**_Construction Lien Act_ Review Consultation Meeting Summary**
**Ontario Bar Association - Construction and Infrastructure Section**

**October 22, 2015 (9:00 a.m. to 1:00 p.m.)**

**Attendees:**

Ted Betts, Yonni Fushman, Brendan Bowles, Todd Robinson, Howard Krupat, Ted Rotenberg, Joseph Cosentino, Karen Groulx, Richard Wong

Bruce Reynolds, Sharon Vogel, James Little, Soizic Reynal de St. Michel

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**

*OBA Construction and Infrastructure Section Committee* (the "OBA Section Committee")

The OBA Section Committee representatives outlined its process in approaching the issue. In 2014 the OBA Construction and Infrastructure section reviewed Bill 69, *Prompt Payment Act, 2013* ("Bill 69") and made submissions at that time. When the Review was announced, the OBA Section Committee was created and began by reviewing the entire Act. Subcommittees were created and tasked with preparing reports to the OBA Section Committee on various issues.

The OBA Section Committee applied the following three considerations to its review of the issues:

1. Issues that involve a large number of the membership;

2. Smaller issues where the Act can have an adverse impact on individual people or companies; and

3. Issues that are technical in nature and may not be raised by non-legal industry experts.

The OBA Section Committee does not have a homogenous position on all issues. There are a lot of diverse positions and its members represent a variety of industry participants. Its mandate is to be of assistance to the Review and put forward positions that are in the interest of the public or its members. While this mutes some of the strength of the recommendations, it still provides clear direction on potential legislative reform.

The OBA Section Committee's written submission recently received unanimous approval from the Construction and Infrastructure Section Executive, and approval from the OBA Bankruptcy and Insolvency Section with respect to trusts and holdbacks.

This meeting provides an opportunity to respond to questions, discuss the research in more detail, and provide assistance to the Review. The three main issues for discussion are prompt payment, public-private partnerships (P3s), and trusts.

## 1. Prompt Payment

The prompt payment subcommittee identified nine areas for consideration: eight are substantial and one is general. The biggest issue is identifying the affected parties and who a prompt payment regime should apply to. There was significant opposition to Bill 69 from owners. In the United States, many states have prompt payment legislation that only applies to contractors.

The most difficult and important part of assessing prompt payment is making sure that whatever scheme is proposed balances all affected parties. For example, what happens to bond claims if a prompt payment default happens?

Bill 69 was a good first attempt at trying to create a scheme but only focused on contractors and subcontractors without considering owners and other key participants.

The prompt payment issue was the issue that generated the Review. It does not exist in a vacuum and must be considered in the context of the Act. The heart of these issues is the contract, which binds everything together.

The Review explained that the issue of prompt payment may be viewed as falling into two separate categories:

1. Prompt payment in the ordinary course of business, in respect of which there is a concern that the payment process has been elongated over time.

2. Where the prompt payment stream becomes "gridlocked" because a major issue has emerged in the life of the project.

The distinction between these two categories seems to be accepted in the industry. The methods to address these separate issues are different. In the first category, there are ideas in the Information Package and the OBA Section Committee submission which would facilitate the flow of funds (e.g. mandatory certification of projects, phased substantial completion, and reducing the holdback amount). These methods go to the issue of the flow of funds and would not necessarily require a Bill 69 approach. The second category relates to dispute resolution. The issues are linked because what happens in the first category affects the second.

*Potential Exclusions from a Prompt Payment Scheme*

There was some discussion about whether owners should be excluded from an Ontario prompt payment regime, similar to what is done in other jurisdictions. There was no

consensus on this issue but it was suggested to the Review that prompt payment is generally a problem involving general contractors and subcontractors.

A prompt payment scheme may work if there are appropriate exceptions. There may be exclusions for certain types of projects or exceptions for when prompt payment may not be required. Prompt payment affects set-off rights and owner clients may refuse to pay down if there are set-off claims.

The OBA Section Committee suggested that consideration be given to excluding P3s, large and complex projects, and home renovation projects should be excluded from prompt payment. It was noted that in Illinois, contracts under $20,000 are excluded from prompt payment.

*Monetary or Project Thresholds*

The OBA Section Committee suggested that consideration could be given to establishing monetary thresholds based on the amount of the claim. Claims under $25,000 could go to small claims court. Matters under $25,000 can be very costly to litigate. The small claims court does not have jurisdiction to hear a lien action and parties are often forced into expensive legal procedures. Linking these claims to the small claims court would make sense.

*Adjudication*

The OBA explained that there are situations where an owner's set-off claim is legitimate. There are also cases where there are exaggerated set-off claims. Other jurisdictions have adopted an adjudication approach to address this. It is a very important and sensitive issue because set-offs can be valid or invalid.

The OBA suggested that the Review should consider adjudication because if there is a requirement to advance a set-off claim promptly and in a meaningful way, it will reduce the number of invalid claims. If owners have to prove the right not to pay, they will be mindful of the fact that if they are not reasonable, an adjudicator may find against them. It forces them to get serious about real damages. They cannot just refuse to pay the contractors and force them to work without getting paid. There could be a default period of time to advance a set-off claim and also the ability to go to court.

Most of the time the issue would be clear and it could be addressed in the 28 days. In others, it could be more complex and require experts to determine the reasons for the delay. It should not be a one-size fits all approach. There may be situation where an owner claims a right of set-off but damages are not crystallized. Owners are reluctant to release funds and then try to recover them. If the 28 days were able to be extended, it may become a routine process. There should be clarity around which projects are included, what the exceptions are, and when parties need to go to court.

The Review discussed the United Kingdom adjudication model. The OBA Section Committee expressed the view that there is a gap in the dispute resolution process which adjudication seems to fill but if that is something that is recommended, the

Review would need to think very carefully about the interrelation between lien remedy and the adjudication process and the ripple effect within the lien mode of securitization.

The OBA Section Committee suggested that the process would also need the support of all stakeholders, including government to provide resources and infrastructure. The government could establish, through regulation, a method for qualifying and licensing adjudicators. Ideally, the parties would choose the adjudicator or have one imposed. Engineers, architects, lawyers and other professionals could qualify as adjudicators. Government assistance would be needed to help set up an adjudication system.

*Payment Terms and Freedom of Contract*

The OBA Section Committee is very familiar with the issues related to the imposition of payment terms. In most cases, a monthly invoice and payment works well. When dealing with different types of projects, this breaks down very quickly as a workable solution (e.g. milestones or phased projects). A number of experts may be required to determine if work can be certified and this can run longer than 30 days because of the complexity. A statutory obligation would add some rigour and discipline for some projects.

Functionally, imposing payment terms may not work for all projects. In complex projects, a lot of information goes into the invoice and this takes time to prepare. For example, there may be five people providing input to the invoice. Owners would not have the time to properly review invoices and would be forced to just make a payment. Public owners may say that this scheme is unworkable because of internal approval processes.

At the subcontractor level, concerns have been raised about slow payments. The OBA Section Committee noted that government has been releasing more funds throughout the project and there is a greater openness to this at the municipal level. If the rules of the game are clear and there is an exception for certain types of projects, parties could assess their own payment risk. Otherwise, the cost would be borne by the people in the middle (general contractor or subcontractor who is one tier down). It would be difficult to distinguish the work done by a subcontractor.

*Interest*

One partial solution to the elongation of payment that has been suggested is legislatively imposed punitive interest. If a party breaches the payment terms they would be obligated to pay interest. This compensates for financing cost but it does not provide money if one does not have financing.

*Early Release of the Holdback*

For smaller companies that are experiencing pressures from financial institutions, releasing the holdback early would help to free up money. The OBA submission discusses creating separate contracts on larger projects to allow for release of holdback. There is a mechanism to do this in the current Act with early certification of completed work (Sections 25 and 33).

On P3 projects, there are complex provisions that try to find ways to comply with the Act. There would need to be a clear distinction in the scope of the work such that the Act would allow for phased components. If there are clear milestones, it could allow for certificates of substantial performance to be provided in relation to phases of the work. There must be some flexibility. The owner and general contractor can agree on phased agreements and release holdbacks accordingly.

Manitoba or Saskatchewan provide for an annual release of holdback, which allows for phasing of the release.

Security for holdback may be another option. There was no agreement among the OBA Section Committee on this issue.

*Contracting Out of a Project Payment Regime*

Bill 69 would have provided for the imposition of a payment structure on every contract. Another option would be to have a prompt payment regime in the Act which could be contracted out of. The effect would be to cause the regime to apply in circumstances where there was no written contract or where the contract does not deal with payment. The OBA Section Committee noted that there could be pushback from subcontractors that they would be forced to sign off on an exemption. This could become a routine practice and undermine the fundamental premise of the Act, which is that one cannot contract out of the Act.

If the Act were no longer the "Construction Lien Act" and deals with different clusters of issues, there could be a more nuanced approach where parties could contract out of certain elements of the Act. It would be very difficult to come up with a one-size fits all approach. There should be an ability to deal with different projects in a different way.

P3 projects can be defined because there is financing and that separates it from other types of projects. The contractor either has to finance or they do not. It can be tricky to define these projects and there should be flexibility in terms of what is included. There are more sophisticated players involved in P3s and we could allow parties to negotiate and have freedom of contract. A monetary amount of $100M could be considered.

In other jurisdictions there are monetary cut offs on the low end and high end. Manitoba has a cut off for the holdback. This is the easier approach in terms of clarity and understanding. However, it may not recognize changes and how a project can evolve over time.

Monetary limits could be linked to the claims regime. One issue is that there is no clear sense of the final amount at the outset of the project. Should there be lien rights at the beginning of the project? Should there be lien rights throughout the whole project?

*Use of Regulations to Provide Greater Flexibility*

Any proposed solution must allow for flexibility. This is why the OBA Section Committee suggests using regulations to make changes over time in terms of which projects are excluded. Regulations may be useful for establishing monetary limits which change

over time, such as the amount of security for posting a lien bond. Regulatory amendments should still involve public consultation.

It was noted that the definition of substantial performance would be hard to change over time, even with a fixed indexing regime.

*United Kingdom Approach to Prompt Payment*

There is an alternative approach in the UK, which is to have government establish an entity for the purpose of promoting prompt payment within the construction community, for example. In the UK, the government has created such an entity and it has gained traction in improving the payment cycle by approaching industry stakeholders and having them subscribe to the objective of speeding up payment processes.

If this has improved the payment cycle, it is worth considering as a potential recommendation as an alternative to recommending that every contract be subject to the legislation.

Government is the largest consumer of construction in the province. It could benefit from this approach, as there are often complaints about government payment processes and delays. It would allow for better education in respect of more complicated payment and project structures. This is particularly important if the new federal government moves forward with its stimulus plan for infrastructure in municipalities.

## 2. P3/Infrastructure

The OBA Section Committee explained that P3s are not consistently complex for everyone in the chain. A lot of projects involve small contractors who are making a very discreet deal. One approach is not to exempt P3s but to provide statutory protection for sub-contractors regardless of the project. The OBA Section Committee's written submission suggests that if there is no sub-subcontract there should not be a requirement to obtain the holdback for the subcontract. The purpose of P3s is to save the government money and the holdback is an inefficient use of funds. The practice in Ontario is not to retain holdbacks in an account. At the end of the project, the government holds that money and they pay it down.

For some P3 projects, there may be multiple sites in different cities and one project agreement. The parties create their own definition of substantial completion and treat them as separate contracts under one project. The project agreement is ignored as a prime contract. Some contracts have referred to substantial performance of different phases. Any disputes that arise are resolved privately. This model requires a lot of due diligence on the part of all parties.

P3s have been challenged in other jurisdictions and can be problematic where there is an insolvency. The OBA Section Committee stated that there should be clear procedures for P3s and other large projects.

It was noted that there was some discussion in the written submission about clarifying the ownership interests exposed in P3 models. The subcommittee found this to be a very complicated issue.

A key concern of government and the committee that last reviewed the Act was to ensure that small contractors are protected. One way to address this while providing enough flexibility for the market to make large projects succeed is to establish monetary thresholds. Most small contractors are likely on standard 30 day payment periods. In theory, P3s should be less of a problem because it is a controlled financing situation. The solution would have to be bifurcated (e.g. big/small contractor).

In a case involving use of bonds, funds were scooped by the lender. Subguard insurance did not provide protection to the sub-subcontractors. Several practitioners made the comment that things happened in the case that no one anticipated.

The Review noted that the OBA Section Committee recommendations are focused on achieving the realization of the objectives of the *Construction Lien Act*, not the *Bankruptcy and Insolvency Act* (BIA).

*What is Crown and what is Private*

One of the technical issues is that P3s are a hybrid of what is considered Crown and what is private. It is unclear to lien claimants what they are securing against because the claim is a registered lien as opposed to a served claim for lien. On a P3 project the lien is secured as a charge against holdbacks, as opposed to registering a lien against the title of the property. One suggestion to address this is to carve out P3 projects and not require claims for lien to be registered. The claim would be a charge against the holdback. The claim for lien would be served in the same manner as other Crown projects.

## 3. General Procedures

The general procedures subcommittee looked at the following areas of the Act that can be improved and made more efficient.

*Mandatory Publishing of the Certificate of Substantial Performance*

There is real value in requiring that certificates of substantial performance be made public. There could be a dollar value where anything above that amount must be published. On larger projects, there is a greater level of sophistication among the parties. There is increasing frustration about the lack of information.

In terms of sanctions for the failure to provide information for certificates, owner should be penalized if they offer an incomplete or insufficient certificate. Architects may push back as they are expressing the wishes of the owner.

*Remove Sheltering Provisions*

The subcommittee did not have a unified view on the advantages and disadvantages of removing the sheltering provisions. It is sometimes used where there is a small lien.

It may be time to consider this issue because of the vagaries of sheltering and the fact that it is rarely used. Clients are not advised to shelter because of the concern about imprecision. If these provisions remain in the Act, there should be a notice requirement and greater specificity.

Sheltering creates uncertainty because you do not know whether a lien is sheltered or not from a review of title. There could be scenarios where sheltering is a huge issue and it can move a lot of money around. The original impetus was that it was a way to deal with smaller claims where legal fees can be expensive. It could have much broader implications.

*Increase in Monetary Amounts*

There are suggestions in the submission that certain monetary values should be increased (e.g. the definition of substantial performance, and vacating a lien by payment into court). The subcommittee took the position that it would not be specific in terms of amounts. The feeling was that these provisions should be considered with a view to updating them to reflect current realities.

*Right to Information*

Parties further up the chain want information and they do not know how to obtain it. There is a need for information and documentation to verify what is being said in the responding letters. The subcommittee did not consider the format. It was thought that providing clear guidelines about what information should be required would remove the ability to provide insufficient information.

The case law is not entirely clear on the state of accounts.

*Cross Examination*

The idea is to limit the time for cross-examination and require parties to go to court to request more time, especially when dealing with large liens. In one case, the right to cross-examination was abused, such that parties were continually added and it became a very lengthy process. The subcommittee felt that there should be a stated limit.

Another form of abuse is when a party serves a notice of cross-examination and the deponent attends but does not provide meaningful information.

There are no rules of civil procedure that apply to cross-examinations at large. There should be some rules of the game for these proceedings. There is no longer an affidavit of verification, so it is no longer a cross-examination on an affidavit. This is an unintended consequence of an amendment to the Act.

## 4. Trust Provisions

The Act provides for two very distinct regimes and remedies. Trusts are a fundamental part of the legislation. It is odd that the Act precludes a trust action from being joined to a lien action.

The OBA Section Committee explained that in a recent case out of Halifax, *Kel-Greg Homes Inc.,* the court addresses the BIA and paramountcy issue in well-written and well-thought out decision. The case involved a statutory trust in that province and other provinces. The issue related to a co-mingled trust account. A bankrupt builder received money deposited pre-bankruptcy and post-bankruptcy. The trustee argued that because the funds were co-mingled they lost their trust character. The court looked at the source of the monies. Most of the money had been deposited ($85,000) and $50,000 of it remained. The source of the money was received the day before the bankruptcy from a purchaser of a new home. The court looked at the *Hallett* case, which stands for the proposition that a trustee may be presumed to spend its own money first before spending money in the trust. The trustee must identify its own funds. The $50,000 was excluded from the property of the bankrupt because of the presumption that could not be rebutted. The same principle was used for post-bankruptcy funds. The decision goes through the history of bankruptcy cases and cases involving the interplay between construction lien statutes across the country. It refers to a 2005 Ontario Court of Appeal decision where the court found that co-mingling of trust funds is not fatal. When monies can be traced, you have certainty of trust.

The OBA Section Committee written submission also refers to an article entitled *"Managing Trust Funds: The New York Model*" by Duncan Glaholt. This article and the *Kel-Greg* case highlight the issues that arise out of trust provisions, including the personal liability of the principal of owner when they breach the trust even unintentionally. Provisions in New York law require a trustee to hold funds as a fiduciary for the beneficiary and sets out the rules for separate trust accounts. It requires an accounting of the funds that have been received.

*Mandatory Project Bank Accounts*

Mandatory project bank accounts are a good idea because of the hardships involved in major insolvencies. An issue for further consideration is how far security should go. Even with the holdback, if there are no liens the money goes to set-off and the security is lost.

There is a line of cases which say that if a trustee intends to assert a set-off against trust funds, they should segregate funds. When you look at the idea of separate accounts and add a requirement for notification for intention to set off, there may be synchronicity. The holdback either flows out in the ordinary course or, in the case of notice of intention to set-off, the money remains in the project account after the liens go on. The liens have been preserved and the money in the trust account is safer in terms of a potential BIA constitutional argument.

The written submission suggests that the trust provisions in the Act should be amended to require statutory trust funds to be held separate in order to protect the holdback from other creditors. The OBA Section Committee is in favour of this proposal because the idea of having monies that are deemed to be trust funds but are not actually identified anywhere creates uncertainty in the law and affects a number of parties. There should be a mechanism for achieving the three certainties of a common law trust.

The Supreme Court of Canada will eventually be asked to address this issue. If we can clarify this legislatively, then this is an outcome of intellectual interests only. The OBA Section Committee suggested that the Review may want to consult the Ministry of the Attorney General, Constitutional Law Branch for advice on potential constitutional issues involved in establishing mandatory trust accounts.

The OBA Section Committee will consider whether the holdback draw should be deposited into each account.

If there was a legislative requirement for a trust account that met the three certainties, there would be greater clarity. A clear requirement to segregate funds would bring clarity to the picture. There should be certainty for the beneficiary of the trust and the trustees themselves and clear rules about trust accounts. There would also be clarity for breach of trust. If adjudication applied in this situation, it could provide a mechanism for rapid payment out of the account.

Distinctions can be made between the Act and other industries and jurisdictions. The loan brokers legislation says you have to set up an account for the funds. In the United States, money just goes into a trust account.

As a practical matter, it may not be a solution for all stakeholders and clients. Lenders and the contractor community may view this as an administrative burden. Most contractors keep separate accounts for costs and other expenses. They should be able to keep separate holdback accounts.

## 5. Condominiums, Subdivisions and Leasehold Liens

*Leasehold Liens*

The OBA Section Committee explained that there are issues in liening leaseholds as there is no marketable asset and there is currently no access to the notice of lease, which creates problems in identifying who the landlord is. The real value that the lien claimant could get is the pot of money for leasehold improvements, rather than selling the property. When a tenant fixes the premises up and then defaults, there is no value to sell so it would not make sense to put a lien on title when there is a better substitute.

When trying to make a registered owner liable as an owner of the leasehold interest, the test is at what stage the landlord gives passive approval and at what stage it becomes actively involved. The basis for holding anyone liable is that they are funding the improvement and they get benefit for the lease. It would be better to attack the funds to make a much clearer bright light on where liability exists.

*Adding Landlord to the Definition of Payer*

The subcommittee has not considered the mechanics of how the definition could be amended. The landlord could be a payer and payment could also come from the lender. Liability should be on the party who is funding the improvement if they are identified as a secured lender. They would have security through the mortgage of a lease.

Generally, the landlord agrees to pay a certain amount to the tenant when the tenant agrees to the leasehold improvements. If the landlord is funding the improvements, the lien claimant should have access to that money. It would be too easy for a landlord to use that money for set-off. The only set-off the landlord will have is for future rent.

Another key improvement should be the mechanism for effecting service. Usually when there is a claim for lien there is a government office, hospital, etc. to serve. You may also have individuals, partnerships, and business offices. There must be a method to effect service in order to preserve the lien and perfect it (e.g. by attaching it to the door of the last known address, if necessary).

*Amendments to Section 39*

There should be a requirement for a landlord, or any payer of a leasehold improvement who is a secured creditor, to provide information on the amount, whether lease is in good standing, and what the default has been.

The problem is not the Act but the reluctance of the owners to use remedies under sections 24 and 39 of the Act. These remedies should be considered.

*General Index for Condominium Units and Subdivision Lots*

The subcommittee recommends that a general index be created for each new subdivision and condominium. The province abolished it in the transition to electronic registration.

*Definition of Homebuyer*

The definition was omitted from the Act in 1983. The experts at the time had not consulted with the home building industry and missed it.

## 6. Crown and Public Land

The written submission on this topic is based on discussions with stakeholders and research on the state of the law. Crown lands were divided into federal, provincial and municipal. There is not much commentary relating to municipally owned lands. For federally owned lands there is a comment on paramountcy.

*Federally Owned Land and First Nations*

There are federal lands leased to non-federal entities (e.g. GTAA and Bruce Power). There is increasing pressure on development (e.g. wind projects). This is part of the economic reality. Consideration should be given to how the Act can facilitate this.

From a constitutional perspective, look at federal undertaking and determine what is taking place and the ultimate purpose. For projects leased by a private developer off federal lands, making the determination helps with clarity. The OBA Section Committee did not advocate for a central disclosure. There is a need for clarity on whether these lands are lienable or not.

Another issue is free floating trust remedies, as distinct from lien remedies. These could be broadened to include First Nations. There was a case where the judge found that the First Nation was constituted as a trustee. This could also apply to cases where projects are liened on federal lands. These projects cannot be liened but there may be a trust that could apply.

To the extent that the Review makes recommendations that touch on lienability or trusts on First Nations land, it will seek consult with the Chiefs of Ontario.

*Provincially Owned Lands*

There can be some confusion involving entities that appear to be public (e.g. hospital). It is not clear whether to lien the land or serve the claim. Some people lien and serve out of an abundance of caution and this is not very efficient.

In terms of serving, consideration could be given to recommending a central clearing house. The OBA Section Committee also considered Crown Law Office Civil (CLOC) in respect of these cases. If CLOC were merged with the central clearing house, this would reduce the burden on the ministry. Currently, lien claimants have to serve the ministry or agency affected and there is sometimes confusion at different levels of the construction period in terms of which ministry to serve and how to serve them. This could reflect a lack of sophistication on the part of the client.

The OBA Section Committee noted that there is reported case law on this (*Durham*) where neither the client nor the lawyer knew how to preserve their rights.

## 7. Home renovations

The OBA Section Committee suggested that the Review consider requiring that matters that amounted to $25,000 or less be heard in Small Claims Court as the process is simpler. The OBA Section Committee noted an issue in the home renovation sector related to an apparent lack of regulations and standards of construction and this is often dealt with outside of the Act. The OBA Section Committee explained that holdback is generally never retained in the renovation context. It was suggested that these issues be dealt with a warranty similar to the new home warranties under Tarion.