Construction Lien Act Review Consultation Meeting Summary
Metrolinx

December 14, 2015 (9:30 a.m. to 12:00 p.m.)

Attendees: Mark Shavoro, Mike Folchick, Karen Woo, Lauren Temple, Paul Jachymek, Tom Goodbody, Michael Kitagawa, Mary Martin, James Purkis, Richard Moore, Leon Stambolich, Hayley Ha, Mark Waters, Mark Ciavarro, Michael Wolcyzk, 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.

1. Mandate of the Review and Objectives of the Act

Metrolinx asked whether the policy objectives of the Act are still clear and relevant. The Review explained that one of the policy objectives was to provide suppliers with a limited collateralization of their credit risk. This was effected by requiring the owner to hold back from its payments a percentage of what otherwise would have been paid in the absence of the act. If the owner did not retain the holdback, the court could order the property sold in order to pay suppliers of services and materials. Another objective was the imposition of a deemed statutory trust, which means that any money earmarked for the project is imposed with a trust. The trust flows with the contractual chain (owner to general contractor, and so on). If anyone in the chain becomes insolvent, the money stays in the project and flows down to people at the bottom of the pyramid. The Review has been instructed to consider these objectives, as well as promptness of payment and dispute resolution.

2. Holdback

A question was raised by Metrolinx about whether 10 percent is right number for the holdback after over 30 years of experience. In the previous statute, it was 15 percent and people said this strands working capital for too long. No one has proposed to the Review that the holdback be reduced. One stakeholder recommended that it be increased to 15%.

It has been proposed to the Review that the Act include early release mechanisms, such as phased release of holdback upon completion of each phase. The other suggestion, which has been utilized in another province, is annual payout of the holdback on multi-year projects.

A number of stakeholders proposed that the Act allow for mandatory certification of the completion of a subcontract. Section 33 of the Act permits the certification of a subcontract, but it is not mandatory. It happens very rarely. There is a concern from other stakeholders about this proposal because if you start allowing several trades to do this, you could undermine the collateralization objective.

Metrolinx explained that for public-private partnerships ("P3") there should be a consideration of independent certifiers and lenders. Lenders are comfortable with the holdback as it stands. It is a known quantity and recognized and accounted for in the P3 model. Problems arise because you can only have one substantial performance. People have tried to do different things to accommodate the Act, such as separating one project into different projects.

Phasing for Consulting Professions and Early Works

Some stakeholders have suggested phased release of the holdback for P3s.

As well, consulting professions perform the majority of their work before construction starts and their money can be held up for years. The Ontario Association of Architects suggested multiple substantial performances to address this issue. Many designers do not know that the holdback may be held up for four to five years.

Metrolinx commented that everyone understands the phasing when setting up the project. They know they need to finance it. If they price it, the owner is the only one paying for the holdback. It is the owner that should be asking them how much they want to spend to protect themselves from liens on the project. If there are delays, it is a challenge for subcontractors and there should be some relief. The ultimate question is what the owner is prepared to pay. If there is early release based on milestones, the holdback should be reduced to provide some protection for owners.

Metrolinx observed that the question is who bears the burden. The Review has heard that the financial burden is borne by the owner (in pricing from the general contractor) and at the subcontractor level. The Review heard that most if not all general contractors have a 'pay when paid' provision so they do not pay until they receive a payment. Subcontractors have to pay for materials in full, or suppliers will not sell to them. If they fall behind on one project, suppliers will cut them off for all projects. If they are union subcontractors, there is no holdback for union wages. They are paying out without the benefit of having a holdback. It is a competitive bidding environment in Ontario so their margins are thin.

The subcontractors are the second layer that is bearing a significant financial burden. The sub trades have said to the Review that they are in a difficult financial position and they cannot price the risk to protect themselves.

The Review has heard from some union stakeholders that they are very supportive of prompt payment because union wages are paid, but pension and health and welfare benefits are sometimes not. The pension and benefit plans have lien rights but do not really know that a subcontractor has failed to pay the benefits until 90 days after the failure to pay. Lien rights have expired before they find out there is a shortfall.

The Review has heard that each labourer has an account and the money that comes in goes into their personal account, from which they can draw funds for benefits. If the account falls below a certain limit, it has an immediate effect on the worker's ability to access benefits. Some unions see prompt payment as a way to reduce the negative effect on workers.

3. Prompt Payment

There is a tension between freedom of contract and regulation. In Ontario, the government decided to constrain freedom of contract when creating the Act. The regulatory effect of the Act is not that intrusive when compared to Bill 69. The owner community says the Bill would represent a very significant intrusion into freedom of contract.

The philosophy behind Bill 69 was to say that when a progress request is made, the elements of that process must be completed in a certain time frame. It has been suggested to the Review that it is just a reengineering of the payment process and it could work. Owner stakeholders have said that Bill 69 assumed that the request is complete and properly submitted. They say that they regularly receive defective requests, so you cannot start counting from the submission of a defective request, but from a properly completed request. For most BPS owners the Review has heard from, there will be a consultant who needs two weeks to review the request, visit the site, and determine percentage of completion as well as several other internal steps. There is a necessary discipline that must be followed and the owner must be satisfied that payment can properly be made.

Some subcontractor stakeholders have said that progress draw requests were much shorter and simpler in 1983 when the Act was last reviewed. Payment took place within 30 days. Over time, there has been growth and complexity in the dollar amount of projects. Types and complexity of contracts have increased. Accounting and anti-corruption requirements have also increased complexity.

Metrolinx explained that it has significant monthly draws, sometimes over $100 million. In those examples, they sometimes have 20 day cycles from the end of the payment period to the time payment is made, so it is possible. They also have the ability to make an adjustment in the following month if there is a discrepancy. The contractor has five days to put the draw together. In the example, Metrolinx has 10 business days to certify that it is correct.

Metrolinx is a very sophisticated owner. The Review is hearing that some public owners, such as certain municipalities and school boards are not as sophisticated. They are thinly staffed and not as experienced in construction, often due to location and scale. Contractors and subcontractors say that their payments, which are supposed to be 30 days, are really being paid in excess of 60 days and 90 days.

Prompt Payment Ontario (“PPO”) commissioned a trade contractor survey. The Review discussed the results of the survey generally.

Metrolinx noted that they often see a general contractor submitting a flawed invoice and there is a dispute over what has been submitted. The subcontractor then calls Metrolinx saying they have not been paid in a year. They are afraid to go to the general contractor. The result is that Metrolinx has to determine whether this contact from the subcontractor is a notice holdback.

Some owner stakeholders have suggested taking away the notice of lien provision. They have also suggested making it easier for people to know where the lien is to be served. Where there is uncertainty in the Act, subcontractors cannot price the risk because they do not know if the owner will agree (e.g. section 33).

The Review has heard that subcontractors are being told by the general contractor that they will be paid, and then their lien rights expire. When you look at allocation of risk, there is a lot being allocated down to the level of the subcontractors.

The proponents of prompt payment say that complexity has elongated the payment period, which pushes them outside the lien period and strands working capital for an extended period of time.

Proponents of prompt payment are very focused in maintaining a dialogue with the Review to recommend a Bill 69-type approach. The Review is also getting strong representation from municipalities and BPS owners to the effect that this would be a significant constraint on freedom of contract and the Review should not recommend it.

4. Project Trust Accounts

The deemed trust provisions in the Act are intended to keep money in the project. There are a number of Ontario cases that have come up where banks have attacked this principle. The argument has two elements: the first is that the *Bankruptcy and Insolvency Act* ("BIA") and *Companies Creditors Arrangement Act* ("CCAA") are federal statutes and, to the extent that the two statutes conflict, the federal legislation trumps the Act; and the second element is that a demand trust lacks certainty of subject matter.

The Review explained the background of Project Trust Accounts in other jurisdictions as well as case law that some stakeholders have raised. This approach is being urged on the Review as a way to protect the holdback. Certain owners are opposed to the creation of such accounts. The concern is that it will constrain the ability of the owner groups to use the holdback as leverage to get the project completed and that it will create an administrative burden.

Bonds as an Alternative to the Holdback

Metrolinx noted that the holdback is being used for other purposes. Contractors may be increasing their prices to accommodate for this. Otherwise, they have to get extra money in the business from other places. In other jurisdictions, they use bonds (demand instruments) throughout the contract. Metrolinx explained that it could have contractors bidding on many projects but not have the ability to complete them. With such financial security, there is an inherent policing mechanism.

This concept is directed towards allowing money to flow while maintaining a reliable security for the owner if the contractor does not perform its obligations. Owners could require that only a certain amount of risk can be passed on to subcontractors.

If you want the contractor to complete the work and you have a demand instrument, it can be used to persuade them to complete the work (the owner will draw if they do not complete the work). The bond is a financial test of the construction company.

Metrolinx has very large projects and they do not want to have a holdback because the contractor would have to finance a lot of money. If the Act allowed for the acceptance of security in lieu of the holdback, the money could flow in the ordinary course and Metrolinx could still hold an instrument.

5. Public-Private Partnerships

Several submissions to the Review suggest excluding P3s or phasing release of the holdback as a way to deal with these projects. It has also been suggested that the definitions should be adjusted to reflect P3s.

The Review has heard about multi-tier bonds and alternative methods of security. The Review met with the Canadian Bankers Association ("CBA") and brought the issue to their attention.

6. Adjudication

Adjudication is a significant issue that has been brought to the attention of the Review. The Review explained the two aspects of prompt payment, and how the "gridlock" aspect could be addressed by adjudication. The Review explained adjudication from the UK context.

The consensus among many stakeholders is that adjudication addresses the issues. Certain stakeholders have already adopted contractual adjudication in Ontario.

Metrolinx will set out its formal view in the written submission.

Metrolinx stated that changing the Act would increase the scope to more than what has been intended. The Review will need to consider whether the types of projects Metrolinx is working on should be included in the Act. Not all projects are big projects. If you look at the pyramid and the participants at all levels and put yourself in the shoes of the trade contractors, the lien remedy can be important for them. Metrolinx encourages the big contractors to hire small subcontractors.

Metrolinx noted that the court system is broken. Courts should deal with the consequences of the actions of bad actors.

Metrolinx has had experience with ADR, including dispute resolution boards. It will deal with this issue in the written submission.

7. Definition of Improvement

Another issue is the definition of "improvement" under the Act. It is often a challenge to determine whether a project is an improvement or not. Stakeholders have asked questions such as: When does the Act apply? Which contract does it apply to? (e.g. service contracts).

The intention of the amendment in 2010 was to clarify the case law. It now applies to supply of equipment. This is significant for Metrolinx. In some sectors, the Act is ignored. Metrolinx is uniquely situated to comment on this issue.

A certain amount of Metrolinx projects are on property that does not belong to Metrolinx. Most of Eglinton Crosstown is on municipal property. Municipalities have suggested there is no reason to treat municipal property different than Crown land. Municipalities are not going anywhere and giving a lien in respect of municipal property should be the same as a provincial or federal property.

This may work as long as a municipality cannot go into insolvency. In the US, they can become insolvent. They distinguish between public and private projects. On public projects you cannot lien, and payment bonds are the collateralizing solution. Every public project must have a labour and material payment bond. There is state legislation that imposes prompt payment regimes; some are more intrusive than others. On private projects, the right of lien exists but there is no requirement for bonding.