CITY OF TORONTO
COMMENTS ON THE ISSUES BEING CONSIDERED BY THE
***CONSTRUCTION LIEN ACT* REVIEW**

The City of Toronto (the "City") is pleased to have been identified as an important stakeholder in the expert review (the "Review") of the *Construction Lien Act* (the "Act") being undertaken on behalf of the Ministry of the Attorney General and the Ministry of Economic Development, Employment and Infrastructure.

It is important that proper consideration be given to all of the competing stakeholders in the industry so that the resulting amendments to the Act will be balanced. We look forward to the Review process continuing consultation with stakeholders on any new issues raised or possible amendments.

In September 2015, City Council directed staff to express the City's position on issues related to the Act (Council decision EX8.3). Representatives from various divisions and agencies of the City that are involved in delivering construction projects have carefully considered the issues raised in the July 2015 Information Package provided by Borden Ladner Gervais LLP. The following are the City's comments.

1. Lienability

The definitions in the Act should be revisited.

There should be more clarity in the definition of "supply of services", particularly with respect to the supply by consultants. It can be difficult to determine if the nature of the work is lienable under the Act and this is more problematic when an improvement has not commenced and may not proceed (for example, geotechnical services that are necessary to an improvement but that may be provided well in advance of the construction of the improvement). Retaining holdback from consultants is costly and in some circumstances is only done out of an abundance of caution by the owner as the application of the Act can be difficult to determine.

The treatment of holdbacks for consultant services is inconsistent throughout the province, even when the supply seems lienable under the Act. It can be difficult for an owner to defend its position in retaining holdback from consultants if it is not being retained on similar projects with different owners.

With respect to the definition of "improvement", it can be difficult to determine what is implied by "alteration" to land, "removal" of works and "repair" (versus maintenance). Perhaps consideration can be given to the inclusion of a non-exhaustive list of "supply of services" and "improvements" to which the Act applies and a list of what is excluded so that there is more certainty in the application of the Act. (See the comments under 15. Miscellaneous, below.)

The definitions of "owner" and "contractor" should be revised for more complex construction delivery (and/or new definitions added), as discussed in 9. Public Private Partnerships, below.

With respect to the comments made on page 14 of the Information Package, the "price" that is lienable should be for the services or materials supplied under the agreement, not for damages (including those for delay). The 10% holdback amount is a specific fraction of the actual supply and is not related to a delay claim. The definitions in the Act should be amended to clarify that damages are excluded.

2. Holdback and Substantial Performance

(a) The City supports the holdback amount staying at 10% for all lienable work. It is simple, familiar, and ensures a consistent holdback fund for all trades.

(b) The issue of having large amounts of holdback being retained for very long periods of time may be addressed by phased certification of performance on certain projects. It is important that there be flexibility as to the intervals for certification. The Act should be permissive, not mandatory, for both allowing phased release and the selection of phases. On some projects, it may be preferable to certify at value thresholds, while on other improvements, certification after reaching milestones may make more sense. The City is not in favour of phased holdback release being tied to arbitrary time intervals (such as the legislated yearly release in Saskatchewan) that have no relationship to the project or significant milestones that are being met. If there is no logic to the phases, then it may be difficult to distinguish the work that is being certified from the continuing work.

(c) The City does not support mandatory/automatic holdback release. Currently, holdback may be released after the expiration of time for the preservation of lien rights, subject to completion of the due diligence required by owners to ensure no liens have been preserved, and subject to the exercise of any set-off rights by the owner. The payment mechanisms required to ensure transparent and accountable expenditure of public funds can take time.

If the Act is amended to permit phased holdback release, then presumably there will be less interest in holdback release bonds. In general, bonds are costly and do not guarantee payment (or performance). The impact of holdback release bonds on the set-off provision in s. 12 is unclear.

(d) There should continue to be holdback for finishing work. Anyone who supplies to an improvement should have lien rights, regardless of when they provide the supply. The value of finishing work will also increase if the minimum thresholds for substantial performance are revised to reflect present value.

(e) It would be fair to increase the minimum financial threshold requirements for substantial performance in s. 2(1) by adjusting the "$500,000" amounts.

With respect to consulting services, the Act lacks a satisfactory mechanism for determining when "substantial performance" is reached and the requirements under s. 2(1) can be confusing. If consulting services are provided well in advance of the construction of the improvement to which they relate, the requirement in s. 2(1) that the improvement be ready for its intended use means

substantial performance of consulting contracts cannot be certified. It would be helpful to have the language in s. 2(1) expanded so it can apply to consulting services more easily (to the extent that the services are not excluded from the operation of the Act). If the Act is amended to permit certification of phases, then the issue with consultants and s. 2(1) may become moot so long as the certification of phases for consultants is not tied to there being a physical improvement on the land in place.

(g) The City disagrees with introducing a mandatory "Certificate of Intention to Release Holdback". It would not have any legal force and adds an administrative burden. If a lien was discovered after issuing this Certificate, then funds would still have to be retained.

3. Preservation, Perfection and Expiry of Liens

Generally

The City agrees that there is a gap in s. 31(2)(a)(ii) and s. 31(2)(b)(ii) that can be addressed by adding "termination" as a trigger for the expiry of contractor's lien rights.

The minimum 25% to a $50,000 cap to vacate the registration of a claim for lien should be increased to better reflect actual legal costs today.

Preservation

(a) It is preferable to keep the status quo for the 45-day preservation period.

(b) The City is not opposed to written notices of lien, but the process might be improved if there were a simple form developed so that a written notice of lien satisfies the required elements set out in the jurisprudence and the project can be easily identified. Large, institutional owners can have difficulty identifying a given project and the responsible staff.

In addition, the colloquial phrase "notice holdback" can confuse the concept of holdback (with the 10% basic and finishing holdbacks). It might be worthwhile to create a new defined term for the funds that are retained in response to a written notice of lien.

(c) The City strongly recommends that s. 33 continue to be permissive for certifying the completion of a subcontract for several reasons. An owner and/or its payment certifier usually lack sufficient knowledge to certify that work was done by a certain subcontractor. The owner is not privy to the subcontracts or the pricing. Further, the amount of holdback being retained by the owner is based on the contract and a percentage of the progress payments, not the subcontract. An owner should not have to assume the risk of certifying completion of a subcontract under. s. 33 and then releasing holdback under s. 25.

If certification of subcontracts were mandatory, it would greatly increase the administrative burden of owners (and their payment certifiers). This is would become an even bigger burden if the Act is amended to permit the certification of phases for the purpose of holdback release. In such circumstances, subcontractors performing work for the entire duration of the project might still request certification of their subcontracts pursuant to s. 33 as they complete work in each phase if

it is earlier than the end of each phase. This could result in multiple releases of subcontractor holdback for each phase, before the regular phased holdback release. It is important that any changes to s. 33 or s. 25 consider the impact of other potential amendments first.

(d) While not specifically an "owner" issue, the City opposes the suggested "mechanisms to avoid potential abuse of lien rights". Lawyers take instructions from clients and should not be "certifying" that they have confirmed that the lien is a reasonable and bona fide amount.

Perfection

(c) As with preservation, the City prefers to maintain the status quo of 45 days to perfect.

Another area that might be reviewed is sheltering. Sheltering has long been complicated and problematic.

Expiry under section 37 of the Act

The two year limitation period under the Act is acceptable. The City has no suggestions to align the Act with the *Limitations Act, 2002*. There should be some consideration of the appropriate procedure with respect to a joined breach of contract action if the lien expires.

Requests for Information Pursuant to section 39 of the Act

Some clarity on this provision could be helpful as there are sometimes different expectations as to what should be provided with respect to the "state of accounts".

4. Prompt Payment or Timely Payment for Construction Work

The City is not opposed to prompt payment but prefers that it be dealt with by contractual terms, not legislation. The City made formal submissions to the Provincial Legislature on *Bill 69, Prompt Payment Act, 2013* and maintains its position.

There are many issues that need to be considered before embarking on prompt payment provisions to ensure that the interests of all stakeholders are considered.

(a) Many payment delays are caused by incomplete or improper payment applications. The onus of ensuring correct payment applications should remain with the payee. A payer should not be burdened with correcting erroneous and exaggerated payment applications. There should be no obligation on a payer until its payment certifier has reasonable time to review and certify the work. There can be no "deemed approval" of payment applications as this would be irresponsible and is unacceptable to a public body that is accountable to its taxpayers.

There are certain processes that are required before payments can practically be made by a government institution to ensure taxpayers' money is protected. Immediate payment release is not possible. Any changes that are made to the Act to encourage prompt payment must reflect the processing time realities. If timeframes are established under the Act that are too short, there will

be an increased likelihood of work stoppage and termination of contracts/subcontracts. This will be bad for the industry as a whole.

The City has a Fair Wage Policy to ensure contractors and subcontractors pay their workers union rates, or, for non-union work, the prevailing wages in a set schedule. If the City learns of non-payment of wages, it will retain funds from progress payments and pay workers directly for any back-wages owing. Any amendments to the Act should take into consideration these types of policies so that they may continue to be applied.

(b) The right of set-off should not be restricted by any amendments to the Act. Our comments on automatic release of holdback are provided above at 2. Holdback and Substantial Performance, part (c).

(d) A "one-size-fits-all" approach will not work given the variety of construction delivery models. Complex or time-sensitive projects may be better suited to having payments tied to project milestones or set payment schedules so that important steps in a project are completed on time. Set payment requirements would also not work in the context of PPP projects. The Act needs to allow flexibility.

(e) Pay-when-paid clauses can be problematic in the industry.

As the Review moves forward, the City would like the opportunity to comment on specific prompt payment provisions that may be suggested by other stakeholders.

5. Proof of Financing

Any financial information required of contractors (or subcontractors) can be obtained through pre-qualification and/or contractual clauses requiring disclosure rather than legislation. It is not necessary that the Act address these requirements. Even if a contractor (or subcontractor) shows strong financial ability at the beginning of a project, the status can change quickly and drastically.

Bonding provides some assurances in the absence of knowledge of a contractor's finances or when those finances are disclosed and seem fine but then payments stop flowing. On certain projects, the City still requests financial disclosure even with bond requirements. Bonds are costly yet sureties do not always respond to claims on them. These issues should not be dealt with by the Act.

The City and its agencies should be exempt from any requirement to provide proof of their financing to contractors or subcontractors as financial viability is not an issue and approved budgets for capital projects are publically available on the internet. Budgets are subject to a rigorous process that is accountable, transparent and incorporates significant public and stakeholder input.

6. Trust Provisions

(a) The trust provisions could be clarified, including adding a provision to confirm that privity applies to trust obligations.

An issue that the Review may consider addressing in the Act is the ability of a trustee to pay out trust funds in response to: (1) garnishments and other forms of execution and/or attachment; and (2) directions for payment by the beneficiary of the trust to someone other than the beneficiary itself.

With respect to (1), s. 77 of the Act sets out the priority of "liens" to garnishments, etc., but there does not appear to be a corresponding provision for the priority of trust funds to anything. Case law such as Elmford Construction Co. v. South Winston Properties Inc., [2002] OJ No 1124 (Div Ct) suggests that trust funds in the hands of the trustee are not subject to garnishment, but this result was not reached because a priority per se was given to the trust funds over the garnishment.

With respect to (2), there does not appear to be any provision in the Act that directly prohibits nor authorizes the payment of trust funds by the trustee to a third party named by the beneficiary of the trust in a direction, whether or not that third party is part of the construction pyramid. Case law such as Nicholson v Edgecon, 2015 ONSC 1237 suggests that payments by trustees to third parties outside the improvement pursuant to direction from the beneficiary nonetheless successfully expose the trustee to claims by those further down the construction pyramid. Furthermore, it is not clear whether it makes a difference if the trustee were directed by the beneficiary to pay one of the beneficiary's immediate beneficiaries (eg. if the owner is directed by the contractor to pay one of its subcontractors) or someone who is not the beneficiary's beneficiary, but still within the pyramid (eg. a sub-subcontractor), or someone completely outside the construction pyramid.

These issues should be clarified one way or the other so trustees know the extent of their legal obligations when faced with competing claims.

(b) The City opposes a mandatory holdback trust account or project bank account for government entities (or their agencies). It would be administratively burdensome and cause increased costs. There is no risk to holdback or project funds with the City (or its agencies).

7. Interrelationship with Insolvency Legislation

The City does not have any suggestions but agrees that there should be a review of the issues identified.

8. Priorities

It would be helpful if mortgages identified their financing purpose (acquisition/construction/ both) as suggested so that "building mortgages" could be more easily identified.

9. Public Private Partnerships

The City agrees that the Act does not accommodate the PPP delivery model well. Either the current definitions have to be rewritten to incorporate Project Co, etc. or new definitions can be created specifically for parties in PPP projects. It may be simpler to have the definitions and payment obligations for PPP projects set out separately in the Act.

There are other models in which the traditional (property) owner outsources the delivery of the project that can also lead to difficulties in terms of holdback obligations and other processes. The entity delivering the public project is not always a private entity.

If an owner contracts with its subsidiary to deliver a capital project (with the subsidiary hiring and paying contractors) and the owner flows money to the subsidiary to pay contractors as construction progresses, the Act would appear to require a 10% holdback be retained by both the owner and the subsidiary. This can unduly complicate project delivery.

In some projects, the lands on which the improvement is being made is owned by multiple parties, with one owner overseeing all of the construction and payments being made through it by the other property owners. If a written notice of lien is received, it can be confusing to determine which "owner" is responsible for retaining funds or is best able to set aside the full amount.

10. Non-Waiver

The City does not support the waiver of lien rights. These are important rights to protect suppliers of labour and material in the construction industry. It may also add uncertainty into the system to allow for waiver as a subcontractor further down the pyramid may not be aware of a waiver provision in the contract or subcontract above it.

11. Bidder Exclusion Provisions

It is important that procurement processes remain outside the scope of the Act and that there is no interference with freedom of contract and an owner's use of privilege clauses.

The City does not have a bidder exclusion provision in relation to litigation brought against it but does reserve the right to not award to the lowest bidder based on past poor performance. This helps ensure a certain level of workmanship will be provided when awarding to the lowest bidder and provides some control when, for example, a contractor has had compliance failures with respect to the *Occupational Health and Safety Act.*

Privilege clauses are an important tool for proper governance over public funds and the City strongly opposes any efforts to impose restrictions on them.

The City also has a Right to Reject Debtors and Set Off Policy that includes a right to not award to parties that are indebted to the City. This is a necessary tool for the same reasons as above.

12. Alternative Dispute Resolution

The City would prefer all ADR to be elective, not legislated.

Adjudication of owner's claims and contractor's claims may lead to many mini-hearings with the focus of participants shifting from completing the project to making/defending claims. Depending on the size and complexity of the project, this may be worth consideration, but should not be mandated in legislation.

There can be value to having a Dispute Review Board on certain projects, and in those instances, they can be referenced in the contract. The City does not support mandatory ADR provisions in the Act.

13. Summary Procedure

Some of the requirements around interlocutory steps could be dispensed with, such as the requirement to seek "leave" to bring a motion. Additionally, documentary discoveries and examinations for discovery could happen on agreement of the parties, and if no agreement, then the party seeking the discoveries could ask the Court. It may be more efficient and economical if interlocutory steps could be agreed to by the parties.

The appropriateness of an appeal from an interlocutory order will depend on the direction of the Review and whether the Act is revised so that lien actions are treated as potentially complex litigation (with automatic discoveries, etc.) or if there are is a movement to align the Act with a more summary procedure.

14. Surety Bonds and Default Insurance

The City's position on the bonding issues listed in the Information Package with respect to mandatory labour and material payment bonds, adjusting bond claims, requirements to pay promptly, adjudication and electronic delivery, is that they should not be legislated.

(b) The City is unsure as to how a surety could require a labour and material payment bond payee complete its subcontract but takes no position on this issue at this time.

(c) The City typically requires labour and material payment bonds on contracts valued at greater than $250,000 (or if there are certain risk factors). The cost of bonds is borne by the owner so they should remain within an owner's discretion.

(g) The City has no comments on whether changes to the third party beneficiary rule are appropriate without reviewing a specific proposal. There is risk to an owner making direct payment to a third party without privity of contract and the certainty that the amount being claimed/paid is justified. Any new provision would have to ensure that owners are not exposed to future liability.

(h) The only inclusion of insurance in the Act is with respect to insurance proceeds if a premises subject to a lien is destroyed. It is unclear what is being proposed by the reference to default

insurance. The Act should not interfere with freedom of contract by mandating insurance and/or bonding. Parties should be free to allocate risk and set requirements to mitigate risk in their contracts.

15. Miscellaneous

(a) The City agrees with providing for greater precision in setting out the technical irregularities that can be cured under the Act.

(b) The City agrees with the use of letters of credit with international commercial conventions in their terms.

(e) It would be helpful to have a periodic review of the Act on an ongoing basis.

Project identifier

An idea for consideration is to require contracts to have a "project identifier". This could be a number (perhaps following a set format) that could be passed on from owners to contractors to subcontractors, used on all project documentation and forms under the Act. It can sometimes be difficult for an owner to determine which project or premises a lien relates to when there are multiple improvements on one premises/road, or when the work under a contract takes place on multiple premises/roads.

Liens on roads

With regard to liens on roads specifically, some provisions and forms of the Act should be improved. For examples, better identification of projects and locations would assist owners and also parallel similar requirements on forms for liens that attach to land.

Practice Guide/Interpretation Bulletin

For the first time in decades, all of the sectors in the construction industry have been engaged to provide input as part of a full review of Act. Alongside the amendments to the Act, the City suggests that consideration be given to developing a practice guide and interpretation bulletins.

It is well established to have Practice Directions issued by the Court to explain details of court procedure that are absent from the Rules of Civil Procedure. It might be helpful to have additional guidance complement the Act for other issues. Given the complexity of the Act, changing technologies, and the broad cross-section of individuals affected, supplementary documentation could both explain the Act and facilitate the delivery of construction projects.

A practice guide could assist in the application of the Act and could also include other non-legislated steps that may be adopted on agreement of the parties. For instance, the guide could include a chart or drawing to more clearly show priorities that are only described with words under the Act. Also, if suggestions are made to impose a process for mandatory mediation and they do not end up being incorporated into the Act, the structure could instead be set out in the guide as a

reference tool for parties who agree to use mediation to resolve a dispute and want to adopt an established process.

The idea to introduce interpretation bulletins, like those used by the CRA for income tax, or a similar document, is to help resolve confusion in interpreting the Act. For example, an interpretation bulletin could set out specific examples of what is and is not lienable.

We look forward to further participation in the Review and may seek additional opportunities for consultation with the Province as per the Agreement on Consultation and Cooperation, if warranted.

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