



SEPTEMBER 2016
OVERVIEW BRIEFING
“STRIKING THE BALANCE”

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General Overview

The Ontario Construction Industry

- The construction industry is a vital sector of Ontario's economy
- The Construction Lien Act (CLA) hasn't been updated since the early 1980s
- Between 2002 and 2013 alone, the average collection period in construction has increased from 57.3 days to 71.1 days
- Industry payment cycles have become elongated due to:
 - Increased size and complexity of projects (e.g. AFPs)
 - Increased complexity of contracts and payment processes

Security of Payment

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- The CLA is an example of **security of payment** legislation
- Internationally, security of payment legislation has received great attention over the last 20 years in regards to:
 - ▣ Promptness of payment
 - ▣ Efficiency of dispute resolution
- Bill 69 was a local manifestation of the international security of payment movement
- Prompt payment is a very serious issue and continues to be a rallying point for reform

The International Context

- In the US security of payment is comprised of:
 - ▣ Liens and statutory trusts at the state level;
 - ▣ Mandatory surety bonds on public projects at the federal and state levels; and
 - ▣ Prompt payment legislation at the federal and state levels.

- In the UK security of payment is comprised of:
 - ▣ Promptness of payment and adjudication legislation; and
 - ▣ Project bank accounts;
 - ▣ No liens or surety bonds as we know them in North America;
 - ▣ The UK approach has migrated to multiple jurisdictions.

The *Status Quo* in Ontario

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- ▣ Lien/Holdback Regime
- ▣ Statutory Trusts
- ▣ Lien Actions (a form of class action)

The Basic Principles of the CLA

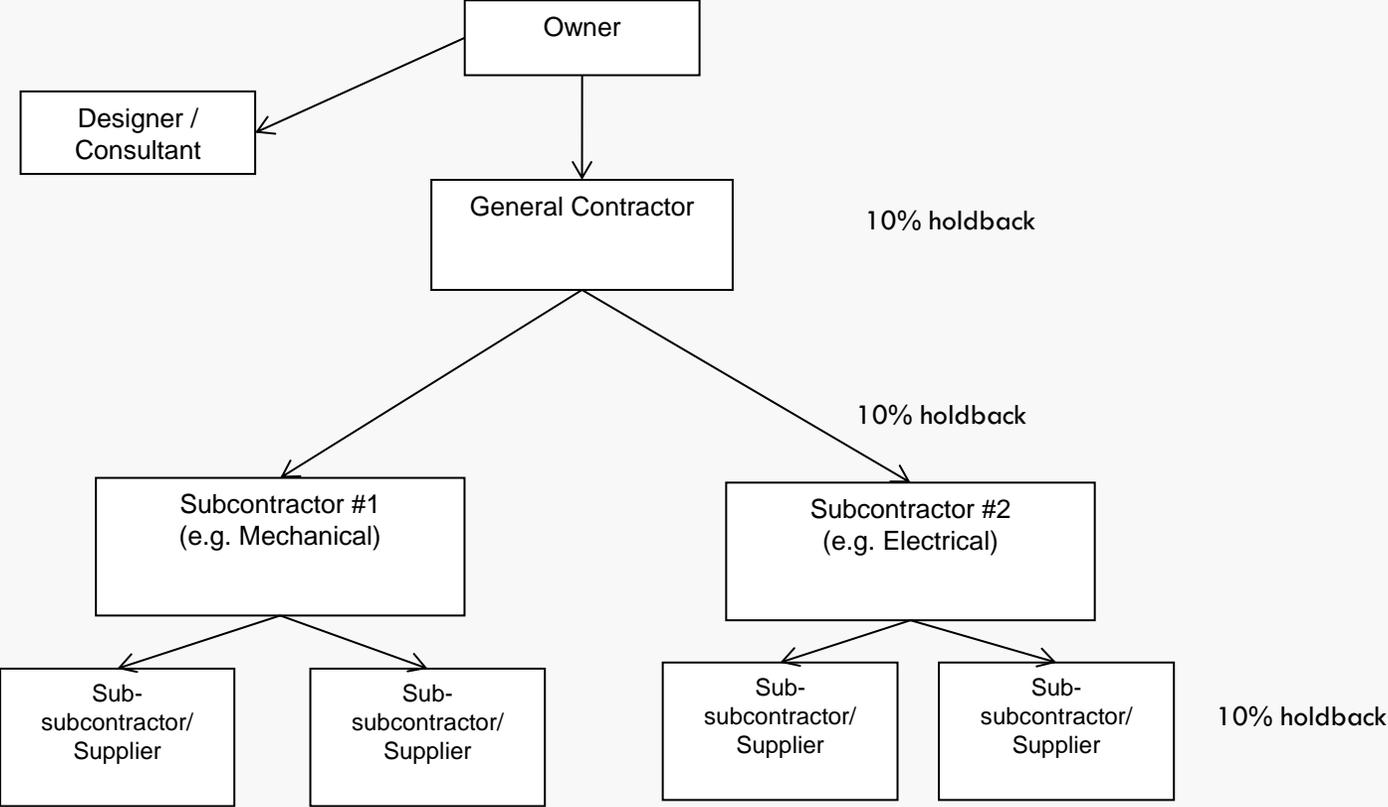
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□ Ownership of Holdback

The holdback represents money already earned by those who have supplied services or materials to a construction project. Despite this fact, very often those persons find that the owner has not set aside this money and that their claim to a lien against the premises is lower in priority to those of other secured creditors of the owner. [...] Thus, the holdback operates as an interest-free loan, used to help finance the owner's project.

Discussion Paper on the Draft Construction Lien Act, Ministry of the Attorney General, November 1980.

The Contractual Pyramid (traditional example)



Weaknesses of the CLA

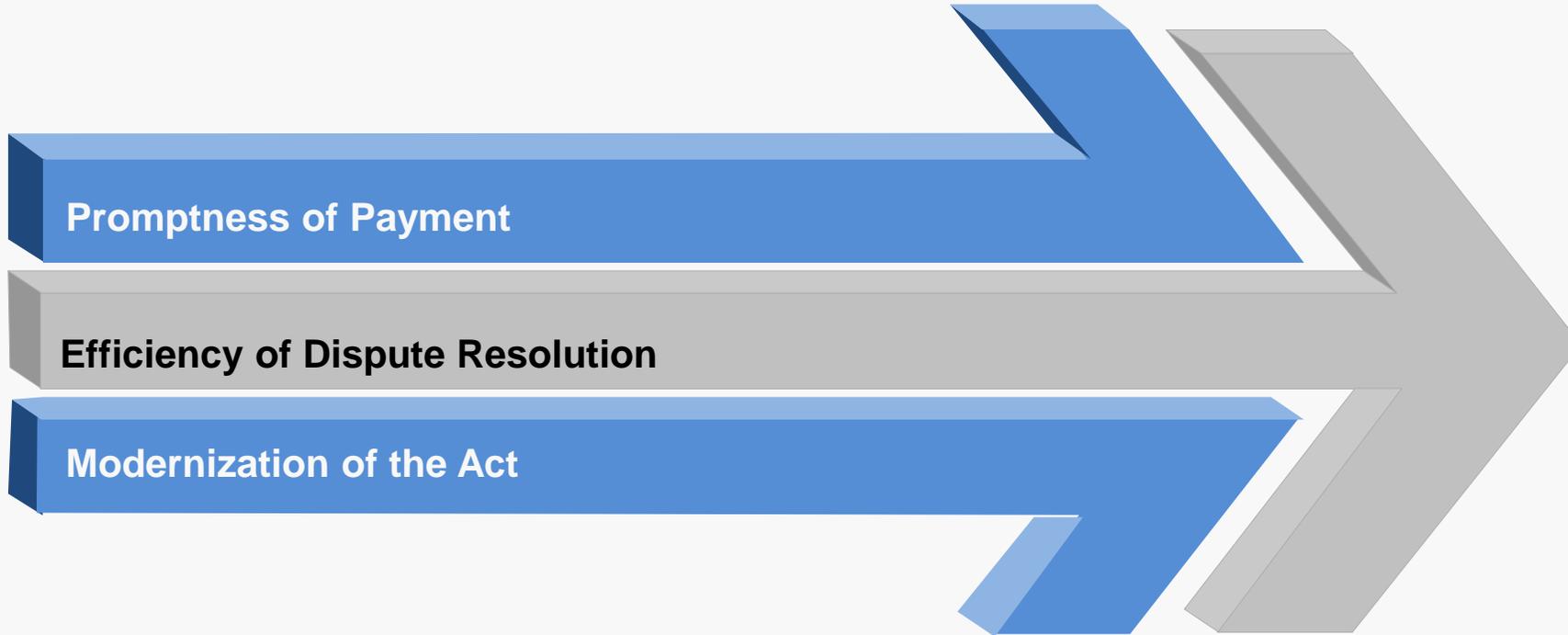
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- ❑ After substantial performance liens expire, holdback is subject to set off
- ❑ Does not address promptness of payment
- ❑ Elongation of the payment cycle is a reality
- ❑ Subcontractors bear the financial burden of slow payment
- ❑ Dispute resolution is very slow and expensive
- ❑ Insolvency may trigger paramountcy of federal legislation

The Expert Review: Three Focal Points

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Modernization of the Act

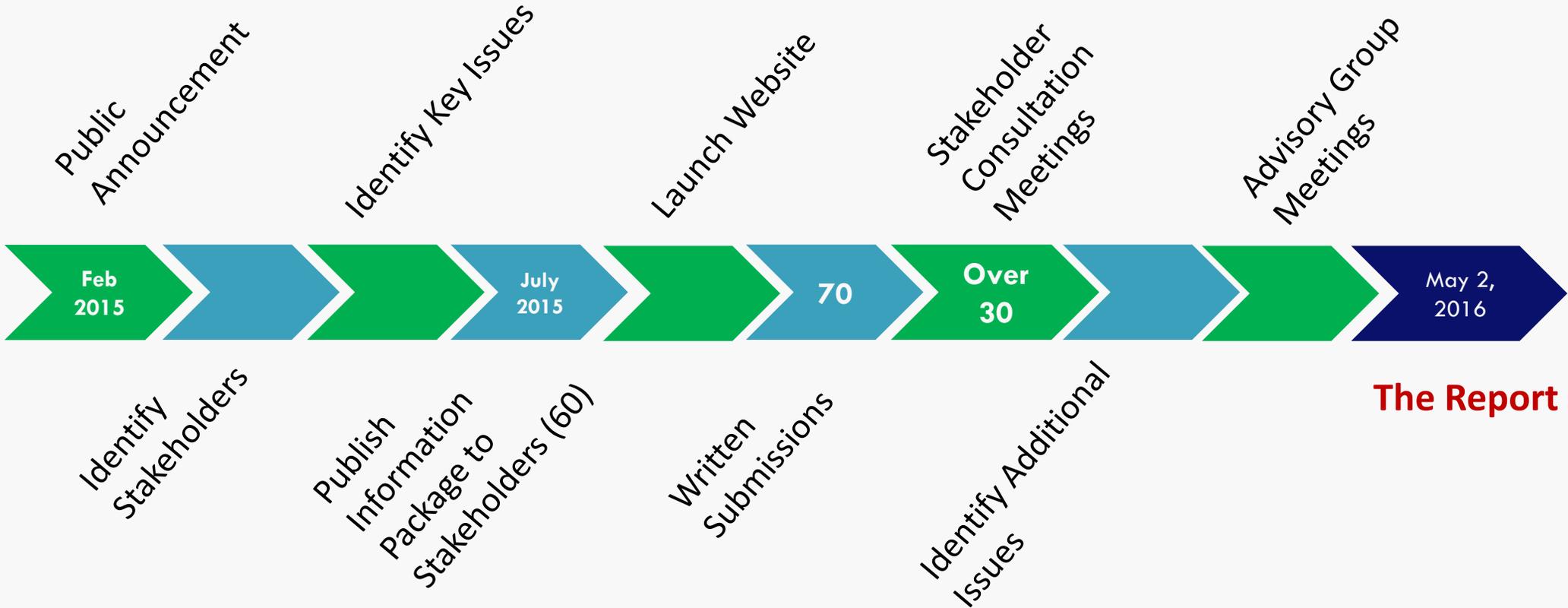


The Expert Review: Process

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- Facilitated Consultation Process
- Transparency, Inclusiveness, Collaboration
- Broad Consensus on core issues achieved within Advisory Group
- Report delivered Monday, May 2, 2016 (French translation May 9, 2016);
- 10 Chapters containing 101 Recommendations.

The Expert Review: Process (Cont'd.)



Advisory Group

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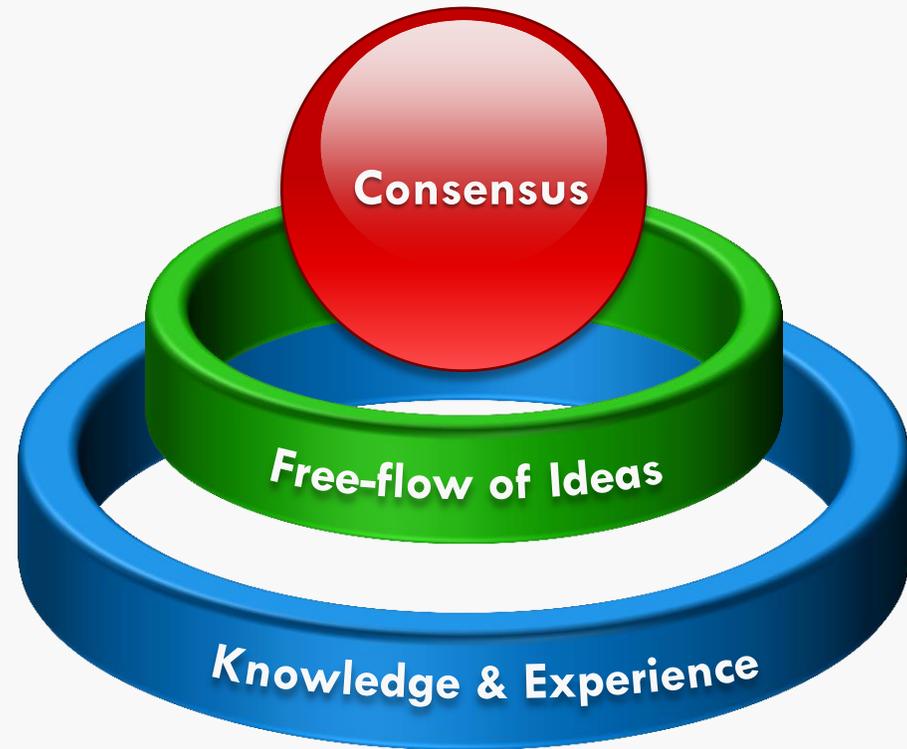
□ **Advisory Group Members**

- Glenn Ackerley, WeirFoulds LLP
- Geza Banfai, McMillan LLP
- Ray Basset, Travelers Insurance Company of Canada
- Glenn Clarke, Simcoe Muskoka Catholic District School Board
- Marni Dicker, Infrastructure Ontario
- Derek Freeman, Freeman Law - Barristers
- Duncan Glaholt, Glaholt LLP
- Howard Krupat, DLA Piper
- Tanya Litzenberger, City of Toronto
- Jeffrey Long, Koskie Minsky LLP
- Bernie McGarva, Aird & Berlis LLP
- Jerry Paglia, York Region
- Howard Wise, Goodmans LLP

Advisory Group

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- Advisory Group Meetings
 - From January to April of 2016, the Advisory Group participated in a series of meetings
- The Advisory Group process has produced a broad consensus on three key elements of reform:
 - ▣ Modernization of the lien/holdback regime, including:
 - ▣ Promptness of payment
 - ▣ Modernization of dispute resolution through adjudication



The 10 Chapters of the Report

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- ▣ Lienability
- ▣ Preservation, Perfection and Expiry of Liens
- ▣ Holdback and Substantial Performance
- ▣ Summary Procedure
- ▣ Construction Trusts
- ▣ Promptness of Payment
- ▣ Adjudication
- ▣ Surety Bonds
- ▣ Technical Amendments
- ▣ Industry Education and Periodic Review

Lienability

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- Clarify the definition of “improvement”
- Add the definition of “capital repair”
- Amend the definition of “owner” for AFP projects
- Amend the definition of “price” to include certain out-of-pocket costs for extended duration
- Remove requirement to register liens against municipal lands
- No change regarding registering against hospital, university and school board lands

Preservation, Perfection and Expiry

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- Increase the time period for preservation to 60 calendar days
- Increase the time period for perfection to 90 calendar days
- Add termination to the list of events that trigger the commencement of the time limit for preservation
- Prescribe a mandatory form of Notice of Termination or Abandonment
- No mandatory certificates of completion

Preservation, Perfection and Expiry (Cont'd.)

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- Amend rule for common elements of condominiums (single PIN)
- Notice of lien condominiums to be given by prescribed form
- Condo unit owners should be able to post proportionate security for their share of the common elements
- Remove lot-by-lot preservation provision for subdivision lot
- Address the abuse of lien rights by replacing the concept of “grossly exaggerated” liens with “wilfully exaggerated” liens.

Holdback/Substantial Performance

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- No change to the quantum of holdback (i.e. 10%) or to finishing holdback
- Update the calculation of substantial performance
- Update the calculation for deemed completion
- Amend the Act to provide for mandatory release of holdback, subject to notice of set-off, but not mandatory early release of holdback
- Permit partial release of holdback (on a phased or annual basis) in certain circumstances
- Permit segmented release of holdback for clearly separable improvements (particularly for AFP projects)

Holdback/Substantial Performance (Cont'd.)

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- No mandatory early release of holdback for design consultants except for purposes of phased release
- Permit deferral agreements to be entered into for the purpose of allowing certification and publication of substantial performance
- Supplement the current scheme to allow replacement of cash holdback with a Letter of Credit or demand-worded Holdback Repayment Bond

Promptness of Payment

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- Prompt Payment developed in the U.S. and subsequently in the U.K. and has spread to many commonwealth countries (e.g. Singapore, Ireland, Australia, Malaysia, etc.)
- U.S. Prompt Payment
 - ▣ Varies from state to state and federally (i.e. Prompt Payment Act)
 - ▣ Includes features such as payment triggers (proper invoice), interest penalties, payment periods, suspension rights – **but** parties litigate if there is disagreement
- U.K. Prompt Payment
 - ▣ Prompt payment default regime supported by freedom of contract (i.e. parties can agree to terms) and adjudication
 - ▣ Broadly applies to every construction contract for carrying out construction operations (and all levels of the construction pyramid)

Promptness of Payment (Cont'd.)

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- For public and private sectors
 - ▣ Contracting parties free to provide for terms in their contracts that meet their specific needs, so long as such terms meet the minimum standards of the legislation.
- To apply at the level of owner-general contractor, general contractor-subcontractor, and downwards:
 - ▣ Provide a mechanism for GCs to notify subcontractors of non-payment of owners and to undertake to commence or continue proceedings necessary to enforce payment so as to defer payment obligation

Promptness of Payment (Cont'd.)

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- Trigger for payment period to be the delivery of a “proper invoice”; provided that certification for payment (if contracted for) must follow submission of the invoice
- Parties free to contract in respect of the timing and contents of a “proper invoice” but once delivered payment must be made within 28 days (owner to general) and 7 days (general to subcontractor)
- Payer(s) may deliver a notice of intention to withhold (to assert set-offs)
- Rights of set-off should not extend to set-offs for debts, claims and damages related to other contracts

Promptness of Payment (Cont'd.)

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- Mandatory non-waivable interest requirements
 - ▣ Higher of contractual rate or *Courts of Justice Act* rates
- Right of suspension (if failure to observe adjudicated outcome of dispute)
 - ▣ Compensation for demobilisation and remobilisation
- No mandatory financial disclosure
 - ▣ Not part of any other prompt payment regime

Adjudication

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- Adjudication is a swift and flexible mechanism of interim binding dispute resolution(28 to 42 days)
- Adjudication has worked in the U.K. for almost 20 years. It is a proven, pragmatic solution for projects gridlocked by disputes, a solution that frees cash flow and resources, while at the same time striking an appropriate balance among competing interests.
- Following its creation in the U.K., adjudication has been implemented as an effective dispute resolution process in many commonwealth countries (e.g. Australia, Malaysia, Singapore, Ireland)

Adjudication (Cont'd.)

- Adjudication should be implemented as a targeted interim binding dispute resolution mechanism
- Parties should be free to contract to their own adjudication procedures so long as they meet a minimum statutory scheme
- The default scheme will be established by regulation
- Any party to a construction contract or subcontract to have the right to refer a dispute to adjudication
- Permit back-to-back adjudications
- Multi-issue adjudication only through consensual contractual arrangements

Adjudication (Cont'd.)

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- ▣ The first tranche of adjudicators (eminently qualified persons, key centres)
- ▣ Adjudicators should: be a natural person, without conflicts, member of good standing in a self governing professional body, 7 years relevant working experience in Ontario's construction industry, qualified under standardized training program with certificate, not otherwise disqualified
- ▣ Nominated after a dispute has arisen, named in the Notice of Adjudication
- ▣ Parties to have 2 business days to agree on an adjudicator, in the absence of which an Adjudicator Nominating Authority appoints within 5 business days
- ▣ A single official ANA should be created
- ▣ Adjudicator immunity

Adjudication (Cont'd.)

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- If parties do not agree on an adjudication process, the default scheme will be implied with respect to the notice, appointment, timetables, powers of the adjudicator, duties of the adjudicator and process
- Parties free to agree on adjudicator fees, else fees will be decided by the ANA
- Each party bears its own costs / legal fees
- Adjudicator can award costs in certain circumstances
- Decisions are binding on an interim basis but enforced in a manner similar to an arbitration award under the *Arbitration Act, 1991*

Streamlining Lien Proceedings

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- ▣ Lien claims under \$25,000 to be referred to Small Claims Court
- ▣ Claims from \$25,000 to \$100,000 to be subject to simplified procedure
- ▣ Lien actions case managed in all regions
- ▣ Remove requirement to seek leave of the court for s. 67(2) motions and third party claims (s. 56.2)
- ▣ Amend prohibition of appeals from interlocutory orders (s. 71(3))
- ▣ Remove prohibition of joinder of lien/trust claims
- ▣ Ministries to consider issues in relation to gaining access to the courts to vacate a lien (particularly outside major centres)

Other Key Issues

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- Other key issues raised by stakeholders relate to:
 - ▣ Construction Trusts
 - ▣ Surety Bonds
 - ▣ Technical Amendments
 - ▣ Industry Education and Periodic Review

Construction Trusts

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- A set of statutory trusts are contained in Part II of the *Act*. This is a separate set of rights in addition to lien rights, intended to keep all funding within the “construction pyramid” until all accounts for work and services are paid in full.
- The Review focussed on enforceability in bankruptcy/insolvency.
- The impact of federal insolvency legislation (i.e. the BIA or the CCAA) on these rights was the most difficult issue considered by the Review.
- The basic issue is traceability.

Construction Trusts (Cont'd.)

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□ International trends

■ United States

- Various trust provisions (e.g. some states trust legislation only applies to private projects)
- New York Lien Law

■ UK

- Exploring project bank accounts in various jurisdictions by way of pilot projects

■ Australia

- Exploring project bank accounts

Construction Trusts (Cont'd.)

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- Recommendations:
 - ▣ Statutory requirements for trust fund bookkeeping (New York Model)
 - ▣ Require broad form surety bonds issued on all public sector projects (form to be developed based on consultation with Surety Association of Canada)
 - ▣ Pilot project for Project Trust Accounts (over two years for public sector projects with published results)

Surety Bonds

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- Require broad form surety bonds on public sector projects in a form developed in consultation with the Surety Association of Canada
- Payments of undisputed amounts within a reasonable time from the receipt of a payment bond claim
- A surety claims protocol to be developed in consultation with the Surety Association of Canada

Technical Amendments

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- Clarify the Act in relation to curing minor irregularities (S. 6)
- In relation to the *Registry Act*, implement separate forms (one to release, one to discharge and one to vacate a lien)
- Modify s. 32(2) to incorporate further details such as the legal description, PINS, municipal addresses and to whom a lien is to be given
- Written Notice of Lien
 - Amend the definition of written notice of lien / require that a withdrawal of a written notice of lien be in a prescribed form
 - Amend Section 44 to allow for the posting of security to vacate a written notice of lien

Technical Amendments (Cont'd.)

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- Amend Section 39 to increase the information that can be requested
- Amend Section 44 to increase the costs component of amount of security required to be posted to vacate a lien
- Permit Letters of Credit with reference to International Commercial Conventions as acceptable security subject to certain conditions
- Amendments to the process of a mortgagee financing both land acquisition and the construction of an improvement

Industry Education and Periodic Review

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- Provide ongoing education, awareness and support for industry participants (i.e. bulletins and a practice guide)
- Stakeholders should be proactive in education and training
- The Act should be reviewed within 5 years of the enactment of recommendations, and every 7 years thereafter

Over-Arching Issues

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- Must be taken forward as a whole.
- Private sector will be very concerned if the government decides to exempt itself from key recommendations.
- Some additional costs to government will be incurred, this must be weighed against the substantial loss or revenue and increased costs that industry participants will incur if the status quo is retained.

Over-Arching Issues (Cont'd.)

- Importantly, if there are existing processes that comply with the spirit of the proposed framework (e.g. MTO's agreement with the road builders on the referee process), these can continue.
- There is major momentum for change.
- An expectation that the government will act.

Tensions

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- Freedom of Contract vs. Regulation
- Promptness of Payment vs. Security of Payment
- Simplicity vs. Complexity

Thanks to:

The AG's Office

The Advisory Group

The Friends of the Review

The BLG Team

The Stakeholders