Ontario
Infrastructure Ontario

777 Bay Street, Suite 900, Toronto, ON M5G 2C8
777, rue Bay, bureau 900, Toronto, ON M5G 2C8

MEMORANDUM

RE: Construction Lien Act Expert Review: Considerations and Recommendations

Infrastructure Ontario welcomes the opportunity to provide comments and recommendations to the Construction Lien Act Expert Review Panel (the "**Panel**") for the reform of the *Construction Lien Act* R.S.O. 1990, c. C.30 (the "**Act**" or "**CLA**"). Infrastructure Ontario applauds the Panel's commitment to canvassing the perspectives from the many industry stakeholders and establishing a framework for a revised Act that is reflective the developments in the construction and real estate industries over the past two decades.

The consultation regarding the Act is an opportunity to understand developments in the construction and real estate industry. Some of these developments include the expansion of the newer AFP delivery model, the increased sophistication of agreements used for both AFP and traditional delivery models and increasing calls from supply chain stakeholders to legislate prompt payment obligations. In light of these developments, it is important that a revised CLA:

- reflects a balanced and commercially reasonable approach to the competing interests of all stakeholders;
- recognizes that different approaches may be required for contracts delivered pursuant to different project delivery models;
- recognizes and adequately responds to the different ownership structures, the sophisticated contractual arrangements between stakeholders, and allocate responsibility, liability, payment scheduling and obligations accordingly;
- be cognizant of the constraint of operating within the government context particularly in relation to the imposition of commercially unreasonable timelines and disclosure obligations that result in unreasonable administrative burden; and
- gives deference to the freedom of the parties to contract and agree to terms and price their liabilities accordingly without undue legislative intervention.

The following provides an overview of the Government of Ontario's Real Estate Portfolio, Infrastructure Ontario's role in both Traditional and AFP project delivery and IO's position regarding a measured approach to prompt payment and adjudication considerations.

1. The Province of Ontario's Real Estate Portfolio

The Government of Ontario maintains one of the largest general real estate portfolios ("**GREP**") in Canada, second only to the Federal Government. The Minister of Economic Development Energy and Infrastructure ("**MEDEI**") has jurisdiction and control/ownership of the properties in the GREP.

The GREP consists of 45.06 million square feet of rentable space, 35.26 million of which is owned by MEDEI, and 9.8 million leased from third parties. The GREP includes 5,057 buildings and structures, 4370 of which are owned by MEDEI, and 659 leased locations. Properties in the GREP include office buildings, courthouses, correctional institutions, heritage buildings and laboratories.

The GREP does not include properties owned by the many Provincial consolidated entities, for example, properties owned by transfer payment agencies, school boards, hospitals and colleges. It also does not include lands managed directly by the Ministry of Natural Resources and Forestry and the Ministry of Transportation.

2. Infrastructure Ontario

Infrastructure Ontario is a Crown Agent of the Government of Ontario, and reports to MEDEI. Infrastructure Ontario is responsible for the delivery of public infrastructure renewal, oversight of the Government's real estate portfolio, administering Infrastructure Ontario's Loan Program and other Government asset modernization initiatives. In support of the Government's initiatives to modernize and maximize the value of public infrastructure, Infrastructure Ontario provides a wide range of services including strategic planning, realty advice, comprehensive project management and delivery services to properties within the GREP. These projects are predominantly delivered by the traditional delivery models. Infrastructure Ontario also provides its services and expertise to non-GREP properties owned by municipalities, hospitals, colleges, non-profit and related entities. These projects are predominantly delivered by the AFP model.

3. The Traditional Delivery Model

Infrastructure Ontario outsources some of the operations related to its project management function to external project management services providers ("**PMSP**"). The outsourced project management services approach enhances the cost effectiveness of project related activities, allows Infrastructure Ontario to leverage both public and private best practices and expertise and facilitates the implementation of a standard methodology for the effective and efficient delivery of project management services across the Province.

Commencing in 2008, PMSPs have been retained pursuant to master services agreements ("**MSA**") for project management services. These MSAs allow Infrastructure Ontario to issue work orders or authorizations to PMSPs to initiate a specific assignment. Upon receipt of a work authorization, PMSP enters into agreements with contractors, consultants, design professionals

and related trades as required, to deliver the assignment. This arrangement means that the Contractor is not hired directly by IO to provide materials and services.

PMSPs provide services related to all phases of project delivery including project planning, design, construction and closeout. PMSPs provide services required to deliver studies (e.g. building envelope review, HVAC review, electrical, loading and roofing studies) as well as program management, reporting and administration to meet government and IO's policies, process and reporting requirements. Under the outsourced project management services approach a small number of specialized projects are internally managed by Infrastructure Ontario staff, while the majority of assignments are outsourced to PMSPs. Since 2008, on average 1,560 projects are delivered by PMSPs annually with an approximate annual value of $223M.

4. Prompt Payment and the Traditional Delivery Model

Infrastructure Ontario is committed to facilitating the payment of PMSPs and the supply chain within a commercially reasonable time period that does not compromise Infrastructure Ontario's ability to complete the due diligence steps required at the end of each phase of project delivery. Reflective of this commitment - PMSPs performance is rated against, for example, IO established invoice approval and payment standards and timelines (Key Performance Indicators or KPIs). PMSPs who do not achieve minimum standards/KPIs are subject to having a pre-determined percentage of their fees deducted for failure to achieve the standards. Additional comments regarding prompt payment and payment timelines are set out in Appendix B attached.

5. AFP Delivery Model

Infrastructure Ontario partners with provincial ministries, Crown corporations, municipalities and not-for-profit organizations to deliver the Province's public infrastructure renewal projects. Infrastructure Ontario delivers large and complex public infrastructure projects through the AFP model which uses private sector financing and industry expertise to maximize project success.

AFP is a modern project delivery technique that makes the best use of private-sector resources and expertise to provide on-budget and on-time project delivery. Projects are designed to meet client specifications. Risk transfer is central to ensuring that the private sector delivers projects and that the public interest is protected. Financing and payments are structured to drive performance through construction and, in the case of Design Build Finance and Maintain ("**DBFM**") projects, through lifecycle and maintenance periods.

The classical AFP contract may either be a Build Finance ("**BF**"), Design Build Finance ("**DBF**") or a 30 year DBFM contract, called the Project Agreement, between the Authority (e.g., a Hospital) and Project Co. In other words, the Project Agreement includes not only design and construction, but also financing and maintenance. Project Co typically does not receive progress payments but, rather, gets paid no more than 60 - 85% of the capital cost of construction when

the facility is substantially complete. Project Co enters into a Construction Contract with a construction contractor and enters into a Services Agreement with a service provider.
As of September 30, 2015, there have been 52 AFP Projects completed (value of $15.90 billion) and 21 AFP Projects under construction (value of $17.71 billion). Projects listed on Infrastructure Ontario's market update are estimated at $7.55 billion (design and construction cost), consisting of both civil and social projects.

Infrastructure Ontario prides itself in its on-time and on-budget performance. In the recent independent third-party review of the performance of AFP projects that have reached Substantial Completion in the prior fiscal year, the Track Record Report 2015 revealed that 98% of AFP projects were delivered on-budget and 73% of projects were delivered on-time, with 18% delivered early. Infrastructure Ontario's on-time and on-budget performance exceeds generally accepted industry standards for both AFP infrastructure projects and traditional delivery projects.

For more information on key AFP considerations for the purpose of the review, please see Appendix "A" attached. Critical to the success of the AFP program is Project Co's financing of the project until Substantial Completion (though the degree varies).

Please note that capitalized terms not defined herein or in the Appendices are standard terms defined in Schedule 1 of the Project Agreement. For reference, please see the Peel Memorial Centre Project Agreement where Borden Ladner Gervais LLP acted for Infrastructure Ontario/Hospital.

Link to the Peel Memorial Centre Project Agreement:
http://www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147492195

6. AFP Misalignment with the CLA

As noted by Borden Ladner Gervais LLP in the Information Package, when the CLA was introduced in 1983, there were no AFP projects in Ontario. The AFP model has Project Co situated between the Authority and the Contractor. Project Co is not recognized by the CLA, which assumes a traditional structure of an Owner hiring a General Contractor directly. Some examples of the misalignment between the AFP model and the CLA include: the definition of "Owner" and "Contract", the impact of these definitions on holdbacks and lien issues if Project Co is considered the "Owner" for the purposes of the CLA. These are discussed in further detail in Appendix "B".

7. Prompt Payment and AFP Considerations

The payment structure of an AFP transaction is specifically designed to transfer risk from the public to the private sector and achieve value for money for the province. As such, payments are not made according to a strict 30 or 31 day payment schedule in the Project Agreement, but rather on an availability basis. This means that the Substantial Completion Payment, representing

a large percentage of capital costs is paid upon certified completion of a facility, with availability payments paid over the life of the project. Prompt payments, that impose a mandatory statutory payment period, would negatively impact the AFP model and compromise the value for money that is derived from the risk transfer achieved with private financing. Furthermore, the Project Agreement has clear timelines for payment which are consistent with market norms and have been tested and accepted by the industry. Across the AFP portfolio, all payments are made on a timely basis and in accordance with the Project Agreement. Deference should be given to the freedom of contract and ability of sophisticated parties to negotiate and come to an agreement.

8. Adjudication in AFP Project Agreements

Statutory adjudication in the UK was introduced following the Latham Report (1994) under Section 108 of the *Housing Grants and Construction and Regeneration Act, 1996* (the "**Housing Act").** Latham recommended that a system of adjudication should be introduced within all of the standard forms of contract, unless some comparable arrangement already existed for mediation or conciliation. In May 1, 1998, the construction parts (Part II) of the Housing Act commenced and at the same time, an exclusion order reduced the scope of adjudication in relation to certain statutory provisions, contracts relating to Private Finance Initiatives ("PFI"), which are the UK equivalent of AFP contracts. Currently, statutory adjudication in the UK does not apply to PFI agreements but does apply to the agreement between the special purpose vehicle and the contractor. Infrastructure Ontario would recommend that a similar approach be taken in Ontario, with AFP Project Agreements excluded from statutory adjudication and the Construction Contract between Project Co and the Contractor subject to the statutory adjudication requirement. The Project Agreement currently has in place a modified version of the UK Construction Industry Council's Model Adjudication Procedure in the Dispute Resolution Procedure Schedule. For more information, please see the sample Project Agreement reference in Section 4.

9. Comments and Recommendations

Please refer to Appendix "B", attached, for responses, and comments to the specific issues raised by the Panel.

We look forward to discussing our submission with the Panel at the consultation meeting on December 15, 2015.

APPENDIX "A"

AFP KEY CONSIDERATIONS

(a) Type of Agreements

The Authority is the public sector party (e.g. Hospital or on occasion, Infrastructure Ontario as agent and delegate of the Ministry of Economic Development, Employment and Infrastructure) entering into an agreement with the Project Company ("**Project Co**"). The Project Agreement is the AFP contract that is executed between the Authority and the Project Company that is a special purpose vehicle formed for the purpose of carrying out its duties for the particular project. The Project Agreement has schedules that consist of other ancillary agreements, such as the Independent Certifier Agreement pursuant to which the parties agree to appoint an Independent Certifier for the purposes of obtaining certification services and resolving disputes related to construction delay and compensation entitled thereof, amongst other services set out in the relevant schedule. The Independent Certifier does not certify substantial performance. The Project Agreement stipulates that the Independent Certifier must be jointly appointed with both parties paying equally for its fees.

The Project Agreement makes reference to a Construction Contract to be entered into by Project Co and a Construction Contractor. It is important to note that this agreement is not made directly between the Authority and the Contractor. The parties to the Construction Contract, which is a Design-Build Agreement, include only Project Co and the Construction Contractor. The Construction Contract sets out the obligations of the Contractor with respect to design and construction of the Project in accordance with the timelines of the Project Agreement. The Construction Contract also has schedules that consist of other ancillary agreements including the Payment Certifier Agreement, pursuant to which the parties sign an agreement with a Payment Certifier for the purposes of certifying substantial performance in accordance with the CLA, amongst other services. It is the Construction Contract, not the Project Agreement, for which substantial performance is certified. The Construction Contract stipulates that Project Co shall be responsible for the payment of all fees and costs of the Payment Certifier.

The type of agreements elaborated in this section, make the definition of "Owner" pursuant to the CLA difficult to reconcile with the Authority. The Project Agreement becomes, in effect, the construction contract referred to in the definition of "Contract" under the CLA. This has implications for lien rights and holdbacks.

(b) Stakeholder Engagement

Upon issuance of a Request for Proposals ("**RFP**"), through Commercially Confidential Proponent Meetings, individual Proponents have an opportunity to discuss the Project Agreement and suggest amendments. After the evaluation of Proposals, the Preferred Proponent is identified to negotiate minor revisions to the Project Agreement. The lead up to Commercial

Close of a typical AFP transaction is approximately 4 – 6 months with all contractual terms of the Project Agreement and schedules are negotiated between the parties.

Infrastructure Ontario notes that stakeholders have ample opportunity to present their concerns, price contingencies and negotiate favourable terms during the transaction phase of an AFP Project. Furthermore, Infrastructure Ontario recently held a legal market sounding regarding its Project Agreement, in which law firms and counsel to various stakeholders including contractors, consortia and lenders were invited to provide input into what the market considers reasonable along with recommendations to revise to the template. The outcome of the legal market sounding was that the AFP template was generally highly regarded with some recommendations that Infrastructure Ontario has since incorporated and others that are in the process of being incorporated.

Many of the sections in the Information Package for Stakeholders can be addressed by giving deference to the freedom of the parties to contract and agree to terms and price their liabilities accordingly without undue legislative intervention.

(c) Types of Payment

In the Project Agreement, there are different types of payments that are made at different milestones. The largest payment, of 60 – 85% of the contract price, is made at Substantial Completion. The test for achieving Substantial Completion of the Project Agreement is a higher threshold than that required by substantial performance of the Construction Contract, but incorporates the latter as a requirement. There may also be interim payments made at particular specified periods during the Construction Phase of the Project, such as after the completion of a phase of the Project. Infrastructure Ontario is experimenting with more frequent payments, while still requiring Project Co to finance a significant portion of construction. Monthly Service Payments are made during the Operational Term to Project Co over a course of 30 years, with adjustments based on service, availability and quality failures.

In the Construction Contract, like Traditional Delivery, there are monthly progress payments that are made on account of the Contract Price and the equipment procurement fee in the amounts and on the dates specified in a schedule to the Construction Contract.

The different types of payments outlined in this section have different timelines and thresholds that have to be met in order to be successfully paid to the counterparty. The AFP model anticipates lender oversight and at-risk capital in the Operational Term. By legislating mandatory prompt payment, the value for money achieved through AFP would be undermined in its entirety.

(d) Dispute Resolution

The Project Agreement and the Construction Contract have parallel dispute resolution procedures set out in a separate schedule of approximately fifteen pages. Expeditious resolution

of disputes without causing undue delay to project timelines is integral to the dispute resolution procedure. The parties are to act in good faith and cooperate with the third party that is resolving the dispute. The dispute resolution procedure requires the parties to resolve disputes firstly by the lower levels of management, secondly by their respective party representatives and lastly, by the senior officers of each party, failing which the parties go on to consider alternative dispute resolution mechanisms. The range of options to resolve disputes include a systemic consideration of experts, adjudication, arbitration and litigation. The Independent Certifier also has a large role in resolving issues for the parties with respect to disputes related to the services provided by Project Co. Such disputes may include those related to Substantial Completion, minor deficiencies on the project and whether any proposed work constitutes a variation/change order, among others.

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APPENDIX "B"

CONSTRUCTION LIEN ACT REVIEW: COMMENTS AND RECOMMENDATIONS

See attached.