Advice, insight and recommendations to the Independent Review of the Construction Lien Act

DECEMBER 17, 2015

Table of Contents

Introduction 2

Consulting Engineers of Ontario 3

The Construction Lien Act and the Engineering Profession 3

- Application and release of holdback for engineering services 3
- Automatic release of holdback 4
- Continuation of lien rights 4
- Eligible financial instruments for holdback 4

Prompt Payment 4

- Prohibiting holdback 5
- Imposing mandatory payment terms 5
- Establishing new requirements for financial disclosure 6
- Certification of payments 7

Conclusion 8

INTRODUCTION

Consulting Engineers of Ontario (CEO) appreciates the opportunity to provide advice and insight to the Government of Ontario's Independent Review (the Review) of the *Construction Lien Act* (the Act), overseen by the Ministry of the Attorney General and the Ministry of Economic Development, Employment and Infrastructure. This review marks the first significant examination of the Act since its passage in 1983 to replace Ontario's *Mechanics Lien Act*, as such, it holds particular importance for Ontario's engineering profession.

Aside from marginal changes to the Act in 1990 and 2010, it has not been substantially modified since its passage into law. Existing under the jurisdiction of the Ministry of the Attorney General, the Act, until recently, has been widely regarded by industry, political and bureaucratic stakeholders as an "orphan statute." Broad industry calls for changes to the Act only began to resonate with the Ontario government when it was recognized that it could substantially impact the fulfillment of the current economic development agenda. Core infrastructure targets would not be met if the payment system responsible for the efficient flow of $131.5 billion in provincial investment over the next 10 years was not up to the task.

Previous efforts to reform the Act have been frustrated by a lack of industry consensus on what constituted appropriate improvements to the legislation. The Act is a rare statute; it governs payment for services in construction across a broad range of stakeholder classes representing a substantial number of distinct actors within those classes. Originally intended to establish payment relationships between contractors and subcontractors, the Act has failed to keep pace with the changing nature of business relationships in Ontario's construction and design sector. Over the last 32 years, it has come to be applied to a wide range of industry payment arrangements. Not having staid abreast of this evolution, the Act has become increasingly less effective. The result has been an increasing level of frustration among sector actors. This has contributed to a more aggressive business climate where assurance of full and timely payment for completed, certified work has become increasingly less likely.

The fundamental principles governing full payment in construction in Ontario are flawed. The current system has come to favour project owners and constructors. This is of particular concern for Consulting Engineers of Ontario and its members. In its present form the Act does not adequately recognize and accommodate payment relationships outside of the traditional contractor/subcontractor dynamic; including payment for services provided by consulting engineers.

It is CEO's endeavour to support this Review so that recommendations can be provided to government that will produce a payment system for Ontario's construction sector that "makes sense." Such a system, whether realized through revisions to existing statute or the creation of new legislation, must be consistent and flexible; it must also be enforceable. It must establish processes recognizing the unique nature of services provided and work undertaken by different classes of actors. These processes in turn must provide for timely payment for certified, completed work. It must have the inherent flexibility to recognize the needs of every stakeholder involved.

CONSULTING ENGINEERS OF ONTARIO

Consulting Engineers of Ontario (CEO) is a non-profit association representing the business interests of approximately 200 consulting engineering firms collectively employing more than 20,000 people in Ontario.

Professionals in these firms are not only comprised of engineers, but also technicians and technologists, geoscientists, architects, and planners. Our multidisciplinary member firms provide a wide range of engineering services to government and private sector clients, representing more than 30 engineering specializations and 260 sub-specializations. CEO member firms range in size from sole proprietorships to large multinational corporations.

Our association promotes the important contributions the consulting engineering sector makes to the economic, social, and environmental quality of life in Ontario.

THE CONSTRUCTION LIEN ACT AND THE ENGINEERING PROFESSION

Application and release of holdback for engineering services:

The *Construction Lien Act* is written specifically for construction and contracting services; it is then applied to related professional services, such as engineering. The relationship between the prime consultant and sub-consultants for consulting engineering services and other professional services, such as contract administration, are significantly different than the relationship that exists between a general contractor and their sub-contractors and their suppliers. Additionally, professional engineering services provided to clients frequently include planning, feasibility studies, environmental approvals and project management, in addition to traditional design and construction administration services contemplated in the Act.

In the absence of clear definitions, many clients apply holdback to all engineering services offered and do not release these monies until after construction – even though the deliverables for many of these engineering services may have been completed many months, or even years, earlier. Consulting Engineers of Ontario does not believe it was the intent of the Act to include in its prerogative engineering services other than design and construction administration.

It is CEO's recommendation that to produce a more efficient, equitable, timely and effective payment system for Ontario's construction industry, that proposed revisions to existing or new statutes exclude that class of work undertaken by our profession and their firms that is not "construction related." CEO wishes to be clear that it is not proposing that the engineering profession be removed from the jurisdiction of the Act, or any such future statute. Rather, CEO is proposing that specific classes of services be made exempt from the legislation so that it only applies to construction related services. By expressly defining the nature and scope of work to be included under the purview of such legislation, it will ensure a consistent, uniform and proper application of the holdback provision.

a) Automatic release of holdback upon expiration of lien rights

Design services, as well as other services noted above, are performed and often completed prior to the beginning of construction. In many cases design services may have been performed and completed many months or years prior to construction, yet holdback is not released until construction of the project is completed. CEO recommends that any revised or new payment statute governing Ontario's construction and design industry should require the provision for the release of holdback on design services, or other services if they continue to be covered under the Act to realistically reflect the nature and completion of the services provided.

b) Continuation of lien rights through to 45 days after substantial performance unless there has been early release of the holdback

For those construction related engineering services for which holdback is taken and held through to project substantial completion, CEO recommends that any revised or new payment statute governing Ontario's construction and design industry should require the continuation of a parties' lien rights through to 45 days after substantial performance unless there has been early release of the holdback.

Eligible financial instruments for holdback:

Legal interpretation of the Act by some clients has led to the creation of the requirement for project holdback to be held exclusively in cash; this is an issue of substantial concern for CEO and its members. Given the numerous options available to business for secured lines of credit and guaranteed bonds, it can be argued that it was and is not the intent of the Act for holdback be taken via an instrument, such as cash, that imparts such a considerable expense to the consultant. Additionally, given the advances in banking technologies since the passage of the Act in 1983, secured or guaranteed instruments as readily available as cash. CEO strongly recommends that any revisions to current statute or any new legislation governing Ontario's construction sector should provide for the use of alternative, secured, financial instruments such as appropriate letters of credit or bonds.

PROMPT PAYMENT

The motivation for a legislated payment regime for construction in Ontario:

The uniquely complex nature of business relationships in Ontario's construction industry amplify the problems arising from late or delayed payment for completed work.

The recent recession spurred actors within the Institutional, Commercial, Industrial (ICI) and Heavy Civil construction industry to try and improve payment processes. Their objective was to ensure full payment for completed work in a timely fashion through proposed amendments to the *Construction Lien Act* in 2010; these efforts failed. The resulting frustration over ever-lengthening payment terms, failure for businesses to be repaid holdback funds due to myriad reasons including, but not limited to: failure to receive payment prior to expiration of lien rights, creative and complex systems used by clients/owners/general contractors to set-off

against holdback funds and inappropriate use of holdback funds for items such as deficiencies, served as catalysts for the development of prompt payment legislation mirroring that used in many other jurisdictions, including the United States.

The United States federal government enacted the first prompt payment legislation in the early 1980s. Since that time similar legislation requiring the timely payment for construction services has been implemented almost every U.S. State, the United Kingdom, Australia, New Zealand and most of the European Union. Until the tabling of *Bill 69* in the Ontario Legislature in the spring of 2013 Canada had failed to keep pace with the industry trend to create a statutory regime to ensure the timely payment of construction accounts.

The proposal for Ontario:

The prompt payment system proposed by organizations such as Prompt Payment Ontario would apply to every construction contract or subcontract, public or private in the province.

However, the intent of the proposed system as currently written creates objectives that are not proportional to the scope of work it would capture.

The proposed system has three fundamental objectives:

1. Prohibiting holdback other than that required under the *Construction Lien Act*.

The system proposes to change current industry practice on holdbacks. If enacted, it would require statutory holdbacks as defined under the Act to be paid within one day after the applicable lien period expires. It also proposes to disallow any holdbacks other than those permitted or required under the Act.

The only holding back of funds that would be permitted under the proposed system would be for amounts claimed in an invoice for which a payer objects within 10 days. This provision would seem to prevent an owner/constructor from withholding payment for current or future invoice payments even if a deficiency is discovered relating to work that has already been completed and paid for.

Also excluded would be milestone payments, deficiency or completion reserves or set-offs. This would appear to conflict with section 17(3) of the Act.

2. Imposing mandatory payment terms.

Prompt payment would also create several mandatory payment terms, making them enforceable.

The system would create a progress payment structure that would be applied to all projects. If a contract or subcontract stipulates progress payments, those payments would become payable no later than 31 days after the first day that services or materials were provided to the project.

If a contract or subcontract does not stipulate progress payments, then under this system an owner would be required to pay its contractors within 20 days after their having submitted a monthly invoice. This system would also would require contractors to pay subcontractors within 10 days after a payment certificate was issued or 30 days after the subcontractor submits its invoice.

While these suggested processes seem to try to create a balance between cash flow and completed work, it is not clear how they would apply to the many types of projects that do not lend themselves to a progress payment structure. Larger and more complex projects that provide payment through milestone provisions are not accounted for by this system. It is also unclear how a prompt payment system would apply to contractual relationships involving fees for ongoing operation and maintenance that include repairs, renovations or other construction work.

Under the proposed prompt payment system all invoices submitted by payees would be deemed to be approved by the payer 10 days after they are submitted unless the payer provides written notice of disapproval or amendment.

All late payments under this system would accrue interest from the date a payment was due at the greater of (a) the prejudgment interest rate determined under the *Courts of Justice Act* or (b) the rate specified in the contract or subcontract.

Perhaps most important, the system would allow a party to suspend work or terminate a contract or subcontract if the payer did not make a progress payment on time or in full. These new terms would apply to all payers and would put any firm in a difficult position if they were not paid by the client. Ultimately, the payer in question would either have to make payment to the payee itself or sue the client for payment.

3. Establishing new requirements for financial disclosure.

An Ontario prompt payment system would require greater financial transparency; both for clients and for project payees.

The system would require owners to demonstrate to their prime contractors that they had the necessary financial resources ability to pay for their project before they could enter into a construction contract.

If created, an Ontario prompt payment system would also create obligations for disclosure for project payees. Once paid for project work, contractors or subcontractors would be required inform all of their subcontractors in a timely manner and would have to post this information on a public website.

ASSESSMENT

Consulting Engineers of Ontario and its members strongly support the premise of timely payment for certified, completed work. However, strong public policy must serve the public

good. Therefore, any changes to existing statutes or the creation of new statutes establishing and governing payment relationships and terms for Ontario's construction sector must not create an environment that picks "winners and losers." The proposed prompt payment system as currently written will do just that.

The system would create a disproportional onus on those firms positioned higher-up in the construction pyramid. For consulting engineers this onus would be most greatly felt in the requirement to certify payment. The proposed system provides a very short review period of just 20 days. In this time the owner and their consultants would have to review applications for progress payments and then make those payments. Having invoices deemed to be approved 10 days following submission unless the payer gives written notice of disapproval would be difficult to achieve, particularly on larger or more complex projects where there might be a number of different design professionals involved. Having a firm timeline such as this does not appear to allow for any deviations, no matter the reason, and is a strict standard. Even without a strict timeline the process of approving contractors' applications for payment exposes engineers to a variety of potential claims. This risk would be heightened substantially under the proposed regime.

For consultants it is their signature on the payment application, and if something goes wrong, plaintiff lawyers may use it in an attempt to hold our members responsible.

It is already common for owners to equate the consultant's duty to sign payment certificates with that of inspecting the contractor's work. Some believe that by issuing payment certificates, the engineer is "certifying" — in essence, guaranteeing — that the contractor has complied with the project's plans and specifications, and that the contractor's figures are correct. Owners' attorneys have been known to argue that because a consultant signed an application certifying the contractor's work, he or she must have looked at how it was constructed. Even though consultants are not auditors and are only a part-time visitors at project sites as part of their construction observation services; owners do try to hold them accountable for any discrepancy.

Claims involving payment applications may allege negligence (usually the failure to identify defective work) and/or negligent over-certification or under-certification of payments. Owners do not want to pay money prematurely or needlessly. If the consultant over-certifies that the contractor is entitled to, for example, 50% of the contract sum, but they are actually only entitled to 25%, consultants can be exposed to a claim. In another example, if the contractor defaults, the owner could sue the contractor, sue on the performance bond and sue the consultant. The bonding company could also sue the consultant for instructing the owner (or lender) to release funds too soon.

Conversely, contractors need — and are entitled to — their money as soon as it's earned. If the consultant under-certifies (resulting in a smaller payment to the contractor), they may make it impossible for the contractor to continue to pay its bills and stay in business, exposing themselves to a claim by the contractor as well as the surety.

In terms of mitigating the risk involved with these processes, the best thing consultants can do is to train their personnel to do a thorough job performing construction observation

services. This however is not always possible depending on the nature of their contract (particularly in public projects where they often want to assume this role in whole or in part to save money).

Having a 20 day deadline is very aggressive and would seem to expose consultants to considerable potential liability.

The corresponding counter-remedy for failure to perform/complete work does not appear to be at least as equally compelling as that available for failure to receive payment. The contractor/subcontractor right to suspend work or terminate a contract if not paid their progress payment is a drastic remedy, and could lead to significant problems and massive financial losses to an owner. Inevitably, projects will experience delays and that will result in associated costs. There must be some form of process included in this system to attempt to reconcile legitimate payment delays before work is suspended or contracts terminated.

It is also important to note that the proposed prompt payment system would only practically apply to work undertaken by a small portion of Ontario's construction and construction-related sectors. It would be incapable of adequately, if at all, addressing payment for large and complex construction projects; particularly public-private-partnership (P3s) or alternative financing and procurement (AFP) jobs. By its nature the system could not address the vast majority of work undertaken by Ontario's ICI and Heavy Civil construction industry tied to municipalities, universities, schools and hospitals.

Clearly, if Ontario's construction sector is to have a system to ensure timely payment for completed work, further effort is required. A successful payment system must:

i. Accommodate the payment processes and timelines to support large and complex public infrastructure projects e.g. milestone payments.
ii. Provide for processes that permit adequate time for proper due diligence be conducted before accepting work as complete and certifying payment to contractors and subcontractors.
iii. Include timelines that reflect the necessary processes to provide for payment as dictated by the size, scope and complexity of the infrastructure project under contract.
iv. Provide an adequate payment dispute resolution system that is seen to equally serve the interests of all involved parties.

Until such time as these amendments are incorporated into what has been proposed, a prompt payment system will remain very difficult for the engineering profession to support.

CONCLUSION

Consulting Engineers of Ontario and its members hope this submission proves useful.

The Independent Review of the Construction Lien Act and Prompt Payment is important for Ontario's construction sector and for the engineering profession. This work provides an

opportunity for the full range of skills and services provided by professional engineers to the construction sector to be brought fully into focus for the first time.

Ontario needs a construction payment system that ensures timely payment for certified, completed work. In the years since the introduction of the *Construction Lien Act*, models and methods of procurement have become more complex. This evolution has similarly influenced the business relationships among those who own, contract and complete this work.

This review has the opportunity to bring forward to the provincial government the recommendations that will empower Ontario's construction sector with the tools to ensure all of its actors can work together fairly and equitably.

Thank you again for the opportunity to provide our advice, insight and recommendations to this important process.