Construction Lien Act Review Consultation Meeting Summary
Ministry of Transportation

November 25, 2015 (9:00 a.m. to 11:00 a.m.)

Attendees: Gerry Chaput, Paul Lecoarer, Tony Tuinstra, Henry Weilenmann, Mary Gersht, Bruce Reynolds, Sharon Vogel, James Little

Sheryl Cornish, Counsel at the Ministry of the Attorney General, attended the meeting to record a summary.

For the introduction provided by the Review, please see document titled BLG Consultation Introduction.

1. Ministry of Transportation Overview

The Ministry of Transportation ("MTO") does not have a problem with construction liens. They have never had a dispute go to trial because they always find a way to deal with it outside the court system. The Act is working well in the context of MTO's work.

MTO manages about 16,900 km of roadway. There are almost 5,000 structures and 2,800 are bridges. It has four tunnels, 29 remote airports, and 9 ferry services. At last check, the replacement value of these assets was $82 billion. The current program is almost $3 billion. It tenders about 350 major and minor capital projects on a yearly basis.

MTO is unique and consults regularly with its partners – the Ontario Road Builders Association ("ORBA") and Consulting Engineers of Ontario ("CEO"). Consulting engineers are responsible for design and contract administration. It also deals with the Concrete Association, Sand and Gravel Association, and others. MTO consults and tries to reach consensus, but this does not always happen. It does what is best for the people of Ontario. MTO also participates in Ontario Provincial Standards for Roads and Public Works and it works with municipalities.

Construction Contract Model

MTO's primary contract model is design-bid-build (75 to 80 percent of work). About 25 percent of work is undertaken through alternative means and 10 percent in design-build and P3s.

MTO pays on a unit price basis, not lump sum. There may be 100 items and it pays as the work progresses. Any liens are addressed as the work proceeds. It has specifications and contract requirements which must be met before it pays. For asphalt, the contractor starts and it does not end when he or she meets the end of the contract but when MTO analyzes the data to ensure that the work meets the contract requirements. Contractors and MTO take quality control samples. MTO ensures that it gets value subject to the holdback requirements in the Act. It is buying an engineered product and wants to ensure that it receives what it bargained for.

Design-build is done on a lump sum basis, so there are milestones. For Alternative Financing and Procurement structures ("AFP"), MTO does not pay unless the work is done. It has modified this approach given some issues that have emerged in the field.

In general, MTO is of the view that there should be freedom of contract to structure contracts. There is a long history of doing this with ORBA, CEO and other organizations. In terms of subcontractor work, MTO permits up to 60 percent of the work to be subcontracted in the design-bid-build model. MTO recognizes the issues associated with this, but it has served them well. For design-build it has opened it up a bit.

Pre-Qualification and Bonding

MTO is unique as an owner in pre-qualification and bonding. MTO does not bond for the majority of work. For contracts under $1 million they get security, but for the majority of work contractors are pre-qualified. MTO makes sure that contractors have the financial resources, people resources, and proper structure to undertake the work. It has renewed efforts to go into specific companies to verify what they are reporting. This was introduced in the 1950s to build an industry that could respond to its needs. MTO has a strong, robust industry. There are very few instances where someone goes into receivership.

Where there is a contractor insolvency, MTO generally makes subcontractors whole once due diligence is done. It can take the work remaining and outstanding and find ways to reduce risk to get the work complete. Some work is done on an emergency basis and some is taken away and lumped into larger contracts. It gives flexibility to go in and look at what needs to be done. There are significant benefits in this process. It is cheap in terms of saving on the cost of bonding and subcontractors have the assurance that they will be made whole. They bid the work accordingly.

Changes to the General Conditions of Contract

In 2010, MTO redrafted the general conditions of its contracts through consultations with ORBA. It spent a lot of time thinking about risk distribution and trying to balance it. In the sub-prime relationship, MTO has no involvement in agreements or payments to subcontractors. Its contract is with the prime and complaints are directed to the prime.

MTO recognizes that contractors price risk. It is a principle that may be lost to some but the good ones price it well and recognize the benefits to cash flow. MTO structures the contract with flexibility to ensure cash flow, including early release of the holdback for multi-year contracts. It ensures that there are no outstanding issues related to the contract, and in the event that there are no issues, MTO reduces the holdback from 10 to two percent on an annual basis.

In terms of the Act, MTO is taking some risk and the prime is as well, because they attest that there are no issues. They provide a statutory declaration. This is done across the board on multi-year contracts. The prime will ask for some release of the holdback and then MTO will start the process to ensure that there are no outstanding liens. There is a threshold on the amount of work remaining – 60 percent of the work remaining on a

two year contract or 40 percent on others. It is in MTO's interest to get the money out in the public. There is a lot of flexibility provided that there are no outstanding issues, such as deficiencies.

Some stakeholders have proposed that the Act be amended to allow for release of the holdback in phases or on an annual basis. From MTO's perspective, the Act is working fine as is. They would rather work outside of a regulatory framework because it gives greater flexibility. It should not be regulated.

MTO has contract completion provisions in its contracts. These are optional at MTOs discretion. The contractor will make a submission and MTO will decide whether it is complete or not. There are also advance payments for certain types of work (e.g. precast elements, stockpiles, structural steel, bridge elements, concrete culverts, large steel culverts). Contractors will put the materials in a secure site with a lease arrangement.

Payment Process

MTO works on a net 30 day basis. Once they verify the work, they release the money. There is a lot of back and forth with the contractor about what they ought to be paid as opposed to what they would like to be paid. Payment is made within 30 days from the issuance of the certificate of payment if there is an agreement about the work. MTO usually meets these payments but sometimes there are system glitches. It beats the 30 days on a lot of contracts.

There is a concern with the contractor giving an invoice and MTO having to pay within 30 days, given its structure and quality control requirements. Once the funds have been released it is hard to get them back.

MTO has a good track record once the certificate has been agreed on. There may be an elongated process to arrive at an agreement because of its process. Once they have agreed, it would be odd to go beyond the 30 days. There is no data on payment readily available but it is an extremely high percentage. MTO has an electronic payment system. MTO will try to get data on payment.

MTO noted that the conversation between the parties usually takes five to ten days. What often happens is that they decide to put an element aside for the next payment. For example, there may be a dispute on how much work has been an undertaken or the parties may be waiting for test results. It is very rare that a contractor and MTO are very far apart in their views and cannot agree.

The Review is looking at whether the current philosophical approach of the Act of one size fits all is the way the Act should be structured. When it comes to prompt payment, no one has been critical of MTO when it comes to ordinary course payments. This changes with stakeholders when it comes to claims for extras.

Necessarily, not all owners groups can be as sophisticated and efficient with payment processes as MTO is, so there could be areas for dialogue where MTO is the best practices standard.

There is recognition that there are different kinds of payment. MTO will pay for work that has been done and it needs to verify this. The majority of items are paid upon completion and test results. Where there are change orders and claims and MTO needs to negotiate the value, the industry or suppliers may skew the issue by saying that they have not been paid. The problem is that the parties have not agreed on certain issues and that is why payment has not been made.

One way of measuring payment timelines is from the issuance of progress request. The time frame between the progress request and the certificate of payment being issued is where public owners say that they need sufficient time to ensure that the work has been done. The request must be in the proper form to be approved. Contractors have expressed frustration with broader public sector ("BPS") owners that the time between the submission of the progress request and the issuance of the payment certificate is unreasonably elongated.

MTO approaches this deliberately because it wants to be an attractive owner to the industry. It is important to provide certainty for the industry that they will get paid on time. If MTO does not meet the payment terms, it pays interest. This is a best practices approach.

MTO explained that when the Review considers changes to legislation, it needs to be mindful not to disrupt what MTO has achieved. For any owner assessing the quality aspect of the work, payment should only occur if work is done as required. If the Act requires payment with no quality procedure, this would be a challenge.

MTO's concern goes beyond quality. There are other mechanisms around payment. For example, there may be disputes, default, or liquidated damages. In certain circumstances, receiving and paying an invoice would be in conflict with the contract. The public should only pay for what MTO negotiated for in contract.

2. MTO's Dispute Resolution Process

MTO consulted with industry and got very close to consensus on how to approach disputes going forward. MTO has a three-step process, which has changed somewhat. The contractor is required to perfect the claim, and receive a response, at the field level. Once a response has been provided, the contractor can either accept the offer or push the claim to the regional level. MTO has five regions in the province – Thunder Bay, North Bay, Toronto, Kingston, and London. MTO wants to keep the decisions in the field level as much as possible.

The Manager of Operations would consider the claim through his or her staff. The best place to resolve issue is at the field level. The contractor can get the best results to complete the job and resolve the issue. The Regional Manager has a set period of time to respond to the claim. The Manager will make a written offer to accept or reject the entire claim or parts of it. The contractor can either agree or disagree.

The third level is the head office level. The Manager of the Claims Office hears all provincial claims. This manager has a set period of time to analyze and review the claim and try to determine what is appropriate and what is not. Everything is done on a

principled basis. The contractor's claim cannot change or morph throughout the levels. They are to provide information once. Besides pricing, the principle of the claim should not change throughout the process.

The claim makes its way through the three levels. At any level, it may go to a third party referee. This is not adjudication or a court proceeding. It is an individual who MTO works with to hear the dispute. The contractor and MTO send information about the claim to the referee and the referee reads it and may visit the site. The referee will render an interim non-binding decision in a certain period of time. The decision is binding until the end of the contract. This helps to preserve the relationship. Both parties have to decide whether or not to accept the referee's decision. There are timelines associated with the process. Either party can agree to extend the timelines.

If either party decides not to accept the decision, they can consider other methods such as arbitration or litigation. The contractor may suggest another method.

January 2016 is the launch date for the process. MTO is working towards 2016 contracts at the latest. ORBA is positive about the new approach. From a dispute resolution design perspective, it seems like a good solution to enhance the relationship between MTO and its contractors.

Referees

Referees are skilled and know the industry. The challenge will be to find people experienced in the linear world. The referee process should have benefits for both parties.

MTO has not gone out to individuals yet with respect to the referee roster. It is working on the parameters for the qualifications, skills and experience requirements. MTO is not sure if it will include engineers, lawyers or others. It is almost ready to share the referee services agreement with ORBA.

With respect to costs, the contractor will pay half the referee's fee. ORBA is paying a portion of the cost to develop the agreement.

3. MTO's Concerns about Dispute Resolution and Freedom of Contract

MTO would not want to be subjected to some other form of dispute resolution. It is very sophisticated relative to the BPS. Prompt payment legislation in the United States was initiated by the adoption of this legislation at the federal government level. In more than a few states, the Department of Transportation is excluded from the operation of prompt payment.

MTO should have the freedom to contract. It did not support Bill 69. There were significant concerns about the Bill. MTO wants to enjoy the ability to contract with its partners. It does not always agree with them and the relationship may sometimes be strained, but they find a way forward. MTO has a robust industry and has never had a lien go to court. This speaks to the integrity of its system. It is concerned that this would be changed by legislation.

MTO's concern was that the Bill would have impacted freedom of contract and the ability to sort things out with contractors. The majority (80 percent) of work is done on an item basis. There is generally no dispute on the amount of work that has been done within those items. It is rare to get into a dispute on a payment application. MTO is concerned that legislation would impact ability to work with contractors to resolve disputes. It may have to change the way it contracts. It must pay what it has bargained for.

The Review observed that a common challenge is getting from submission of the progress request to payment in the best and fastest way. In San Francisco, they turn around payments in 30 days (from progress request to payment). The Review is considering whether it is reasonable for legislation to try to manage that process, or whether it is too intrusive.

Importance of Maintaining the Current MTO Process

The key message from MTO is that on a $3B program, it does not have an issue so the recommendations in the Review's report should not create one. Any attempt to manage the process would be disruptive of what MTO has accomplished and would be too intrusive.

MTO has become disciplined because it has had all of these payment issues in the past. It is now working very well. Contractors price work based on how they will be working with the Ministry. The relationships are important and MTO is trying to rebuild these relationships. The Review should not impose something that will have a negative effect on the Ministry's ability to work with its partners. MTO sees itself as part of the industry. Whatever happens in the industry affects MTO as well.

The Review has heard differing views among the contractors that work with MTO on prompt payment and freedom of contract. The Act does place some restrictions on freedom of contract. MTO noted that there are always situations that warrant intrusion on freedom of contract but, where possible, the parties should be able to negotiate among themselves.

Continual Process Improvement

MTO's other objective is continual improvement. They continue to work with industry. The goal is to drive prices down so that contractors are paid a reasonable price and taxpayers receive a benefit.

MTO is not in the business of putting contractors out of business. They want to protect the industry as well. They are very upfront with changes to the contract. They want to make sure that the market stays fair. If a contractor makes a low bid, they may then make a lot of claims to make up for the margin that they have lost.

MTO has a contractor performance review. The number of claims is not taken into account in this process. The referee process should filter out illegitimate claims. This would be a good outcome from a policy perspective.

4. Concerns Around Administrative Effort

The way MTO contracts, it sees very few liens. Any administrative burden is a negative and MTO does not support it. Multiple dates for early release of the holdback is an unnecessary administrative burden. The subcontractor knows full well whether they should lien or not.

5. Separate Trust Accounts

The banking sector has identified this as a constitutional issue in relation to which the Review has been receiving a lot of submissions.

The Ontario Bar Association section committee created to comment on the Review (the "OBA Section Committee") has raised the issue of separate trust accounts because of the *Bankruptcy and Insolvency Act* ("BIA") issue. In other sectors of the industry, insolvency issues are coming to the forefront. There is tension in the case law between the federal legislation and lien rights. A focus is whether the creation of project trust accounts administered by owners and contractors would help address the issue to avoid the banks taking the holdback.

The BIA and *Companies Creditors Arrangements Act* ("CCAA") are federal statutes that apply in an insolvency situation such that a debtor can take the protection of the legislation. They have priority over provincial legislation in certain circumstances. Courts in Ontario have found that trust funds, which can include the holdback after liens have expired, is not protected for the benefit of the subcontractors as intended by the Act because the deemed trust under the Act is imperfect. The trust has been found to be imperfect because there are requirements in relation to the existence of a trust, one of which is certainty of subject matter. Some Ontario courts have said that the mere fact that the Act says it is trust money does not satisfy this certainty requirement.

The proposed solution from stakeholders is to have the owner fund the 10 percent holdback into a joint account as it accumulates. If the general contractor becomes insolvent and the trustee asks for the money, the subcontractors can reject the request because the monies are in a separate trust account and there is certainty of subject matter. This is a key issue because there has been an upsurge of contractor and subcontractor insolvencies in the market recently.

MTO indicated that this requirement would impose an additional administrative burden on the Ministry. This issue is outside of its industry. MTO does not have a problem paying what it has contracted for. Creating an entirely different regime administratively, and from a controllership perspective, would be significant for the government. There is uncertainty about how it would work with the existing process.

As a public owner, MTO has an interest in making sure money flows in a predictable fashion in a way the market can bear. In this situation, there would be intervention from a third party who now controls the money. For MTO, the concept does not work. The money would have to be dispensed in the year it was set up.

MTO does not experience bankruptcies so it cannot comment on what has happened in the industry. From MTO's perspective, this would not work.

This is one area where consideration of labour and material bonding has come up. The issue from a policy perspective is that the Act exists to provide a limited degree of collateralization for the subcontractors. In the event of contractor insolvency, the subcontractor can use the holdback to partially compensate their losses.

In British Columbia, the money cannot come out of the account without the approval of the owner. If the owner has legitimate quality concerns, the contractor cannot get the money out without owner agreement. When the owner certifies payment, they pay to the contractor and the holdback would go into the account. The account holders would administer the account.

MTO's approach to contracting is different than BC. Ontario does not bond. When a contractor is insolvent, MTO gets a claim from the subcontractor and goes through it to determine whether it is valid. They go through a process to determine what is owed and what is not. There is a lot of back and forth. MTO needs to ensure that it is not paying twice for the same thing.

A lot of work goes into determining what subcontractors are owed and whether it is reasonable or fair. This is not contractual, it is a policy issue. MTO wants to make the subcontractors whole and is in a position to do so. There may be other owners that are not in that position. MTO wants to deal with these issues as one offs. The contract should deal solely with the prime contractor. The Ministry has structured the way it does business to ensure that the prime is healthy and robust. For every contract they bid on, MTO has assurance on whether they are viable or not.

6. Miscellaneous Issues

Financial Disclosure

MTO has been fortunate because on every contract it ensures that there is financial capacity. It indirectly pays for it, but it gets the certainty. This reduces the number of bids that MTO receives. It gets the benefit of the bid, but it would lose that if there is a statutory requirement.

The financial disclosure provision in Bill 69 was problematic for owners because it would be difficult to put parameters around it. MTO provides disclosure through public accounts.

Registration of Liens on Municipal Lands

Municipalities want municipal land to be excluded in the same way public highways are. MTO has not considered the issue of registration of liens on municipal lands.

Written Notice of Liens

In terms of the written notice of lien and how it gets delivered to MTO, it is haphazard and difficult. There is an issue there. There should be a claim for lien process and a

form with proper service. The *Proceedings Against the Crown Act* speaks of advance notice and who it goes to. Eliminating the written notice of lien would make things more efficient according to MTO.