Construction Lien Act Review Consultation Meeting Summary
Prompt Payment Ontario

October 27, 2015 (9:00 a.m. to 1:00 p.m.)

Attendees:

Sharon Skivsky, Geza Banfai, Michael Mazzuca, Dan Leduc, Ron Johnson, John O'Grady, John Galt, Sharon Vogel, Bruce Reynolds, 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

Prompt Payment Ontario

PPO believes that no matter what changes are made to the Act, they will not address the cash flow problem. Prompt payment is a priority. The Act needs work, but the first priority is prompt payment.

When PPO first started with prompt payment years ago, it was viewed as a separate issue because a review of the Act is a lengthy and complex process. This industry cannot wait years to resolve payment issues.

In this meeting, PPO will present the results of its recent trade contractors' survey and the impact of payment delays on workers' pension and benefit plans. A total of 535 trade contractors responded to the survey and there was a good representation across sizes and markets. PPO has a number of residential trade contractor members.

The National Trade Contractors Coalition of Canada ("NTCCC"), who also participated in the meeting, was formed as a national group. Some associations amalgamated under NTCCC and the common issue is prompt payment. NTCCC is seeking to get prompt payment addressed at the federal level. They are very encouraged and optimistic about the prospects of this. The trade groups are all participating at the provincial levels on this issue.

1. Trade Contractor Survey

The survey PPO presented was administered by Ipsos Reid, one of the largest survey firms in Canada. It was designed by PPO with the advice and consultation of Ipsos Reid. The questions were refined as necessary to ensure that PPO would get meaningful responses from the respondents. It was also tested to ensure that respondents understood the questions.

The survey drew responses through two channels – 272 responses through telephone interviews and 263 online. There were a total of 535 responses, which is a very good response. There was a good distribution across size and type across the sector, including payers. The institutional and commercial sector represented 52 to 79 percent of responses and low-rise residential represented 42 percent. This speaks to the confidence that one can attribute to the survey results. The results are accurate 19 times out of 20 within +/- 5.9 percent. Most of the responses are decisive and the 5.9 percent was not relevant.

Payment practices in the industry

PPO wanted to measure the prevalence, severity and consequences of late payment. The questions were framed in a couple of ways to obtain indicators.

a) <u>Average Age of Current Receivables</u>

This is the most conservative indicator of late payment. Some fraction of invoices issued would turn out to be subject to late payment.

The average age of current receivables is 61.3 days. The median is 60 days. The average is heavily influenced by an outlier, whereas the median is not. The median is a better indicator than the average. Statistics Canada data for other industries have lower averages, so the construction industry stands out.

b) <u>Invoices Outstanding for More Than 30 days.</u>

The second finding is that 1 in 5 contractors (18.7%) are carrying current receivables with an average age of 90 days or more. 24.7 percent of contractors reported that late payment forced their company to face a threat of insolvency.

The survey also asked about invoices outstanding for more than 30 days. Two thirds were also outstanding for more than 45 days. This is significant when it comes to the Act.

Risk and probability falls into two categories:

(1) reasonable risk which is subject to probability analysis (assurance)

(2) ‘tail risk’, which is phenomena that simply occur and are not subject to probability analysis. It is the category of invoices where a trade contractor does not know when or if they will be paid. The problem in the construction

industry is that late payment over 90 days is tail risk. Contractors cannot anticipate or plan for tail risk. If it is a small amount of invoices, the contractor could deal with it. In the industry, the risk is substantial and far too high. The contractor may know that some fraction of their invoices will be subject to significant delay, but they do not know how long the delay will be.

PPO explained that after 90 days, banks stop counting it as a receivable. It is a claim and it gets written off. Banks do not acknowledge what a holdback receivable is. There is pressure to write it down. It would be difficult to get a judicial determination of rights in 90 days.

There are particular types of payment situations that can become elongated (e.g. change order disputes). Invoices in respect to change orders are generally not issued until the dispute has been resolved. There may be delay on the main contract because of a dispute on another aspect of the project.

There are two distinct issues according to PPO: the first is how late payment has affected the average age of receivables. This is a financing problem where the finance burden has been shifted. The second, and more serious, problem is the number of receivables that have been outstanding for a long period of time. This is not as tractable to a financial management strategy because contractors do not know what kind of reserve they need.

The delays where there is uncertainty about when and if payment will be made represent a different problem than the stretching out of the payment of invoices. Some stakeholders have suggested that imposing mandatory interest may address the financing problem.

PPO explained that almost one quarter of trade contractors report that they had to lay off workers because of delayed payment. Some declined to pursue work, avoided investing in machinery, and added a contingency factor to bids.

By way of example, PPO said that there are contracts in the residential sector where the trade agrees to a 180 day payment term. In terms of the survey, this would be considered late but in business terms it may be consistent with the contract.

c) <u>Cascading Effects of Payment Delay</u>

PPO noted that five percent of respondents in the survey had indicated that they were forced to delay hourly payroll. 11.6 per cent were forced to delay salary payroll. This resulted in delayed remittances to employee benefit funds, source deductions, bank payments, leases on equipment, and payments to subcontractors and suppliers. This is attributable to the pyramid structure according to PPO.

The conclusion from survey evidence is that payment delay is embedded and pervasive. In the public sector, there is bureaucratic delay. In the private sector, there are financing problems or undisclosed delay. Disputes are also a contributor to late payment. The undisclosed reasons for delay are a key factor. Other factors include the bureaucratic process around payment, financing issues, and disputes.

d) Experience with the Lien System

PPO explained that more than three quarters of the respondents say they use the lien system never or rarely. The perceptions are overwhelmingly negative, as is their experience with the system.

On average, PPO said that the survey showed that trade contractors receive 61.5 cents on the dollar. The median cost for registering a lien is $15,000. The longest period to receive satisfaction from a claim is three years or more.

PPO said that large contractors have a greater the propensity to use the lien system. Small trade contractors use it much less (see page 12 of the Trade Contractor Survey Report). PPO explained that there is a greater burden on smaller contractors. In addition, the capacity to wait the system out for resolution is greater for larger contractors than smaller ones. Smaller contractors are likely to settle for a lower payout. Some small contractors are worried about being blackballed so they do not want to lien anything. This is a problem in the residential sector according to PPO.

There is a perception problem with the Act (according to PPO's members) that may take years to improve, amongst industry stakeholders.

e) Experience with Receiving Holdback Money

PPO explained that 18% of trade contractors reported that, on average, they receive monies within 45 days. The earliest was 55 days for those who get it after 45 days. There is an administrative period of time to facilitate payment. Half of contractors reported waiting 90 days or longer, very often or always, to receive holdback. This is when there are no deficiency claims in PPO's view.

On the release of holdback issue, the Review has heard several suggestions from stakeholders to consider amending the Act to allow for project holdback trust accounts. The Review has also heard some stakeholders suggest requiring the owner to provide a notice of intention to set-off by a certain date so that the general contractor and trades would know in advance whether owner would claim a set-off.

f) Prevailing Contractual Terms

In the survey, very few trade contractors reported using unaltered CCDC. Many respondents suggested publishing the CCDC in an editable pdf form due to the tendency for them to change. PPO discussed this issue internally and suggested, however that it should be left in the current format because people are familiar with it and can change it on a case-by-case basis.

The majority of respondents say that contracts do not include a right to stop work provision. There may be a right to suspend work but it is initiated by the owner to the general contractor and the general contractor to the subcontractor.

42 percent of the respondents say that disputes over change orders often lead to payment delays. There must be some dispute resolution method.

PPO explained that it is promulgating a holistic treatment of the issue with three components: a prompt payment scheme, revisions to Act, and adjudication. The main takeaway for today is that, from PPO's perspective, this holistic approach is the only one that will solve the problems described with the survey results. The rights in the Act are security for payment. There is nothing in the Act that mandates payment and no obligation to actually pay the holdback.

2. Prompt Payment

In 2011, the NTCCC took the initiative to introduce prompt payment legislation in Ontario. The NTCCC and OGCA created working groups with a good representation from both groups. After 18 months of working together to develop a consensus draft, the trades and general contractors reached an agreement on the terms of a draft document. The group discussed the issues raised by the review in the information package and questionnaire but did not deal with milestone payments or Public Private Partnerships (P3s).

NTCCC explained that the essence of the document was the obligation to pay in 30 days, the right to extend or terminate work, and expanded rights to information about the receipt of monies upstream. There was a right to set-off, but only with written notice and limited to the reasonable value of the amount in issue. The amount not in dispute was required to flow. There was a limited overhead amount tied to this. The deficiencies had to be identified so the trades could address them.

PPO suggests that the Review team consider the consensus draft, instead of Bill 69, because it was a more thoughtful document with input from a lot of people. PPO explained that it is not perfect and not complete, but it is a good starting point for provisions dealing with prompt payment.

According to NTCCC, the NTCCC and OGCA envisioned consulting with the construction community, if only to confirm that a prompt payment regime could work within a P3 regime. At the top of the chain you have one or two payments, but throughout the process you have monthly or milestone payments.

The NTCCC has considered the issue of milestones and determined that there are some broad, overarching principles that should apply. The prompt payment regime should cover milestones, they should not be excluded. Milestone payments from a general contractor to downstream should only be permissible if the general contractor gets a milestone payment. It would then flow down to the trades. PPO does not want a system where the owner pays 30 days to the general contractor but the general contractor imposes a milestone downstream.

The situation gets complicated if an owner imposes a milestone on the general contractor. PPO is aware of the issue and would need to think about it collectively. In the tendering process it could be identified upfront that trade contractor is bidding on a milestone regime. Some members will not bid if it is based on milestones. The flow of information is important. According to PPO, the cultural problem is that P3s are a very small part of the industry.

Large projects may be phased, and are based on milestone payments. Other stakeholders are suggesting that a 30 day payment regime does not work because payment is not flowing down the chain on that schedule. It varies from project to project. It is difficult to define major projects and figure out what you do and how you address payment issues.

If the rules are clear going in, there may be people who do not bid because of the cost. It does not address the culture we have today. The status quo from every level of construction was deemed unacceptable. There could be scenarios that do not work for the standard project. P3s are not the bread and butter for members of PPO and the NTCCC.

If trade contractors are given a defined scope of work and a schedule, they can work within this model. It comes down to an assessment of risk. The financial risk would be different if there are not sufficient milestones to allow for reasonable flow of funds. A trade contractor who wants to do this work can decide not to bid for financial reasons or they can price the risk. The risk they cannot price is the tail risk because the timelines are imponderable.

This is an elongation of the CCDC model of payment on a percentage of completion. The NTCCC encourages its members not to take these contracts but some will if they are desperate.

PPO explained that if there are other models, eventually owners and general contractors will structure their contracts to accommodate for those models to avoid prompt payment. Contracts that allow for milestone payments should be subject to prompt payment. If the trade contractor is doing the same work, it should be on a 30 day payment cycle. Milestones can be divided accordingly to bring project within the prompt payment requirements. If owner has to meet prompt payment requirements, everyone has to comply. There could be one phase broken down into 20 payments.

With P3s, Ontario attracts offshore investment and equity and we have a well-established set of template documents for P3 projects. One obstacle to PPO's proposal is that it would require international investors to do things differently in a way that has the effect of requiring them to push more money out sooner in the process. There is a tension between the interest of debt and equity and interests of the trade contractor.

PPO noted that the reward may be more competitive financing. There would likely be a low impact because if the money is drawn down sooner, the interest would also be paid sooner. From a trade contractor's perspective, if there is a defined scope of work and a schedule, they can bid competitively.

P3s are public sector projects, so the public will pay regardless. An efficient market will put financing costs on the party that can get it at the lowest rate. Currently, financing costs are offloaded on parties that are least able to bear the cost. There was a time when the general contractor had a lot of people on the job. Today, the general contractor subcontracts everything and those least able to sustain cost are expected to do so.

There was agreement that prompt payment can be viewed from two perspectives:

1. Ordinary course with an elongated payment cycle. The objective of PPO is to shorten the payment period and not allow it to elongate.

2. "Gridlock" where there is a major dispute on a project.

NTCCC is working with the Canadian Construction Association to do a national change order process in order to develop an acceptable process.

3. Impact of Delayed Payment on Construction Workers

PPO discussed the negative consequences of the payment system on those at the bottom of the pyramid.

The survey indicates that 13.6 percent of contractors are forced to delay remittances to employee plans. This seems low with respect to the extent of delinquencies PPO has seen in dealing with these funds.

Benefits for construction workers are different because they rarely work for one employer for their entire career. If they had to rely on one employer, the system would not work. We have a system of multi-employer plans. Construction workers will maintain eligibility in plans offered through employer associations and trade unions throughout their career as long as they work for employers that are bound by the collective agreement.

The plans are co-sponsored by contractor associations and trade unions and are administered by joint board trustees. They are funded pursuant to contributions made under collective agreements. The typical collective agreement obligates the employer to remit to benefit plans a certain amount per hour. Eligibility for benefits is dependent on the contributions actually coming in. Trustees have a fiduciary duty to act in best interest of all plan members, one of which is to make sure the money comes in.

The agreements contain explicit provisions about payment. It may be due on a certain day of the month. There is no ability for employers to delay the payment because it is part of the salary package. If contributions are late or not made, there are negative consequences to the members, their families and the contractors. There is a bit of a prorogation aspect, but most of the consequences are borne by members.

There are two varieties of pension plans – defined benefit and defined contribution. Defined benefit is referred to as flat benefit where members earn an amount per hour of work for contributions coming in. They earn a monthly benefit equal to 1.2 percent of employer contributions made on their behalf. The benefit is directly linked to the contributions. If the contributions come in late, the plan may not accept it or approve the benefits. The plan is funded on the assumption that contributions will come in when they are due. When they come in when due, they are invested and the plan makes money. If money doesn't come in, the plan cannot earn interest income.

Defined benefit plans are now termed "target benefit plans". In the construction industry these benefits are not guaranteed. The actuaries develop assumptions of what the plan needs to earn over the long term in order to provide the benefits. If the assumptions turn out to be incorrect, the benefits can be reduced. Members can suffer a real loss going forward and on accrued (earned) benefits.

Defined contribution plans work like RRSPs. The employer must remit a certain amount per hour and the money goes into the worker's defined contribution account. Whatever amount the worker is able to earn during their career is what they have when they retire. Retirement benefits are based on contributions. If contributions are late, the member does not receive income.

Health and welfare plans provide benefits such as prescription drugs, dental, vision, life insurance and disability benefits. Eligibility for these benefits is almost entirely based on contributions that have come in. They typically work on a dollar bank system which is credited to the workers bank. The worker must have a certain amount in their bank to be eligible. Employers must remit contributions for a certain amount of hours. Once they become eligible for benefits, continued eligibility depends on a certain amount of hours. PPO explained that if bank goes below a certain amount of hours, the worker loses eligibility. This happens in the construction industry because of the cyclical nature of employment and because contributions are not being made.

The employee receives a paystub showing deductions and assumes that he or she is earning pension and benefits, but this may not be the case. Wages will be paid because the consequences are immediate, but the consequences to benefit plans may be delayed. If the employee has fallen out of benefit and become injured or ill, they could be ineligible for disability benefits. There would be a bigger outcry if every employee knew the minute the contribution was not made. The pension calculation may be lower than anticipated when they reach the age of 65.

Because the obligation of the collective agreement is not a pay when paid, the employer’s failure to pay is a failure to meet obligation. The trustee must ensure that the money comes in when it is contractually due. There are legal costs for employers and also interest. Grievances are filed and heard by the Ontario Labour Relations Board and costs are ultimately borne by the plans. The plans are forced into situations of spending funds to recover the money. This is loss of funds that are no longer available for members for benefits. There are employers that are habitually 60 to 90 days late.

A worker for a trade contractor under a collective agreement where the trade contractor underbids on a contract would be paid less. This is a risk to members of the union that are outside of the prompt payment context. In this situation, the trade contractor would eventually go bankrupt. If the trade contractor were obligated to pay every 30 days, the effect would be to channel more money down more quickly, which would go to the plans. Delayed payments have a real demonstrable effect to people at the bottom of the period. There are significant costs to plans for collection.

4. Proposed Amendments to the Act

The “gridlock” issue discussed earlier is in relation to security for payment and resolving disputes. The industry is predicated almost exclusively on cash flow and needs legislation around this. PPO proposed the following amendments to the Act:

Segregated Holdback Trust Account

PPO suggested that the holdback could be deposited 30 days after publication. According to PPO, there would be pushback from owners if the suggestion was to draw down monthly on mortgage financing. The key is communicating information down to the beneficiary of the holdback. If the holdback is not in the account, then the trade can file a lien. This provides some certainty.

Mandatory Certificate of Substantial Performance on Projects over $250,000

PPO explained that the administrative expense of this type of certification would not be too high. The owner or contractor could publish it. The certificate of substantial performance should include names of the parties, information about the bond, etc.

Some stakeholders had suggested using Section 39 to get at the required disclosure. PPO explained that Section 39 is a great tool but if you can challenge it in court, it is not very useful. Trade contractors would want to find out how much money is in the holdback account and get a general sense of the total contract amount. It could be published as part of the certificate of substantial performance.

Mandatory Certificate of Subcontracts under Section 33

This is the weakest part of the legislation. If you make it mandatory, it is money that has to be paid anyway. Section 33 does not work. It should be mandatory for all subcontracts. PPO will discuss this further in its written submissions.

PPO stated that fee simple owner should be added as an owner under Act as well. This should be the person who is listed under the *Land Titles Act*.

According to PPO, this is also tied to low-rise residential projects. The definition of homebuyer should be removed from the Act because it takes away the leveraged asset for the purpose of the Act for that contractor. The Review noted that this is a policy decision because the Act protects homeowners in a way that it does not protect other owners. Homeowners are a very significant constituency of consumers who benefit from this protection. It has been suggested by some stakeholders that the Review should consider recommending that home renovations be completely excluded.

If the definition is removed, homeowners would be exposed. The money would be held back on closing from the developer and they must verify that there are no liens. PPO stated that developers should be required to indemnify the homeowner.

Leasehold interest

PPO raised concern about how a trade contractor could lien when you have a tenant inducement (i.e. a leasehold improvement). There could be a further definition that identifies tenant inducements as trust funds. They are funds being used for construction purposes.

If the lease is not registered on title, the lien attaches to the fee simple interest. This gives the lien claimant a charge against the holdback. Currently, PPO's view is that people do not comply with sections 18 and 19 of the Act.

Dispute Resolution

Outside of Ottawa and Toronto, where you can't get a master, there is no real mandated process for dispute resolution in terms of the court system. With respect to section 58 of the Act, PPO suggested that the judge should be a case management judge in jurisdictions that do not have masters. The parties could set the matter down for trial and milestones could be set by the court. The Act could provide for masters and/or judges for lien matters. If this amendment is made, you can remove section 60 because no one in Toronto uses it and it is unnecessary where there is case management.

It has been suggested that outside of Toronto and Ottawa that it takes two weeks to post a lien bond. This is a prompt payment problem. There is only one full time construction master in Toronto. It is better to have a sensible approach that is more consistent.

Holdback and Lien Period

PPO suggested that the 45 day period should remain the same if there are prompt payment provisions. Otherwise, consideration of 60 days should be considered. If there are mandatory 30 day payments, then lien rights do not need to be extended.

According to PPO, the issue to consider is that if you leave the 45 days as is, you cannot require general contractor to pay in 30 days relative to the holdback. You either have lien rights or payment, but you do not have both. The issue is whether to allow trade contractors a longer period to preserve their lien. The concern is whether this will affect the payment cycle.

PPO explained that with prompt payment in place, there should not be a list of deficiencies at the end of the project because they should be addressed throughout the project.

Some contractor stakeholders have advocated that holdbacks should not be used as set-off for deficiencies. If you have a fully funded holdback account which is a trust account and you get a notice of set-off, the trades can lien and invoke adjudication.

5. Trust Provisions

Part II of the Act identifies the what, how, and why but not the when. It does not say *when* you have to discharge your fiduciary obligation. Independent of the contract, there is a trust obligation.

PPO suggested wording in Part II which provides that trust funds must be paid immediately upon receipt. If payment does not happen immediately, it is deemed to be a breach of trust. If the beneficiary is not paid there is a breach of trust because it is tied to the trust obligations. If the owner wants set-off, it must be put into a segregated account. An issue to consider is that the contract will define when payments become due and owing.

PPO also suggested the removal of subsection 50(2), which does not permit joinder of trust and lien claims.

6. Lienability

PPO suggests permitting the contracted amount of interest to form part of the lien amount. If there is no contracted amount of interest, parties could defer to the *Interest Act*.

For publicly funded projects, PPO suggested that the Review consider mandating a two-tier bond as is done with federal projects. In the event of insolvency, you may have more than your holdback. All public contractors should be bonded, subject to a threshold. Lower amounts would not require a bond.

7. Adjudicated Dispute Resolution

PPO strongly endorses adjudication.

In terms of the mechanics, PPO explained that it will have to be worked through. There are adjudication regimes in the United Kingdom and Australia. The basic principles are easy to articulate. Everyone should be able to obtain adjudication in a wide range of disputes (e.g. payment, change order, bond claims, etc.). PPO will consider whether non-monetary claims should be included.

8. Low Rise Sector

PPO suggested that there should be a general lien, rather than liening on a lot-by-lot basis. This way you do not lose the ability to lien as each asset is sold.

According to PPO, in the residential sector they use a system of acknowledgements rather than a certificate of substantial performance. They have a different system of payments and identifying deficiencies.

9. Surety Bonds

PPO suggested that surety bonds could be made mandatory and that the market would take care of any other issues.

A related issue is linking surety bond enforcement to adjudication. There is a concern that you would be in breach of contract if you terminated or suspended the work.

10. Bidder Exclusion Clauses

PPO is not in favour of bidder exclusion clauses.