudication regime are outlined below.

Who can require an adjudication?

- Any party to a construction contract or subcontract would be entitled to refer disputes arising under that contract or subcontract to adjudication. Adjudications would typically involve a single issue. Multiple issues/disputes would only be addressed simultaneously in a single adjudication with the consent of the parties.
- Back-to-back adjudications would be permitted in respect of disputes between an owner and a general contractor that flow down to a subcontractor.

Who can adjudicate a dispute and how is the adjudicator nominated?

- Adjudicators would be members of a self-regulating profession (e.g., lawyer, engineer, quantity surveyor, accountant or architect); have at least seven years' relevant experience working with the Ontario construction industry; and have completed certain standardized training and certification with the government authority. Initially, a temporary roster of highly qualified adjudicators would be selected until the authority implements the training and certification system.
- Adjudicators would receive immunity from liability in respect of their decisions and not be compelled to testify in civil proceedings.
- The adjudicator would be nominated when a dispute arises by the party delivering notice of the adjudication. The parties would then agree on an adjudicator within two business

days after delivery of the notice, failing which the authority would step in to appoint an adjudicator within five business days.

Which disputes get adjudicated?

- Adjudication would apply to disputes that arise from a claim for payment under a proper invoice submitted in respect of a construction contract or subcontract, including the following

(i) valuations of the subject matter of the invoice

(ii) monetary claims made pursuant to the contract (e.g., change orders)

(iii) claims in relation to security held for a construction contract

(iv) withholding and set-off in respect of amounts owed under the invoice

(v) delay issues relating to claims for payment

- It is not entirely clear from the Report which claims would be excluded from mandatory adjudication, though it appears that the intent is to exclude negligence claims against design professionals as well as delay claims related purely to schedule extensions.
- Disputes under $25,000 may be referred by the parties either to adjudication or to the small claims court.

What process and at what cost?

- The default adjudication process would set out minimum standards for notice of adjudication, appointment of the adjudicator, timelines for the adjudication, duties and powers of the adjudicator (including establishing the adjudication process) and the binding interim nature of the adjudicator's decision.
- The Report recommends that the total period of time for the adjudication process would be 30 days, from the initial referral of the dispute through appointment of the adjudicator, submission of relevant documents, interviewing of witnesses, retaining of experts, submissions by the parties, holding of a hearing and rendering the adjudicator's decision. For large and complex claims, compliance with this time period may be a challenge.
- As a general rule, the parties would apportion the costs of the adjudicator equally and each would be responsible for its own legal costs, subject to the adjudicator's ability to adjust the default apportionments based on a party's bad faith, frivolous or vexatious conduct.

How are adjudicated decisions enforced?

- Decisions would be binding on the parties on an interim basis (i.e., until the dispute is resolved by arbitration or formal legal proceedings or until the parties agree that the adjudication decision is final and binding). Interestingly, the Report notes that the vast majority of adjudications conducted in the United Kingdom under a similar regime have, in practice, been accepted by the parties, effectively treating them as final.

- Decisions would be enforceable by way of application to the Superior Court of Justice in a similar manner that awards under the *Arbitration Act, 1991* are enforced.

How would adjudication interface with the CLA?

- The parties' lien and trust rights under the CLA would not be affected by the adjudication regime. Therefore, if a party elects to have a dispute resolved through a lien proceeding, it can follow the traditional preservation and perfection process under the CLA and proceed with a lien action. Trust claims can still be pursued through the courts, as well.

Holdback and substantial performance

In its discussion of holdback and substantial performance, the Report considered the key sub-issues outlined below.

Amount of holdback

- The quantum of holdback would be maintained at the current rate of 10%.

Definitions of substantial performance and completion

- The substantive criteria for a contract to be substantially performed should remain the same, but the formula in section 2(1)(b) of the CLA should be amended to increase the maximum cost of completion/correction to 3% of the first $1 million of the contract price, 2% of the next $1 million and 1% of the balance.
- The "deemed completion" provision in section 2(3) should be similarly amended to increase the maximum cost of completion/correction to not more than the lesser of (a) 1% of the contract price and (b) $5,000 (from its current $1,000).
- These changes are designed to reflect the effects of inflation over time.

Finishing holdback

- The finishing holdback provisions of the CLA would remain unchanged.

Mandatory release of holdback, subject to set-off

- The CLA should be changed from the current permissive release of holdback, to make holdback release mandatory. However, the payer may assert a right of set-off by publishing a notice of non-payment/set-off, which specifically identifies the issues, and related dollar values, upon which the set-off is based.

Phased, annual and segmented release of holdback

- Parties would be allowed to contract for partial release of holdback on either an annual or phased basis (only for longer/larger projects surpassing certain monetary and duration thresholds).
- To address the concerns of design professionals, who have pushed for the release of the holdback on the design portion of their work, the designation of a design phase should be

allowed in the contract for consulting services, but is not mandatory. This would facilitate the phased release of holdback for design professionals.

- In addition, projects involving clearly separable segments, including public private partnerships and other alternative financing and procurement projects in particular, would be allowed to segment their projects to provide for segmented holdback release.

Deferral agreements

- Subject to an appropriate threshold, owners and contractors should be allowed to enter into deferral agreements, whereby portions of the work are deleted from the substantial performance calculation, for the purpose of allowing earlier certification and publication of substantial performance.

Deficiency holdback

- Parties should not be restricted from contracting for a deficiency holdback, but the CLA should not make deficiency holdbacks a requirement.

Use of financial instruments or cash for holdback purposes

- Letters of credit or demand-worded repayment bonds should be allowed as a replacement for cash holdbacks.

Next steps

The Ministry is currently undertaking consultations with key stakeholder groups to gauge reaction to the recommendations contained in the Report. Depending in part on the outcome of those consultations, the Ministry has suggested that it may propose draft legislation as early as the spring of 2017 to address the main principles in the Report.

In the meantime, other provinces and the federal government are closely watching developments in Ontario as they unfold, including British Columbia with the law institute's proposed reform of the *Builders' Lien Act* as well as the federal government with the introduction of Senate Bill S-224 (the proposed *Canada Prompt Payment Act*).

Members of our Construction and Infrastructure Group, including Roger Gillott, Richard Wong, Joel Heard, Paul Ivanoff, Andrew Wong, Tobor Emakpor, Jake Sadikman, Elliot Smith and Rocco Sebastiano, are active in various organizations, including the Construction and Infrastructure Section of the Ontario Bar Association, and would be pleased to discuss the commercial and legal implications of these and other proposed recommendations in the Report in further detail.

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1 Together with the Ministry of Economic Development, Employment and Infrastructure.