Construction Lien Act Review Consultation Meeting Summary
Ontario Association of School Business Officials, Ontario Hospital Association and Council of Ontario Universities

October 29, 2015 (11:00 a.m. to 1:00 p.m.)

Attendees:

Glenn Clarke (OASBO/OPSBA), Jeffrey Bagg (OHA), Alia Karsan (OHA), Lisa Krawiec (COU)(collectively, the "Stakeholder Group")

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.

General Remarks

This is meeting is an opportunity for the Ontario Association of School Business Officials (OASBO), Ontario Public School Board's Association (OPSBA), Ontario Hospital Association (OHA) and the Council of Ontario Universities (COU) to discuss their key issues in relation to the Act.

The Review team noted that from the perspective of the public owner group, it would be helpful to the Review if they could work together as effectively as possible in getting their voice heard in a more cohesive and coherent way.

The public owner group has attempted to do this. They have engaged with a group of public sector owners, including municipalities, school boards, and hospitals. These discussions will continue with respect to developing a joint submission. In public sector organizations, this type of work is done on a voluntary basis and resources are a challenge.

1. OASBO/OPSBA Comments on Prompt Payment

The OASBO/OPSBA was originally involved in the prompt payment issue because of Bill 69, *Prompt Payment Act, 2013* ("Bill 69"). There was a concern about the Bill because only the OGCA and trades were involved. Other groups were not consulted and it seemed to be moving very fast. The subcontractors and generals talked about different issues, but not the root causes. They did not do the fact finding. There was some discussion of issues and root causes in the information package.

The Review has heard from stakeholders that there is a significant concern in relation to payments from owners. There are two main reasons on why payments are delayed: the first is elongation of payment and the reasons given in relation to the amount of time to administer payments in the ordinary course (extended from a 30 to 60 payment cycle to

90 or 120 days). Stakeholders do not understand why this is the case in a time where it is easy to transfer funds electronically. There is a concern about the elongation of payment terms and processing of change orders, which delays payment. In this regard, the Review has heard about the effect of the elongation of the payment cycle on pension and employee benefit plans. Late payment has a negative effect on these funds and the administration of benefits for workers and their families. Payment timing is an integrated system that includes multiple parties. To reduce the time period required to effect payment requires everyone in the system to work effectively together.

The second reason is the "gridlock" situation where there is a significant dispute on a project which stops payment completely. The Review has had discussions with people who viewed the prompt payment issue as exclusively pertaining to the ordinary course side, but over time these groups now accept that there is a related part of the equation for projects where there is a major, unanticipated event which causes the project to go into dispute mode and payment stops. There is an emerging recognition that there are these two facets to the prompt payment issue.

2. Concerns about Bill 69

Payment of the Lien Holdback and Progress Draws

OASBO/OPSBA explained that payment after one day does not make sense. It is more complex than in the past. In the provincial government there is greater accountability with respect to broader public sector procurement directives. School boards are being held more accountable with regard to reviews of progress draws. School boards cannot just affect the progress draws in one day. There are several layers of approval, including a review by the general contractor and subcontractor consultants and the project manager. The result is that the review of the progress draw often extends beyond 30 days. This may cost contractors money but they can price it in the bid.

The payment period in school board contracts has been extended from 30 days to 40 because they were unable to meet the 30 day payment period.

Some stakeholders made the comment to the Review that internal staff vacations holding up the payments of jobs of a significant size is not predictable. The contractor community has a concern about why a vacation should affect the payment stream and the length of time for payment. OASBO/OPSBA indicated that this happens because many organizations are streamlined – there is one project officer who looks after the details and this is the only person who can approve the progress draws. It must go through internal processes. If the documents come in properly and are accurate, payment can occur within 15 days. The school boards are not trying to hold up payment, but they need the flexibility of 40 days.

The Stakeholder Group has been aligned with other public sector owners. They are trying to speak with one voice. There was acknowledgement that people should be paid on time and tools could be enhanced but the whole scheme should not be disrupted just for that purpose. There has been renewal in recent years and the members of the OHA are working closely with Infrastructure Ontario on most projects. The concern from

members is that they do not want to throw the baby out with the bathwater. The OHA believes that any recommendations of the Review should ensure that people are paid on time and in a timely way. There is an opportunity to create an additional tool to ensure that people are paid on time by considering 'pay if/when paid' clauses and determining that they may not really benefit anyone.

The Review has heard different things from different stakeholders about these clauses. Some groups do not like them and some higher up in the pyramid do. The OHA noted that this is not really a clause that impacts hospitals. They pay for work that is done, but it is really the contractor and subcontractor in the middle of the pyramid. The OHA has no views on going one way or the other with respect to such clauses.

There is concern expressed at the lower end that funds are not flowing down in a way that is efficient or timely. The OHA indicated that there is an acknowledgement that there are concerns about not being paid for one or two years down the road. A possible solution is to structure the release of holdback differently so that more periodic payments can be made.

The COU indicated that it echoes the concerns and agrees with the issues raised by OASBO/OPSBA. COU had a lot of the same concerns about Bill 69. There is a danger in removing levers for owners in terms of ensuring that projects will be completed.

The Review is considering ways to modernize the Act with a view to balance stakeholder interests and also make the Act work better and more efficiently in a way that reflects the evolution in the marketplace.

The owner community is not homogenous. Public owners are different than private owners. Public owners differ as well (e.g. the Ministry of Transportation is different than OASBO/OPSBA). Part of the problem is that there is no central owners group. Even in the school board context, different contracts are used by the various boards.

There is a tension between freedom of contract and legislative regulation. OASBO/OPSBA suggested that payment timelines should be decided by the contractor. If there are longer terms, the owner should pay for it as a negotiated part of a contract.

The Review has heard from stakeholders that across the industry, general contractors do the deals and subcontractors subscribe through the tendering process, but they are not aware of the payment terms. OASBO/OPSBA stated that there should be more transparency for subcontractors.

According to OASBO/OPSBA, the problem is the opening clauses of the statutory declaration where the general contractor can say they are in dispute with the subcontractor so they are not making payment. In the event of a dispute between these two parties, the general will still sign off and indicate that they are fully compliant. The contractor should identify disputes in the statutory declaration and be upfront so that the owner can see that they are not paying the subcontractor. This can create problems for the owner down the line.

The COU noted that it is important to the university sector to not restrict freedom of contract. Contractors should be able to negotiate directly with the owner. While the current Act has made incursions in contracts, Bill 69 was perceived by certain groups, including owners, to be too great an incursion on the freedom of contract. There was a clear assertion by municipalities on this point.

Deficiency Holdbacks

OASBO/OPSBA indicated that another problem with Bill 69 was the restriction on having other holdbacks. Owners need a deficiency holdback. The deficiency holdback is targeted to subcontractors that have not performed or where there are deficiencies in the work. It is important to note that after 45 days, the holdback loses its character as a holdback and is just money that can be used as set-off.

Owners want to encourage these holdbacks and maximize them to encourage contractors to come back and finish the work. For example, there as a school construction project that should have taken one year and it was over two years late. Contractors are not motivated to move ahead and get the work done so that the holdback can be released and paid to subcontractors.

The OHA noted that it would be helpful to have a degree of flexibility. The principle to keep in mind is that the projects are for the public good and are paid from the public purse. It is important that they proceed in a timely, efficient way at a cost that is reasonable to the public at large. This is a key point from a public owner's perspective.

Holdback and Trust Accounts

According to OASBO/OPSBA The provision in Bill 69 regarding approval of payment applications within 10 days does not make sense. Payment timing should be left open.

With respect to the payment of the lien holdback, it could be the same as the contract (e.g. if there is a 40 day period in contract, the holdback would also be paid on the same terms). It could be linked to a time agreed to by the parties.

The Review explained another issue of importance to stakeholders being Ontario case law developing over the last few years which has resulted in circumstances where the general contractor has become insolvent and the holdback goes to the receiver or trustee in bankruptcy rather than the lien/trust claimants. This is founded on the argument that the *Bankruptcy and Insolvency Act* ("BIA") is federal legislation which takes constitutional primacy in circumstances where provincial legislation is inconsistent with the BIA.

Under Part II of the Act, all money is deemed to be trust funds. If the trust is enforceable, it does not form part of the estate and it flows down to the trades. Ontario cases that have taken money away from the trades found that there was no certainty of subject matter, which is a necessary precondition of a trust, because there is actually no segregated fund which can be pointed to. There is a recent decision of the Alberta Court of Appeal which disagrees with this argument. There is also a recent case where one of the major banks is attempting to broaden this proposition.

There has been a strong reaction in the construction industry to this issue and a number of stakeholders have recommended the creation of a segregated project trust account into which holdback would be paid incrementally. The account would be administered by the owner and general contractor and payable to the trades once the 45 day period expires and no liens are preserved. This is a hot issue in the industry nationally. There is a concern that the policy objective of protecting those providing goods and services will be undermined by the BIA. The core policy of the Act is to protect the holdback for the benefit of the subcontractors. If the bank takes this fund, this is not consistent with the objectives of the Act.

OASBO/OPSBA indicated that owners may not want a joint account with the general contractor because of the potential problems in managing it. The owners would lose flexibility in managing the account, especially with the right to set-off. The general contractor may not support the right to set-off. In 1997, British Columbia adopted the project trust account approach and it appears to be working. The legislation says an owner must establish an account and pay into it. The owner administers the account with the contractor from whom the holdback is retained. The holdback must not be paid out without the agreement of all parties.

It has been suggested that set-off be addressed by requiring the owner to give notice of the intention to set-off on a reasonable timeline before the 45th day so that trades know the intention of the owner and they can place a lien on the property. The fund would still be maintained as a fund. People can enforce their rights through the dispute resolution process. Sub trades and general contractors are saying that some owners wait until 45th day has passed and there are no liens before they claim set-off that exceeds the value of the holdback. In this situation, liens are not preserved and the holdback is no longer a holdback.

OASBO/OPSBA suggests that this not be done. OASBO/OPSBA will reach out to counterparts in BC to see how it has worked from the perspective of school boards.

Lienability

OASBO/OPSBA suggests that the definition of “improvement” be amended to add the word “repair”. It is unclear why the word “essential” is included in the definition.

The Review noted that the definition was amended in 2010 following extensive consultation with the industry. It addresses a concern that arose as a result of a case involving equipment.

3. Potential Solutions

‘Pay when Paid’ Provisions

Some stakeholders have suggested that consideration could be given to prohibiting these provisions or making the industry more self-policing. Associations and contractors should have a role in encouraging timely payment. Construction associations could consider establishing a discipline function in their associations with respect to payment.

OASBO/OPSBA explained that other jurisdictions have a prompt payment code where the signatories commit to paying within a defined time period. Only members of this system are eligible for government contracts and members must adhere to a code of conduct to maintain membership. It has created a shift in the payment culture through the process and payments are made within 12 days. We may need a change in culture rather than legislation. For example, OASBO/OPSBA explained there are ways to get around the statutory declaration.

OASBO/OPSBA suggested that the Review consider punitive legislation to impose strict penalties, fines or jail time for those that do not handle funds properly.

Preservation period

According to OASBO/OPSBA, sometimes 45 days is too short for subcontractors to register a lien. There is a 40 day payment cycle for school board progress draws. By the time subcontractors see it, they are outside the 40 day period. The implication is that subcontractors would not get funds paid back earlier, but it would help preserve their rights.

Unsatisfactory Performance/Bidder Exclusion

According to OASBO/OPSBA, in Ireland there is a certificate of unsatisfactory performance which precludes contractors from bidding on work within one year. Unsatisfactory performance would need to be clearly defined. It could be problematic if a large contractor gets on the list. It should be imposed fairly. If a school board releases a list, it should not affect other school boards.

Stakeholders have said that some public entities exclude contractors from bidding if they have sued. Some no longer do this. There is an argument that this impairs the right of access to justice. Contractors are afraid of getting blacklisted so they do not pursue disputes. Some owners want to continue to use this tool.

OASBO/OPSBA and COU noted that this is really a procurement issue, as it is part of the vendor management process. As a front end issue, it should not be part of the Review.

The mandate of the Review is to consider any issue related to promptness of payment and efficiency of dispute resolution. The idea has emerged that the Act should become the ‘Construction Act’ and address broader construction issues.

Dispute Resolution

Some stakeholders are in favour of mandatory mediation, and many are in favour of adjudication. There has been a lot of criticism and frustration expressed in relation to the judicial system and the way that it attempts to engage with the “gridlock” aspect of prompt payment. People have said that it is not acceptable to have payment stop and the rights of parties sorted out five years later. The time and cost of lawyers and consultants to resolve issues is significant. There is also the cost of the owner’s time.

OASBO/OPSBA has not been involved in adjudication. It has experienced mediation and found it to be a difficult process. The Stakeholder Group felt there should not be mandatory mediation. There are dispute resolution mechanisms (e.g. mediation and arbitration) in the CCDC process. There must be two willing parties because it will not be meaningful if parties are only doing it out of obligation. Mediation is the best mechanism to resolve disputes only if the parties are willing.

The Review explained that the track record in generating settlements has been effective in the legal industry generally, but has not moved into construction context. A review of case commentary and secondary sources would reflect unanimity around the value of mediation when people are motivated to get a resolution. The experience with other types of mediation in the legal context is that settlement rates are very high. From that perspective, the Stakeholder Group would support it.

OASBO/OPSBA also felt that a dispute resolution board is also a good idea. There could be a mediator role but also the authority to make determinations on disputes. They are not used much in Canada.

Adjudication

Adjudication has become one of the major issues of the review. The Review flagged this issue and discussed it in the information package. To date, there is a view amongst the stakeholders that the Review has met with that there is a very significant value in seriously considering the adoption of this mode of dispute resolution to address the "gridlock" situation.

OASBO/OPSBA was not familiar with this system and thus did not have an opinion on it to date. They agreed to consider it.

Mandatory Certification of Substantial Performance

OASBO/OPSBA felt that the existing 10 percent holdback was reasonable. If it was a higher amount, it would be a challenge.

With respect to the certificate of substantial performance, if owners are looking at putting in other obligations, they can do that in the contract. It has been suggested that it include the title description, contract value and other details to make it easier to register a lien. OASBO/OPSBA suggested setting out the holdback that is being retained. The Section 39 request for information is cumbersome and there is a lack of clarity on what is to be provided.

With respect to preservation and a mandatory certificate of substantial performance, there was concern in OASBO/OPSBA as to how the know an owner would what contract terms were. OASBO/OPSBA suggested that this could become a challenge even with the payment certifier. There is often an interest on the part of the payment certifier in releasing holdback earlier than it should be to get things moving. The payment certifier has the responsibility for certifying, but there can be a discussion about whether deliverables are provided. The payment certifier may just say to release the holdback. This creates a challenge if there is a mandatory certification.

There is a recognition in the stakeholder community that this cannot apply to all sub trades. The example that is given is the excavator. If it is made available to all sub trades, stakeholders have suggested that it would erode the holdback such that the collateralization objective would not be realized.

Surety Bonds and Default Insurance

According to OASBO/OPSBA, there is a challenge for owners in calling on bonds with respect to contractors who do not perform. There are often further delays that drag things out. Owners cannot rely on the bond to get work completed unless there is a bankruptcy. Owners may be more hesitant in releasing funds because of inability of the bond to cover things if there is a problem. Letters of credit may be more acceptable than a performance bond. However, they are difficult to obtain. This issue impacts on payment.

Consideration could be given to default insurance as another way to ensure security for all parties on the project. One suggestion is that bond disputes could also be subject to adjudication. The OASBO/OPSBA supports this.

OASBO/OPSBA does not support the idea of making payments by owners directly to sub-contractors because owners do not know all the terms of the contract, or what work has been done. Unless the general contractor agrees that the excavator has completed the work and should be paid and the owner agrees, they should not make payment directly to the subcontractor. The reason this is an issue relates to the general contractor insolvency issue. There is some case law that supports the notion that the owner can make payments directly to subcontractor. The OASBO/OPSBA did not want to get into that situation unless there were black and white issues, but would consider an ability to make directives to the GC in regard to the subs.

4. General Comments

OASBO/OPSBA asked why certificates need to be posted through the Daily Commercial News, rather than online. The contractor could just post it on a website. The options are a private provider or government.

In terms of the delivery of documents, OASBO/OPSBA suggested that the Review should consider electronic document transfer.

With respect to the owner's financing information, this is generally removed from agreements because contractors do not need to know about financing for a school project. It was noted that contractors have said they sometimes bid on a school project and the budget money is not there, but they are required to hold their price for an extended amount of time. OASBO/OPSBA indicated that when contractors bid, they would know that there is a certain period and they should not bid if they do not agree with this. The alternative is to account for this risk in their price. School boards need approval from the Ministry of Education to go to tender. They are also required to go back for approval to award the tender. School boards have no interest in holding back money and will try to make early payment in many cases.