Prompt Payment Ontario

Submission to the Construction Lien Act Review

NOVEMBER 2015

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November, 2015

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1. Ontario's Construction Industry needs a New Statutory Model

Prompt Payment Ontario

Prompt Payment Ontario (PPO) was established to achieve the enactment of Prompt Payment legislation in Ontario. PPO grew out of an initiative of the Ontario Section of the National Trade Contractors Coalition of Canada (NTCCC). However, unlike NTCCC which is focused only on Trade Contractors, membership in PPO is open to any organization that supports the objective of enacting Prompt Payment legislation. PPO's membership therefore includes, in addition to many trade contractor organizations, the Council of Ontario Construction Associations (COCA), a number of construction unions, suppliers and employee benefit trust funds. A complete list of PPO's current members is reproduced at Appendix C.

The Purpose of the *Construction Lien Act* Review

This review process was announced following the unanimous second reading approval received by Bill 69, a private member's bill short-titled *'Prompt Payment Act, 2013'*. The announcement of the review process stated that it was "commissioned in response to stakeholder concerns related to prompt payment and effective dispute resolution in Ontario's construction industry, such as encouraging timely payment for services and materials, and making sure payment risk is distributed fairly."[1] Issues related to prompt payment and dispute resolution are more than just central to the review. They are the raison d'être for the review.

The primary purpose of this review is *no*t to fix technical gaps related to security for payment in the current *Construction Lien Act*. The review process may identify some of these gaps and suggest useful solutions. However, recommendations to fix technical gaps in the current lien system are secondary to the primary purpose of the review. This review is first and foremost about addressing the problems of payment delays in Ontario's construction industry. Payment delays have become the number one problem in Ontario's construction industry at all levels of the construction pyramid and in all sectors.

[1] Ministry of the Attorney General of Ontario, "Ontario Launches Expert Review of the Construction Lien Act", February 11, 2015.

The success or failure of this review process will turn on the effectiveness of its recommendations to address the problem of systemic and pervasive payment delay.

The Need for a New '*Construction Act*' in Ontario

In a frequently cited decision, Lord Denning observed that "there must be a 'cash flow' in the building trade. It is the very lifeblood of the enterprise."[2] Lord Denning's observation is as true today as when he issued his decision in 1971. Cash flow in the construction industry rests on three pillars:

- security for payment,
- promptness in payment, and
- expeditious resolution of disputes involving payments.

In Ontario, these pillars are in need of serious repair. The *Construction Lien Act* is cumbersome and costly to use. For the majority of trade contractors – and especially for small trade contractors – the current *Act* provides little or no security for payment. There is no minimum standard in use to ensure that payments flow promptly in the construction industry. Nor is there a statutory framework that requires the expeditious resolution of disputes over payments. The current payments regime is neither efficient nor fair. The balance between freedom of contract and legislated standards needs to be redrawn.

- There are pervasive and increasing delays in payments to trade contractors. For the majority of trade contractors, these delays effectively nullify the payment security intended by the current *Construction Lien Act*.
- The delays in payments to trade contractors have a cascading effect. They cause downstream delays in payments to other sub-contractors and suppliers as well as delays in statutory and contractual remittances and even interruptions in payroll.
- The growing proportion of receivables that are outstanding for more than 90 days makes it increasingly difficult for many trade contractors to secure conventional receivables financing. Too often, trade contractors find themselves in a 'liquidity vice' that threatens the solvency of their businesses.

[2] *Dawnays Ltd v FG Minter Ltd* [1971] 2 All ER 1389; [1971] 1 WLR 1205

- Disputes over payments cause cash-flow on a construction project to freeze up and over-burden the courts with matters that should be resolved through more expeditious procedures.

Ontario needs a new statutory model to govern payments in the construction industry. This new *'Construction Act'* should take a holistic and integrated view of security for payment, promptness in payment and expeditious resolution of disputes over payment. The new *'Construction Act'* will also need to address the distinct requirements of non-traditional project delivery methods, such as public-private partnerships (P3s).

When cash flow is secure, prompt and predictable:

- trade contractors will compete for work to the full extent of their technical capacity;
- construction buyers – both private and public – will obtain the best value for their money; and
- trade contractors will have the confidence and the financial means to invest in new machinery and equipment and to replenish the construction industry's skill-base by hiring more apprentices.

From a public interest perspective, the benefits of secure, prompt and predictable cash flow in the construction industry are clear:

- greater value-for-money,
- more employment in the construction industry,
- more skills training,
- more investment in machinery and equipment, and
- greater productivity.

However, when payment is unsecured, delayed or uncertain, the 'virtuous circle' becomes a 'vicious circle'. Trade contractors refrain from bidding on some projects so as to preserve a higher ratio of cash reserves to operations. If the market permits, they also may factor into their bids an allowance for the risk of late and uncertain payment. The result is higher construction costs. Uncertainty about when (or if) payment will be received also leads to greater caution before committing to new machinery and equipment or hiring additional workers or new apprentices. The inevitable result of the additional risk created by unsecured,

delayed and uncertain payment is a construction industry that operates with higher costs and less productivity. To these costs should be added the economic waste that results when viable businesses are forced into insolvency because the payments that are due to them are delayed and these businesses, having exhausted their cash reserves, can no longer access conventional receivables financing.

Ontario's current 'system' for ensuring the continuation of cash-flow in the construction industry is in need of a significant overhaul. Ontario needs a new *'Construction Act'* that provides for reasonable payment for security, a minimum standard for promptness in payments, and a default process for expeditiously resolving disputes that interrupt the flow of cash in construction projects. This submission will set out the principles that should inform the design of a new '*Construction Act*'.

Framework for a New *'Construction Act'*

The new *'Construction Act'* should have four elements:

1) security for payment,
2) obligations for prompt payment and fair dealing,
3) a mechanism for expeditious resolution of disputes, and
4) special provisions applicable to P3s

1. Security for Payment

Contractors and suppliers should be provided with reasonable security for payment by an updated, streamlined and more broadly applicable version of the current *Construction Lien Act*. Important innovations and changes from the current lien system should include the following:

i. For all projects over a certain value (we propose $250,000 indexed to an inflation measure), there should be a *segregated* holdback fund that is held in trust in a bank account, identified as such and disclosed to the beneficiaries of that trust. Bonding off a lien does not and should not eliminate the obligation to hold these monies in a segregated trust. The implication of this principle is that, in all circumstances except small projects, a payer must pay the full amount of a contractor's invoice: 90% of the amount will be paid directly to the contractor and 10% into the segregated holdback trust fund. An alternative would be to allow a 'holdback release bond' posted by the payee, which would obviate the

need to maintain any segregated holdback fund and allow payment of 100% of a contractor's invoice.

ii. For all projects over the specified threshold ($250,000 as suggested above), the full value of the construction project should be backed by either a *segregated project trust account* or a surety bond. For projects that are owned in whole or in part by the Provincial Crown, municipalities, boards of education, colleges and universities, hospitals or other entities which are largely financed by provincial monies, two-tier bonds, akin to those already in wide use on federal public projects, should be used. This will extend protection down the construction pyramid by including sub-subcontractors in the definition of "claimant" and thereby providing a further measure of security for payment.

iii. It should be mandatory to release holdback monies to the intended beneficiary immediately following the expiry of lien rights for that particular beneficiary and without any set-offs.

iv. The notion of a 'finishing holdback' should be abolished as it is not widely used and provides only nominal security for finishing trades.

v. The monies qualifying as 'trust monies' pursuant to Part II of the current *Act* should be payable without delay to the intended beneficiaries immediately upon receipt, failing which there should be a deemed breach of trust and a reverse onus on the statutory trustee and those currently liable under s. 13 of the current *Act* to account for the monies.

2. Express Obligations of Prompt Payment and Fair Dealing

Prior to the establishment of PPO, a statutory remedy to slow payment was proposed by the Ontario division of National Trade Contractors Coalition of Canada (NTCCC). In pursuit of an industry solution, NTCCC (Ontario Section) developed, along with the Ontario General Contractors Association (OGCA), a Consensus Draft for a Prompt Payment Act in Ontario. The Consensus Draft was the product of 18 months of negotiation between NTCCC (Ontario Section) and the OGCA.

The Consensus Draft, which should not be confused with Bill 69, is reproduced at Appendix A of this submission, along with an article from the *Daily Commercial News* announcing the release of the Consensus Draft. PPO believes that the principles reflected in the Consensus Draft continue to provide a basis for reforming the payment system in Ontario's construction industry. The fact that these principles reflected an industry consensus among the general and trade contracting communities should carry particular weight

The new *'Construction Act'* should establish a framework for progress and milestone payments to contractors. Specific elements of the framework should include:

- A requirement that progress payments to contractors be made monthly and that these payment be made within a stipulated period after an invoice has been submitted.
- A requirement that simple interest be paid on overdue invoices and be included in a claim for lien.
- A deemed right of a contractor to suspend work, demobilize or terminate the contract when an invoice has not been paid following the expiry of a specified cure period and upon notice.
- A stipulated period for a payer to object to an invoice, failing which the invoice is deemed due and owing for any and all work to which no objection has been made.
- A process of expeditious dispute resolution (to be discussed in the next section).
- A requirement that a payer provide reasonable financial disclosure that is sufficient to establish that the payer is capable of meeting its obligations to contractors, sub-contractors, suppliers and others in the construction pyramid.
- A requirement that a prime contractor notify sub-contractors promptly when payment has been received by the prime contractor and that sub-contractors similarly advise their respective sub-contractors and suppliers of the receipt of payments.
- Requirements that, if a construction contractor is to be paid on the basis of milestones, the (1) the milestones must be clearly described in the tender documents and not be subject to amendment without the agreement of the contractor, (2) in no event should the time between payment milestones be more than 3 months, and (3) it should not be permissible to impose milestone contracts on a sub-contractor, unless the prime contractor is also subject to corresponding milestones.
- The current prohibition against contracting out of the Act should remain and apply to the foregoing proposed changes as well.
- Statutory prohibition of pay-if-paid clauses, *i.e.*, provisions in contracts which transfer the entire risk of non-payment by a payer to a sub-contractor or other party not in privity with the payer.
- A clearly defined scope of when and how 'pay-when-paid' clauses may operate. This should be based on two principles. The first is an explicit

duty on the part of a payer to take reasonable and timely steps to correct upstream payment problems, including adjudication and registering a lien. The second is an overriding time limit after which no payer may rely on a 'pay-when-paid' provision in a contract to further delay payment.

Express and prescribed prompt payment duties along the lines proposed above will relieve the current lien system of a function that it is not designed to perform and at the same time introduce a much needed greater predictability into the construction industry's payment system.

3. Expeditious Resolution of Disputes

The new *'Construction Act'* should provide for mandatory use of an expedited dispute resolution process. The model for this dispute resolution process should draw on the experience of other common law jurisdictions that have established these processes by statute for their construction industries. Key elements of the expedited dispute resolution process would be:

- The right of either party to a construction contract to refer a dispute to adjudication.
- Stipulated and compact time periods within which an adjudication must commence and proceed to completion.
- The right of an adjudicator to order interim payments.
- The obligation of a payer found liable upon adjudication to make immediate payment in accordance with the adjudicator's order.
- A stipulation that any adjudicator's order compelling or refusing payment should be subject to review at the end of the project.
- A right to enforce an adjudicator's decision by such enforcement mechanisms as are otherwise available at law for the collection of a debt obligation, including execution and garnishment.

4. Special Provisions applicable to P3s and Other Non-Traditional Delivery Models

The new *'Construction Act'* should include a special section dealing with the application of security, promptness and dispute resolution on P3 and similar projects wherein the financing of the project is assumed in whole or in part by the construction team. The issues raised by these business models are sufficiently distinct and complex that that it would be better to address them in their own right, rather than attempt to 'shoe-horn' them into a framework developed with entirely different procurement and execution models in mind. P3s are a key instrument for channelling infrastructure investment. It is important that the progress of the P3 model not be hindered by a legislative framework designed to address the problems in the more traditional forms of construction delivery. At the same time, it is also important that the general legislative framework not be made more complex or ambiguous by being reshaped to accommodate the unique risk-sharing models and role assignments that are common in P3 and similar projects.

Outline of Submission

Chapters Two, Three and Four address key issues pertaining to payment security and the prompt remittance of statutory holdbacks.

Chapter Five discusses extent and consequences of the construction industry's pervasive culture of late payment. Chapter Five also sets out the principles that should be reflected in a minimum statutory standard for promptness in payments.

Chapter Six deals with financial disclosure issues and the need for a minimum disclosure duty on the part of payers.

Chapters Seven proposes the introduction of segregated trust funds for holdback monies and for project accounts.

Chapter Eight and Nine examine claimants' priorities under the existing Construction Lien Act and the potential impact of changes in federal insolvency legislation.

Chapter Ten discusses issues that are specific to public-private partnerships (P3s). Chapter Eleven comments on the need for non-waiver provisions in the recommended 'Construction Act'. Chapter Twelve discusses the pernicious practice of bidder exclusion.

Chapter Thirteen examines the need for a legislated model for expeditious resolution of disputes on construction projects. Chapter Fourteen comments on the role of summary procedure and its relation to prompt payment.

Chapter Fifteen discusses the role of surety bonding and the need to prevent an otherwise useful device from contributing to the problem of payment delay.

Chapter Sixteen discusses the need to legislate a minimum interest payment on overdue accounts.

Chapter Seventeen discusses problems that are unique or more acute in residential construction.

Chapter Eighteen describes the consequences of payment delays to trade contractors for employee benefit plans and the workers whom they serve.

Chapter Nineteen summarises Prompt Payment Ontario's expectations of this review process and our view that systemic and pervasive payment delay in the number one problem in Ontario's construction industry.

2. Lienabilty

The *Construction Lien Act* does not provide Effective Payment Security

As currently drafted, the Construction Lien Act falls significantly short of providing reasonable security for payment to the majority of contractors.

In residential construction, which accounts for more than 30% of new construction, the *Construction Lien Act* often affords little, or no, effective security against payment default. There are two reasons for this. In the first place, lien rights are extinguished when ownership of the house or condominium unit is transferred to the home buyer. A common practice in the residential sector is for payment to contractors to be delayed until proceeds from sale are realized. Consequently, by the time a contractor realizes that there will be a full or partial default on payment, lien rights have expired. The second factor that frustrates lien rights in the residential sector is the requirement to register liens on a lot-by-lot basis, or in the condo sector, on a unit-by-unit basis. The right to a general lien upon the entire project is either non-existent or easily defeated. The requirement to lien on a lot-by-lot or unit-by-unit basis add both complexity and costs to exercising lien rights. In some cases, the need to lien on a lot-by-lot or unit-by-unit basis may also introduce ambiguity when the actual ownership interest is not clear-cut.

In the commercial sector, a lien registered against a leasehold interest is often difficult to preserve and even when preserved, frequently worthless. There are two related reasons for this. In the first place, leases are seldom registered on title, thus leaving a claimant with an undefined asset against which to engage the charge of a lien. Second, a tenant that defaults on payment obligations to a contractor also commonly defaults on rent payments to the landlord, thereby giving the landlord cause to terminate the lease. This extinguishes the security interest against which the lien was registered.

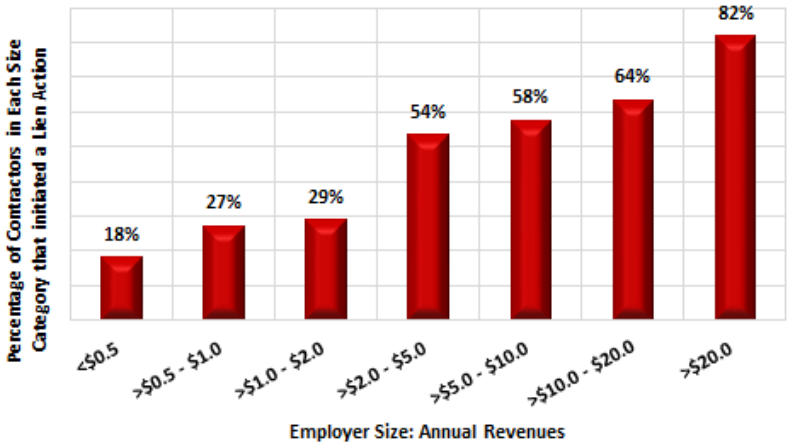
> Throughout this submission, reference will be made to the *Trade Contractor Survey*. This survey was administered on behalf of Prompt Payment Ontario by Ipsos Reid. A total of 535 contractors completed the survey. The survey sample is representative of all major construction sectors, all types of payers, and all sizes of trade contractors. PPO has published a separate report that summarizes the findings of the *Trade Contractor Survey*.

On P3 projects, there is often a lack of clarity over ownership of the asset and the allocation of risk within the P3 arrangement. The 'special purpose vehicle' set up to execute the P3 project often does not hold any lienable assets.

Even when assets are lienable, the security provided by the current *Construction Lien Act* is always costly and time-consuming to access. For many small contractors, using the remedies afforded by the *Construction Lien Act* is so costly that it deters using those remedies and often amounts to a denial of access to justice. The *Trade Contractor Survey* shows that while 82% of

contractors with annual revenues of more than $20.0 million report having initiated a lien action in the last three years, this proportion falls to 18% for contractors with annual revenues less than $0.5 million.

Figure No. 1
Percentage of Trade Contractors in Each Size Category (Based on Gross Revenues)
That Initiated a Lien Action in the Past Three Years
(n=535)



The *Trade Contractor Survey* also found that, on average, contractors receive only 61.5% of the amount claimed in their liens. Their median expenditure in legal costs for registering a lien is $15,000.[3] Asked the shortest time period to receive payment after registering a lien, the median response was 5 months. Asked the longest time period to receive payment, the median response was 18 months. However, 24% of respondents report that their longest time to receive payment was three years or more. It is hardly surprising that, in these circumstances, almost two-

Figure No, 1 shows that the lien process is favoured by larger trade contractors who tend to work on large projects where the value of the holdback would be sufficiently large to justify the costs of registering and preserving a lien. For smaller trade contractors, the holdback amount may be significant in relation to the size of their business, but the amount is not sufficiently large to justify the costs of using the lien system. Many smaller trade contractors are also more dependent on immediate cash-flow and therefore much less able to wait for satisfaction of their claim through the lien process. They are more likely to negotiate a settlement, however unfavourable that settlement may be.

[3] One of the objects of statistical analysis is to estimate the 'central tendency' within a sample. There are three measures of 'central tendency': the arithmetic average (or mean), the mode (which is the most frequent observation) and the median. The median is the half-way point in the sample, i.e., half of the sample is above the median and half is below. In samples which have extreme outliers, the median is a better indicator of 'central tendency' than the arithmetic average. In the *Trade Contractor Survey*, for example, one of the respondents reported legal expenses of $1.5 million. This would bias the calculation of the arithmetic average such that it unrepresentative of the sample and not indicative of the 'central tendency'.

thirds of trade contractors (64.9%) indicate a negative view of the lien system. Their principle criticisms of the current lien system are:

- the excessive time required to register and pursue a lien claim,
- expiry of lien rights before it is apparent that there is a need to register a lien claim,
- the high cost of using the lien system, and
- fear of being blacklisted by general contractors or owners (including public sector owners) for exercising lien rights.

Consistent with trade contractors' negative views on the lien system, more than four fifths (81.9%) of them report using the system either 'never' or 'rarely' to pursue payment.

A new *'Construction Act'* will need to address a number of weaknesses in the current *Construction Lien Act*.

Specific Issues

Definition of 'Improvement':

The current definition (2010) of 'improvement' does not require further amendment. The shortcoming of the definition of 'improvement' revealed in *Kennedy Electric Limited v Dana Canada Corporation, 2007 ONCA 664* were adequately addressed by the 2010 amendment to the Act. PPO does not believe that any further clarification is required.

Definition of 'Owner' in the Context of P3 Projects:

PPO believes that a separate section of the new '*Construction Act*' should deal with P3 projects and similar arrangements. The definition of an 'owner' in the general statutory framework should *not* be amended to accommodate the specific issues arising from P3 projects and similar arrangements. To change the generally applicable definition of an 'owner' to address problems related to P3s and similar arrangements would potentially introduce unintended ambiguities that might subsequently add to the complexity and detract from transparency. (Issues pertaining to P3s are addressed in Chapter Ten.)

Payment Security in the Context of Leasehold Improvements:

Leasehold improvements raise difficult issues for payment security using the lien system. As the *A*ct is currently drafted, the ability to lien against a leasehold interest is often of no value. When a tenant defaults on payments to contractors and suppliers, the tenant also frequently defaults on their lease obligations. This terminates the leasehold interest and extinguishes the lien right which is applies only to the leasehold interest, not to the land and premises. As well, a tenant may style itself differently for business purposes than the party named in a lease. This can invalidate a lien if it is based on the 'trading name' of the tenant. Land registries often do not contain information on tenancies.

The problem of 'trading names' differing from the name that appears on a lease can be addressed by a provision in a new *'Construction Act'* stipulating that when a contract for a leasehold improvement is signed by a party holding itself out as the holder of a leasehold interest, a lien registered against that stated leasehold interest should be deemed to apply equally to any other party who may have the actual leasehold interest or a superior leasehold interest. Aside from this change, there are no easy solutions to the problem of payment security when an improvement pertains to a leasehold interest. Financial disclosure duties and prompt payment obligations would diminish the security problem by alerting a trade contractor to the likelihood of payment problems. A right to suspend work when payment is not received would also limit a trade contractor's exposure to the consequences of non-payment.

There are other options that may be considered to supplement prompt payment requirements. For example, some additional security for payment might be achieved by deeming landlord inducements to be trust monies for the benefit of contractors carrying out the improvement when those inducements are intended to offset a tenant's costs for the improvements. This would limit the ability of tenants to divert inducement monies to other business purposes. However, deeming cash inducements to be trust monies is at best a partial and potentially frustrated solution. In the first place, many landlords offer inducements in the form of rent waivers for a period of time rather than cash payments. This practice could supplant cash inducements if the deemed trust provisions of a new *'Construction Ac*t' were considered too constraining. In other cases, cash inducements take the form of a compensation for tenant relocation costs or the costs of exiting another lease. Styling cash inducements in this way could remove them from the ambit of deemed trust provisions.

There may also be scope for requiring surety bonding on projects above a certain value. However, the difficulty with this option is that a great many tenants will not be bondable. This would be especially true for businesses that are new or which have operated for only a few years.

Finally, the lien might apply to the land and premises as well as the leasehold interest. The difficulty with this option is that some leasehold improvements confer no additional value on

the land and premises and are of value only to the tenant. There is no public interest served by introducing policies which could discourage landlords from approving leasehold improvements that tenants may wish to undertake.

As a practical matter, therefore, PPO does not see any effective solutions to the problem of improving payment security in the context of leasehold improvements except for the introduction of prompt payment duties, financial disclosure rights and the right to suspend work when payment is not received.

Residential Construction:

In residential construction, two changes are needed. First, lien rights on residential properties (both freehold and condominium) should survive the transfer or sale of the property. The current *Act* effectively extinguishes lien rights when the sale of the property closes and the home buyer takes possession. This eliminates security for payment. If the principle of enduring lien rights is incorporated into legislation, akin to that found in the *Personal Property Security Act*, purchase agreements will provide whatever protections home purchasers may require against a lien. These protections could include set-offs against the closing price or payment of the closing amount into trust or escrow accounts. If necessary to protect home buyers, these types of provisions could be deemed to be part of a purchase agreement. In any event, PPO believes it is entirely feasible for lien rights to endure after the sale or transfer of a property without unreasonably encumbering new home purchasers. The second change that is need in the residential sector is the option of a claimant to apply a general lien to the project rather the registering separate liens on each lot or unit. The current requirement to apply liens on a lot-by-lot or unit-by-unit basis adds complexity and cost to the lien process that frustrates the exercise of lien rights.

> Lien rights and payment security need to be made more effective in the residential sector.

Price:

PPO believes that the definition of 'price' should include interest at a specified rate as compensation for delayed payment.

Claims on Holdback Trusts and Project Trusts:

PPO proposes that trade contractors should have the right to make a claim on a Holdback Trust and a Project Trust Account in the same manner as they have the right to apply a lien against lands and premises. (Holdback Trust Accounts and Project Trust Accounts are discussed in more detail in Chapters Three and Seven.)

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3. Holdback and Substantial Performance

Current Practice:

Survey data show that the holdback system does not operate in the manner intended by the *Construction Lien Act*. First, it is common practice for holdback monies to be subject to set-offs when there is a deficiency dispute. Second, even when there is no deficiency dispute, The Trade Contractor Survey found that almost half of trade contractors (47.5%) wait 90 days or longer either 'very often' or 'always' to receive their holdback monies. The 90-day marker is particularly important to trade contractors. Banks will not advance receivables financing on accounts that are outstanding for more than 90 days.

> In principle, the holdback scheme under the current *Act* creates a pool of funds to pay unsatisfied suppliers. In practice, the current holdback scheme chiefly benefits lenders and owners by transferring financing obligations for the construction work to trade contractors.

Holdback Principle:

Holdback monies should be solely for the purpose of providing security to suppliers and sub-contractors who have not been paid by a contractor. Holdback monies should *not* be treated as security for performance of the contract. When, at the end of project, a payer disputes a contractor's performance, set-off should be applied to the final invoice, not to the holdback monies. Holdback monies should be remitted promptly to the trade contractor and should not be subject to any set-offs. A new *'Construction Act'* should set out these principles explicitly.

> The sole purpose of holdback is to provide security to suppliers and sub-contractors. Holdback monies should be kept in a segregated trust account. If no liens have been registered, the holdback monies should be remitted promptly to the trade contractors without any set-offs immediately following expiry of the 45-day period set out in the current *Construction Lien Act*.

Segregated Holdback Trust Account:

When a contractor's invoice is paid, 90% of that amount should be remitted directly to the contractor within the time period specified by the new *'Construction Act'*. The remaining 10% should be remitted *at the same time* to a segregated Holdback Trust Account. This trust

account should not be subject to comingling with other trust accounts or with other monies. The sole beneficiaries of the trust account should be the trade contractors from whose invoices the 10% has been withheld or the supplier or sub-contractors to those trade contractors who have not been paid by the trade contractors. No other claimants should have any priority over these trust monies. An alternative would be to allow a 'holdback release bond' posted by the payee, which would obviate the need to maintain a segregated holdback fund and allow payment of 100% of a contractor's invoice.

Substantial Performance:

The current holdback system is unfair to trades that are engaged in the early stages of the construction process but which must wait for certification of substantial performance of the *entire* project before holdback funds are released. On large projects this waiting period can exceed a year. On projects that are undertaken in phases, contractors engaged on the early phases may be required to wait significantly longer than this – perhaps two or three years – before their holdback is released. At present, no interest is paid on these monies.

> There should be a mandated process for the early release of holdbacks on projects that take more than 12 months to complete.

Sections 25 and 26 of the current *Act* allow for earlier release of holdback. However, sections 25 and 26 are permissive, not mandatory.

PPO recommends that:

- each contracted segment of work should be subject to a certification of substantial performance (CSP),
- the CSP for each contracted segment of construction work should trigger the countdown on lien rights applicable to that segment of the construction work,
- the CSP should be published, and
- upon the completion of the countdown on lien rights, if no liens are preserved, the holdback applicable to that contracted segment of the construction work should be released without further delay.

In essence, <u>these principles would make sections 25 and 26 of the current *Act* mandatory</u>, rather than permissive. These principles would also supersede the requirement for substantial performance for the project as a whole. This would eliminate the ambiguities created by the phasing of large projects.

Certificates of Substantial Performance and Rights to Information:

Sec. 32(2) of the current *Act* sets out the content of a certificates of substantial performance (CSP). There are rights to information presently set out in sec. 39. These information rights should be integrated with the CSP. Specifically, a CSP should also include:

- the names of the parties to the prime contract(s) (if construction management) and the names of the parties between the "contractor(s)" and its/their subcontractors;
- the state of accounts between the owner and the contractor and between the contractor and its subcontractors including the revised prime contract price as at the last certified payment; and
- particulars of any labour and material payment bond by any contractor or subcontractor provided for that particular improvement,

PPO also advocates a mandatory CSP publication process for projects in excess of $250,000 to better inform all parties to the project of one of the more important key trigger dates for the preservation of liens.

Substantial Performance in the Residential Sector:

In residential construction, it is uncommon for a builder to certify substantial completion. The more common practice is for a builder to 'acknowledge' that a trade contractor has completed the agreed work. This acknowledgement allows the trade contractor to initiate the invoicing process. However, the acknowledgement does not imply that the builder has waived its right to allege deficiencies, require further work to remedy the deficiencies, or claim set-offs against the invoice for otherwise rectifying the deficiencies. PPO advocates that where an owner does not certify substantial completion, but rather acknowledges that agreed work has been done for purposes of allowing an invoice to be submitted, the owner must specify any deficiencies within 21 days of the acknowledgement. The acknowledgement would serve the same purpose as a 'declaration of last supply' for the purposing of defining time limits and trigger dates *per* the current *Ac*t.

Finishing Holdbacks:

The financial sums generated by finishing holdbacks are generally too small to be of practical value and they are not commonly used. PPO recommends eliminating finishing holdbacks on the presumption that prompt payment will be incorporated into the new legislative model.

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4. Preservation, Perfection and Expiry of Liens

45 Day Limits on Preservation

Survey data show that the average age of trade contractors' receivables is 61.3 days. Two-thirds (67.6%) of invoices that were outstanding for more than 30 days were overdue for more than 45 days, meaning that lien rights had expired. One of the consequences of embedding of late payment practices in the construction industry is that most contractors are not aware that a payment is in jeopardy until after their lien rights have expired.

> By the time most trade contractors realize they aren't getting paid, their lien rights have expired.

Extending the time limit to preserve a lien would be a remedy that is worse than the ill it seeks to correct. The time limit to preserve a lien cannot be extended without equally extending the time to receive holdback monies. It is perverse reasoning to suggest that the remedy to the consequences of late payment practices should be to extend the time to preserve liens and concurrently extend the time period for retainage.

The current 45 day limit on preserving lien rights is appropriate and reasonable in the context of the 30-day payment cycles that were prevalent when the current lien system was introduced. If a new 'Construction Act' were to apply a 30-day standard for payment, *per* the Consensus Draft on a Prompt Payment Act, there would be no need to extend the current 45-day period.

> Prompt Payment is a crucial component of any reform of the current payment and security system to ensure reasonable cash flow and timelines in the construction process.

Case Management of Lien Actions

In Toronto and Ottawa, an expedited reference procedure is used that is similar to a 'case management' process through the use of Masters. However, this procedure has not been extended to other regions and further, has not been encoded into the current *Act*. PPO believes that lien claimants benefit from the expedition of this procedure and that it should be extended on a province-wide basis. This could be accomplished through an amendment to section 58(1) of the current *Act* mandating a reference to a Justice or Master, where available, who would act as the case manager for all litigation involving the same improvement. This would permit those jurisdictions that do not have Masters to benefit from case management in

construction lien matters. It would also mean doing away with settlement meetings under the current *Act* which are seldom used (ss. 60(2) and 61 of the current *Act*.)

Leasehold Interests

It was noted in Chapter Two that registering a lien against a leasehold interest poses two problems. First, there is currently no statutory requirement to register leasehold interests on title. A contractor may not know and may not have access to correct and legally reliable information on the leasehold interest. Second, in most cases, claiming a lien against a leasehold interest is pointless. The tenant who defaults on payments to a contractor is also likely to be in default of their lease obligations. This often leads to the lease being terminated, thereby extinguishing the leasehold interest.

As proposed earlier in this submission, PPO recommend where a contract for a leasehold improvement is signed by a party holding itself out as the holder of a leasehold interest, a lien registered against that stated leasehold interest should be deemed to apply equally to any other party who may have the actual leasehold interest or a superior leasehold interest.

Other options that could be considered include:

- deeming landlord inducements for leasehold improvements to be trust monies for the exclusive benefit contractors carrying out that improvement and their suppliers;
- requiring surety bonding on projects above a certain value; or
- on projects above a certain value, allowing liens to be applied against the fee simple interest.

Although they merit consideration, there are difficulties will all of these options. PPO believes that the only practical way to ensure cash-flow on improvements related to leasehold interests is to introduce prompt payment obligations together with the right to reasonable financial information, and the right to suspend work when payment is not received. When these provisions are in place, trade contractors will be alerted to payment problems before they get out of hand and be able to take corrective action in a timely manner before substantial claims accumulate.

5. Prompt Payment

It is essential that a new 'Construction Act' prescribe prompt payment obligations. The *Construction Lien Act* was never designed to promote or ensure prompt payment, and indeed, there is nothing in that *Act* which actually requires payment. Nor can the remedies in the current *Ac*t be made to perform that function. This review process will have been a wasted opportunity if it does not propose a prompt payment regime for Ontario.

The Prevalence and Consequences of Late and Uncertain Payment

Late and uncertain payment delay is systemic in the construction industry. There are several dimensions to the problem that this review needs to consider.

A. The Trend for Average Collection Periods to Increase

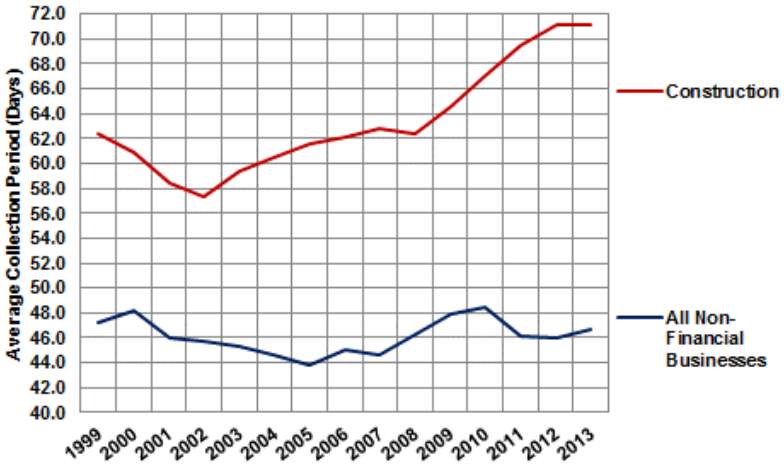
Over the last decade, the average age of receivables in the construction industry has increased. This contrasts with other non-financial businesses where the trend has been essentially stable.

Figure No. 2 compares the trend in the collection period for receivables in the construction industry with the trend in all non-financial businesses. These trends are calculated using Statistics Canada's data on the turnover rates for receivables.[4] The data are published on a national basis only. However, given the size of Ontario in the national economy (approximately 40%), the national trend is indicative of the Ontario trend. The most recent data are for 2013. The data show that since 2002, the average collection period in the construction industry has increased from 57.3 days to 71.1 days.[5] Moreover, these invoices are often not issued until one month's work has been completed. Hence, trade contractors implicitly finance more 100 days construction work (30 +71.1). The data also show that the construction industry trend contrasts with the trend in other non-financial businesses where the collection period is both short and essentially stable.

[4] The average collection period can be computed as: 365 divided by the receivables turnover rate.

[5] In the *Trade Contractor Survey*, the average age of current receivables was 61.3 days. This measure not the same as the average collection period, since actual collection of these receivables will necessarily extend beyond their current average age.

Figure No. 2
Average Collection Period (Days) for Receivables
Construction Industry compared to All Non-Financial Businesses, 1999-2013 (Canada)
Based on Statistics Canada, CANSIM, Table No. 180-0003



The first consequence of the increase in the average collection period is an increase in the financing costs borne by trade contractors. This financing cost is directly proportionate to the interest charged by the credit system for loans secured by receivables. The expected increase in interest rates will augment this financing cost.

B. Prevalence of Late Payment in All Sectors

Figure No. 3 reports data from the *Trade Contractor Survey* that summarizes trade contractors' estimates of the frequency of timely and late payment by sector, based on their experience over the past three years. The data show that late payment is common in *all* sectors of the construction industry.

> Payers in all sectors routinely engage in late payment. The late payment problem is not confined to a small number of payers, nor is it a problem that is limited to a particular sector. Late payment is systemic and embedded in the construction industry.

Figure No. 3
Excluding statutory holdbacks permitted by the *Construction Lien Act*, over the past three years, how often was it for an approved or certified payment to be delayed beyond 30 days when monies were owed?

	n=	Never greater than 30 days	Occasionally greater than 30 days	Often greater than 30 days	Always greater than 30 days	Don't know	Total
Residential Builders or Developers	142	2.8%	13.4%	30.3%	48.6%	4.9%	100.0%
Private Individuals in Residential	102	19.6%	41.2%	16.7%	20.6%	2.0%	100.1%
Commercial Owners	210	1.4%	12.9%	33.8%	49.5%	2.4%	100.1%
Industrial Owners	177	3.4%	11.9%	30.5%	52.0%	2.3%	100.1%
P3s	68	1.5%	11.8%	29.4%	45.6%	11.8%	100.1%
Federal Government	107	8.4%	14.0%	25.2%	46.7%	5.6%	99.9%
Provincial Government	113	7.1%	18.6%	25.7%	46.0%	2.7%	100.1%
Municipal Government	133	8.3%	19.5%	30.8%	39.1%	2.3%	100.0%
Boards of Education	130	6.2%	20.0%	29.2%	43.1%	1.5%	100.0%
Colleges and Universities	133	4.5%	19.5%	27.8%	46.6%	1.5%	99.9%
Hospitals	116	6.0%	19.8%	26.7%	37.1%	10.3%	99.9%
Other Not-for Profits	80	11.3%	17.5%	15.0%	6.3%	50.0%	100.1%
Other Projects (Unclassified)	11	9.1%	36.4%	9.1%	45.5%	0.0%	100.1%
All Projects Irrespective of Sector	272	17.3%	21.0%	24.6%	19.9%	17.3%	100.1%

It is particularly important to note that late payment is also common in the public sector. When trade contractors were asked to identify the causes of late payment in the public sector, the most commonly cited cause is 'bureaucratic delay'. Public sector owners may claim that their practice is to pay contractors in a timely manner. The experience of trade contractors is that this is *not* the case. Public sector owners may point to their diligence duties as justification for taking additional time to approve payments. However, the drawing out of approval times is really an indication of under-staffing the management of construction projects. Ontario is not unique in this regard. In the United States, it was delays in the public sector that initially prompted the enactment of prompt payment legislation.

C. Voiding of Lien Rights

Under the *Construction Lien Act*, a trade contractor has 45 days to preserve lien rights. The unstated expectation in the design of the *Act* is that lien rights will be used in exceptional circumstances, not as a security procedure applied to the majority of receivables. As noted earlier, the average cost of pursing a lien action is $15,000. For the vast majority of trade contractors, it is impractical to lien every receivable. Nor is it in the public interest for the land registry and legal systems to be overwhelmed by routine liening of virtually every construction receivable. However, the reality is that a large majority of receivables now fall *routinely* outside

the 45-day period for preserving lien rights. The *Trade Contractor Survey* found that almost two-thirds (64.7%) of contractors reported that the average age of their current receivables is more than 45 days, meaning that they typically have no lien rights. If the norm is for a receivable to extend beyond 45 days, then a trade contractor will only become aware of the need for payment security on a receivable after lien rights have expired. The effect of the embedding late payment practices in the construction industry has been to effectively void the lien rights of the overwhelming majority of trade contractors. Quite simply, it makes no sense to enact lien rights to secure payments in the construction industry and then, in the name of freedom of contract, to sanction late payment practices that effectively void those rights for the vast majority of trade contractors.

D. Undermining the Credit Worthiness of Trade Contractors

Receivables that are outstanding for more than 90 days pose distinct and serious problems for trade contractors. While receivables outstanding for more than 90 days are not the norm, they have become exceedingly common in the construction industry as a result of the embedding of late payment practices. The *Trade Contractor Survey* found that for 18.7% of trade contractors the average age of their current receivables is 90 days or more.

> Payment delays that exceed 90 days are especially problematic for trade contractors because the banking system does not regard these accounts as 'good receivables' for purposes of security.

Most trade contractors rely on bank financing to provide a significant proportion of their working capital. The security for this financing is what banks characterize as 'good receivables'. To be considered a 'good receivable' for financing purposes, an invoice must typically be outstanding for less than 90 days.[6] Accounts which are outstanding for more than 90 days will either be discounted significantly for financing purposes or excluded entirely. There are sound reasons for this banking policy. In the first place, an account which is outstanding for more than 90 days is automatically suspect to a bank. The payer may be experiencing cash-flow challenges which call the account into question or non-payment may be the result of a dispute. In any event, for many trade contractors, bank financing for accounts over 90 days is difficult or impossible unless additional security is provided. This often forces trade contractors to use factoring services which will purchase these overdue accounts at a significant discount or advance financing, but charge a significantly higher interest rate.

There is no getting around the fact that when receivables extend beyond 90-days, the financing

[6] The standard policy of Canadian chartered banks is to provide receivables financing at a rate of prime-plus with security being 75% of the value of receivables due in less than 90 days. Receivables that are more than 90 days outstanding are generally not treated as 'good receivables' for the purpose of receivables financing. See, for example: BMO, "Working with Your Banker – Business Coach Series" available at https://www.bmo.com/pdf /Working_Banker.pdf

challenges of trade contractors – especially smaller trade contractors – become exceedingly difficult. In the best of circumstances, the added financing costs can reduce or eliminate the profit on a job. More serious, however, is when financing cannot be obtained, as happens when the economy enters a period of credit stringency. In these circumstances, accounts which are overdue for more than 90 days can put the financial viability of a trade contractor at stake. This problem is discussed below.

E. 'Tail Risk'

'Tail risk' refers to the minority of accounts that have three characteristics. First, these accounts are in significant arrears, *i.e.*, they are overdue for 90 days or longer. Second, as a result of the payment delay, from the perspective of lenders, there is a high degree of uncertainty about when or if payment will be received. This makes it difficult or impossible to obtain financing on these accounts on terms that are commercially viable. Third, the overdue accounts are large and therefore the consequences of protracted non-payment or default are severe and can result in the insolvency of a business.

'Tail risk' is important because it is difficult to anticipate and even more difficult to plan for. It is 'tail risk' that discourages trade contractors from taking on additional work which would extend their cash reserves beyond a prudent ratio to their receivables. It is also 'tail risk' that deters a trade contractor from taking on additional payroll commitments. And it is 'tail risk' that leads trade contractors to defer or curtail investments in new machinery and equipment. For trade contractors in every size category, 'tail risk' is a serious matter and an increase in 'tail risk' is especially troubling.

> Outstanding invoices that fall into the 'tail risk' not only impact a trade contractor's ability to secure credit, these long-delayed payments also threaten a contractor's solvency.

The *Trade Contractor Survey* provides telling evidence of the impact of payment delay and the attendant increase in 'tail risk':

- 23.9% of contractors were forced to lay off workers because of delays in receiving payments that were owed to them;
- 39.1% of contractors declined to purse or take on additional work because of delays in receiving payments that were owed to them;
- 57.4% of contractors avoided or delayed investing in machinery and equipment because of delays in receiving payments that were owed to them; and

- 24.7% of contractors faced a threat insolvency because of delays in receiving payments that were owed to them.

As noted earlier, it is difficult to measure 'tail risk'. However, one conclusion is clear. An increase in the proportion of accounts which are overdue for 90 days or longer presumptively implies an increase in 'tail risk' owing to the financing difficulties that are invariably associated with these accounts. The evidence that the average collection period for receivables in the construction industry has increased from 57.3 days to 71.1 days over the past decade is a strong indicator that the amount of 'tail risk' in the construction industry has also likely increased. Perhaps most telling, however, is the finding cited above from the *Trade Contractor Survey*: *24.7% of trade contractors faced a threat insolvency because of delays in receiving payments that were owed to them*. This is a direct consequence of the embedding of late payment practices in the construction industry. This situation will not correct itself. Indeed, the statistical evidence suggests that it has worsened. The only credible option for Ontario is the path chosen by almost every other jurisdiction in the OECD region, namely prompt payment legislation that reins in the late payment practices that have become endemic in the construction industry.

F. The 'Cascading Effect'

Payment delays to trade contractors have a cascading impact. As a result of delays in receiving payments, the *Trade Contractor Survey* found that:

- 5.0% of contractors were forced to delay their hourly payroll;
- 11.6% of contractors were forced to delay their salaried payroll;
- 17.8% of contractors were forced to delay their remittances for source deductions to the Canada Revenue Agency while 20.0% were forced to delay remittances for HST;
- 13.6% of contractors were forced to delay remittances to employee benefit funds,
- 27.9% were forced to delay payments for leases on equipment;
- 19.1% were forced to delay payments to their bank;
- 60.9% were forced to delay payments to suppliers; and
- 52.1% were forced to delay payments to sub-contractors.

The effects of construction workers are particularly important to note. Many benefit plans in the construction industry – especially those in the unionized industry – require the receipt of employer contributions for benefit eligibility to be maintained. If remittances are not received, the workers on whose behalf those remittances were owed, are at risk of having their eligibility for medical benefits suspended. For pension plans, delays in receipt of remittances means that ultimate pension benefits will be lower since the funds received on behalf of the worker had less time to earn interest that would be credited to the worker's account.

> The 'cascading effects' of late payment affect sub-contractors, suppliers, governments and workers and their families. In the construction industry, late payment practices directly undermine workers' entitlements to pension and medical benefits.

G. The 'Gridlock Effect'

The 'gridlock effect' arises when dispute over a payment results in payment delay and this, in turn, triggers the 'cascading effect' throughout the construction pyramid. The cascading effect of late payment cannot be arrested until the payment dispute is resolved. Since the payer has limited or no interest in expeditious resolution of the dispute, the 'gridlock effect' can persist for a considerable period of time. In the *Trade Contractor Survey*, 42.0% of trade contractors reported that disputes over 'extras', change orders or upgrades that led to payment delays occurred 'very often' or 'always'. <u>It is obvious that relying on freedom of contract to address the construction industry's need for expeditious dispute resolution has been a failure</u>. <u>As with prompt payment, the province needs a legislated solution</u>.

> For the economy, the consequences of the construction industry's pervasive late payment practices are reduced employment, a smaller competition pool for new work, diminished productivity, increased construction costs and the damage caused by insolvencies that did not need to occur.

<u>'Freedom of Contract'</u>

In the *The Limits of Freedom of Contract,* Trebilcock describes the considerations that warrant circumscribing or regulating freedom of contract.[7] Of the factors Trebilcock cites, three are germane to the case for statutory regulation of payment obligations.

[7] Michael, J. Trebilcock, *The Limits of Freedom of Contract*, 2nd ed., Harvard University Press (1997)

Externalities ('Third Party Effects'):

Externalities arise when the terms of private contracts impose costs on third parties. In regard to systemic late payment practices, this is the 'cascading effect' described earlier. Survey evidence makes it indisputably clear that while 'standard construction documents' may provide for a regular payment cycle, interest on overdue accounts and a trade contractors right to suspend work in the event of non-payment, these provisions are regularly struck out of actual construction contracts. As the *Trade Contractor Survey* shows the result is that the effects of systemic late payment practices cascade down the construction pyramid, adversely affecting sub-contractors, suppliers, employees' wages, employees' entitlements to medical benefits, employees' pension credits, and remittance obligations to CRA and the WSIB. In other words, the consequences of late payment are not confined to the contracting parties. For these third parties, the consequences of late payment practices in the construction industry are capricious, serious, wholly negative and entirely uncompensated. 'Collateral damage' may be useful as an exculpatory doctrine in military affairs. It has no place in economic affairs.

Intrinsic Unfairness arising from Inequality in Bargaining Power:[8]

The construction industry is characterized by a large number of trade contractors seeking work from a far smaller number of owners and general contractors. This is certainly the case in Ontario where there are fewer than 200 companies in the Ontario General Contractors Association (OGCA) whose members manage the vast majority of tendered construction projects in this province. By contrast, there are almost 4,000 trade contractors that employ more than 20 workers (and more than three times this number who employ fewer than 20 workers). Except in rare circumstances where skills are in exceedingly short supply, the structure of the construction industry favours the bargaining interests of owners and general contractors. This is evident in the widespread practice of unilaterally downloading payment risks to trade contractors by striking out key protections that are found in the standard CCDC and CCA construction documents and replacing these with unbalanced contingent payment provisions. The intrinsic unfairness of the late payment practices lies in the absence of any remedy for late payment in the vast majority of construction contracts. A trade contractor whose invoice is being held up cannot suspend work, is not entitled to interest on late payments, and is almost invariably obliged to sign a contract with contingent payment

[8] Trebilcock uses the term 'coercion', but uses the term to encompass a range of situations which would fall outside a strict definition of coercion. Other scholars in the law and economics field focus on the consequences of inequality in bargaining power. Edwards, for example, describes the dynamic of judicial and statutory limitation of freedom of contract as arising from "the gap between classical contract theory's vision of the institution of contract and the realities of the marketplace where strong parties took advantage of those who were vulnerable to unfair overreaching." Carolyn Edwards, "Freedom of Contract and Fundamental Fairness for Individual Parties: The Tug of War Continues", Marquette Law Scholarly Commons, Marquette University Law School.

provisions that effectively sanction payment delay. The most serious inequity in these contract terms is the ability of owners and general contractors to delay payment to trade contractors beyond 90 days. As noted earlier, this exceeds the period allowed by chartered banks for treating accounts as 'good receivables' for purposes of securing operating loans. Payment delays beyond 90 days force trade contractors to choose between insolvency or obtaining 'receivables loans' on highly unfavourable terms from non-bank lenders. As the *Trade Contractor Survey* showed, payment delays beyond 90 days also raise the risk of insolvency to wholly unnecessary and unreasonable levels.

Asymmetric Information:

An equitable contract is predicated on both parties having sufficient information to judge their interests. In the construction industry, the most important information requirement for a trade contractor is knowing how certain the financing is for project and whether the funds intended for the trade contractor may also be deployed for other purposes. In the current system, trade contractors must effectively operate in the dark. They are not privy to the information the owner shares with the general contractor. Indeed, trade contractors do not even have the right to ascertain whether an owner has released a payment to a general contractor.

The *Construction Lien Act*, itself, represents a circumscribing of freedom of contract in relation to payment security. Three reasons are commonly cited for limiting freedom of contract by imposing a statutory system for payment security:

1) unacceptable third party effects when there is an insolvency,
2) economically and socially inefficient and unfair outcomes with negotiation of payment security is left to unequal bargaining, and
3) the perverse consequences when contracting takes place under conditions of asymmetric information.

These same reasons apply with equal validity to payment terms. <u>The absence of a statutory standard for payment terms has led to conditions where there are serious and socially unacceptable third party effects, where there is intrinsic unfairness in the distribution of risk as a result of unequal bargaining power, and where contracting must take place under conditions of insufficient information on financing</u>. Ontario needs to rectify this situation by applying the same prompt payment principles that the majority of OECD jurisdictions, including the federal government in the United States and virtually every US state, have already implemented.

Framework for Legislated Prompt Payment

The essential elements of statutory model for prompt payment include:

1. a monthly payment cycle which would apply to all contracts, except those that provide for payments based on milestones,
2. regulation of milestone contracts consistent with the principles of prompt payment,
3. limiting the right to withhold payment to the portion of the work that is in dispute,
4. disclosure obligations on the part of payers,
5. mandatory interest on delayed payments,
6. the right of a contractor to stop work or terminate the contract if payment is delayed beyond a stipulated time period,
7. an obligation on the part of a payer to pursue collection, including exercising lien rights, if the receipt of funds intended for sub-contractors is delayed and this payer similarly wishes to delay its own downstream payment obligations,
8. voiding of pay-if-paid clauses and explicit specification of the circumstances in which pay-when-paid clauses can apply.

The Consensus Draft on a Prompt Payment Act (Appendix A) provides a more complete description of a prompt payment system and how the principles can be incorporated into a statute.

1. Monthly Payment Cycle:

PPO proposes a standard monthly payment cycle in which the payee submits an invoice which is deemed to be accepted by payer if an objection is not made within a stipulated number of days. Payment is then due within a specified time of receipt of the invoice without any deductions, except for payments in dispute and then in accordance with a stipulated process for giving detailed notice of such dispute and a mechanism for resolving it.

2. Regulation of Milestone Contracts:

PPO recognizes that milestone contracts are sometimes used and that any prompt payment regime must accommodate them.

The prompt payment principles covering milestone contracts should include at least the following:

1. a payer may only enter into a milestone contract with a payee if that payer is also subject to the receipt of milestone-based payments,
2. the tendering process must make clear it should be clear that milestones will be used and what the proposed milestones are,
3. the milestones in the contract between payer and payee should be based solely on work that is within the control of the payee,
4. milestones should be defined such that there is a reasonable expectation of meeting the milestone within not more than a three-month period and in any event, payment should not be delayed beyond a three-month period,
5. the period allowed for verification of the milestone should not exceed a stipulated number of days after which verification is deemed to have occurred,
6. payment is due not later than thirty (30) days following verification or deemed verification of the milestone.

3. Withholding Payment on Disputed Work:

A payer should have the right to withhold payment on disputed work, but that right should only apply to the portion of the work that is in dispute. The common practice of withholding all payment that is due should be prohibited. When a trade contractor believes that the portion of the payment withheld was excessive, the contractor may raise this matter as a preliminary objection in the dispute resolution process and request an immediate adjustment. When a trade contractor believes that the withholding of payment has been frivolous, the trade contractor may apply to the adjudicator in the dispute resolution process for the addition of a penalty interest payment to the withheld amount.

4. Disclosure Obligations

The proposed disclosure obligations are discussed in more detail in the next chapter. These obligations may be summarized as follows:

> Disclosure of payment schedules: A payer should be required to disclose to its payees the dates on which monies for the project are due to the payer.
>
> Notification of receipt of funds by a payer: A payer should be required to notify payees when funds intended for payment of the payees have been received.
>
> Financial capability of owners to meet payment obligations: Owners should be required to demonstrate that they have the financial capability to meet payment obligations and this information should be available to sub-contractors.

5. Interest on Late Payments

Interest should be payable on late payments. The benchmark interest rate should be a publicly posted interest rate that is transparent and easily accessible.

6. Right to Stop Work

The right of a payee to stop work or terminate a contract if payment is delayed beyond a stipulated time should be expressly set out, and should take precedence over any contrary provisions in a contract. The payee should also have the right to resume that work without penalty when the payment issue is resolved. The right to stop work would not apply when a withheld payment is subject to a dispute resolution process, subject to an overall right to stop work if payment has not been received within three months. However, delayed payment for certified work is not subject to adjudication and therefore the right to stop work when such payment is delayed should not be subject to any qualifications or limitations. A contractor should also have the right to seek de-mobilization and re-mobilization costs when late payment has led a contractor to exercise the right to stop work.

7. Pay-when-Paid Clauses tied to the Obligation to Pursue Collection

PPO recognizes that there will be circumstances in which payers will themselves be delayed in receiving payment, and that these payers should be entitled to delay their own payment obligations downstream. However, this right should be subject to corresponding obligations on the part of such payers to take commercially reasonable actions to pursue collection and/or

prevent further harm to those supplying labour, services and materials. These actions must include any or all of suspension of work and the timely prosecution of their adjudication rights and lien remedies against the defaulting upstream payer.

8. Voiding of Pay-if-Paid Provisions

Pay-if-paid provisions should be rendered as statutorily void. There is no ethical or commercial justification for the transfer of ultimate payment risk to a party that is not in privity of contract and who cannot manage that particular risk.

•

6. Financial Disclosure

Data from the Trade Contractor Survey confirm that financial disclosure is the exception rather than the norm in the construction industry. Nearly three-quarters (72.5%) of contracts do *not* entitle trade contractors to reasonable financial disclosure. Thus, a large majority of trade contractors are unable to make an informed assessment of the risk that they will not be paid or that their payment will be delayed. Only 7.5% of trade contractors reported that they always have financial disclosure in their contracts or on request.

One commentator has noted that "… a lien is not magic. It does not magically create value in a situation that has none, it merely preserves whatever value it can for as long as it can… *it does not transform insolvent projects into solvent projects*."[9] It is precisely for this reason that contractors need reasonable financial disclosure to ensure that they are not take unreasonable risks

Disclosure obligations are an important tool for combating opportunistic behaviour and encouraging a culture of fair dealing.

There are three areas for which financial disclosure should be statutorily prescribed. The first is disclosure of payment schedules. A payer should be required to disclose to payees the dates on which monies are due to the payer on account of the project. This obligation should be apply down the contracting chain and at the outset of the improvement. The second disclosure obligation pertains to notification of receipt of funds by a payer. A payer should be required to notify subcontractors when funds have been received. Finally the third disclosure obligation applies to the financial capability of owners to meet payment obligations. Each of these disclosure obligations is addressed in the Consensus Draft reproduced at Appendix A.

Disclosure of Payment Schedules:

The experience of trade contractors is that some general contractors rely on privity of contract to ensure the confidentiality of their payment schedule with the owner. However, the predictable flow of funds is critical in the construction industry. The need to transparency in that payment flow should over-ride considerations of privity, particularly having regard to the

[9] Duncan W. Glaholt, "Overview of Construction Liens (In Five Easy Pieces)" p 14 [emphasis added]

fact that the payment flow involves monies that are earmarked for downstream contractors. Disclosure of payment schedules will introduce this needed transparency into the construction industry and ensure fair dealing between general contractors and trade contractors. The requirement to provide disclosure of payment schedules should apply to entire construction pyramid.

Notification of Receipt of Funds:

In the current system, it is not uncommon for prime contractors to assert that they have not received payment and to then rely on pay-when-paid clauses to delay payment of monies owed to sub-contractors. This situation is akin to a trustee receiving the trust *res* and misleading the beneficiaries of that trust. PPO believes that such a situation is actionable and should be addressed legislatively. Notification to the subcontractors (beneficiaries) will confirm that funds have been received by the prime contractor (trustee) *per* the payment scheduled or, if delayed, will identify the period of actual delay. PPO believes that disclosure of payment schedules, in combination with notification of receipt of funds, will introduce needed and overdue transparency. It will also encourage a culture of fair dealing and further, is not an administratively burdensome process given the ready access that now prevails to email and ftp uploads. The requirement to provide notification of receipt of funds should apply downwards to entire construction pyramid.

Financial Capability Disclosure:

CCDC-2 (2008) provides that an owner is obliged to provide financial information on the project. The relevant sections read as follows:

> GC 5.1 FINANCING INFORMATION REQUIRED OF THE OWNER
>
> 5.1.1 The *Owner* shall, at the request of the *Contractor*, before signing the *Contract*, and promptly from time to time thereafter, furnish to the *Contractor* reasonable evidence that financial arrangements have been made to fulfill the *Owner*'s obligations under the *Contract*.
>
> 5.1.2 The *Owner* shall give the *Contractor Notice in Writing* of any material change in the *Owner*'s financial arrangements to fulfill the *Owner*'s obligations under the *Contract* during the performance of the *Contract.*

The disclosure rights set out in CCDC-2 (2008) are rooted in earlier versions of CCDC standard contracts. However, the commercial reality is that GC 5.1 is one of the most frequently struck

out clauses from CCDC-2 (2008). The same applies to Appendix A of CCA 50 which is the form which the Canadian Construction Association recommends to prime contractors for obtaining necessary financial information on the ability of an owner or promoter to finance a project.

Even where financial disclosure is made to a general contractor, the right to this financial information does not extend to sub-contractors, save for what might be requested under section 39 of the *Act* from owners and mortgagees, which if often ignored. Moreover, in the residential sector, CCDC contracts are generally not used. In the current system, therefore, trade contractors bear the preponderance of the risk when there is a default on payment, but have few or no rights to obtain the financial information necessary to assess that risk. This imbalance needs to be corrected.

Contractors are often required to disclose financial information to demonstrate their ability to undertake and complete construction work. However, contractors are rarely successful in requiring owners to provide information confirming that they have the financing needed to support the project. And even when contractors do receive this information, they are barred from sharing it with sub-contractors. In these circumstances, most contractors cannot make an informed assessment of the payment risk associated with undertaking work on a particular project. The greater the risk that is borne, the less information is available to evaluate that risk. PPO acknowledges that this risk is chiefly relevant to private sector projects. In conventional public sector projects, there is no material risk that financing will be unavailable. In P3 projects, however, there is a potential financing risk.

PPO believes all contracting parties should have the right to reasonable financial disclosure. For trade contractors, this means that they should have the right to require owners to provide information demonstrating their capacity to honour their financial obligations under the contract. Sub-contractors, in turn, should have the right to obtain this information from prime contractors or other upstream contractors.

PPO specifically recommends the language set out in sec. 12 of the Consensus Draft on a Prompt Payment Act. (See Appendix A). PPO acknowledges, however, that financial disclosure rights may be unnecessary when dealing directly with governments that have the power to levy taxes. This exemption would not apply to other entities in the public sector that lack the power to tax, e.g., transit authorities, hospitals, colleges and universities, municipal housing corporations and school boards, *etc*. as these entities do not have the power to levy taxes.

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7. Trust Provisions

Part II of the current *Construction Lien Act* creates three distinct trusts:

- owner's trust
- contractor's and sub-contractor's trust
- vendor's trust.

PPO supports the continued application of these trusts in the construction process. However, the current provisions of the *Act* have two drawbacks. The first is the co-mingling of trust funds with other funds. The second is the absence of a specific duty of prompt remittance to the intended beneficiaries of the trust. We recommend four changes.

1. Segregated Holdback Trust:

PPO reiterates the proposal made in Chapter Two. When a trade contractor's invoice is paid, 90% of that amount should be remitted directly to the trade contractor within the time period specified by the new statute. The remaining 10% should be remitted at the same time to a segregated holdback trust account. This trust account should not be subject to comingling with other trust account or with other monies. The sole beneficiary of the trust account should be the trade contractor from whose invoice the 10% has been withheld or a supplier to that trade contractor who has not been paid by the trade contractor. No other claimants should have any priority of these trust monies. The monies held in trust should not be subject to any set-off. An alternative would be to allow a 'holdback release bond' to be posted by the payee. This would obviate the need to maintain any segregated holdback fund and allow payment of 100% of a contractor's invoice.

PPO also suggests that with the introduction of the segregated holdback trust account, that the *Construction Act* also mandate a right to all beneficiaries of that fund, being subcontractors, in the form of a charge even if their lien rights have expired akin to what is known in British Columbia as a *Shimco Lien*.[10]

[10] *Shimco Metal Erectors Ltd. v. Design Steel Constructors Ltd*., 2002 BCSC 238 (appealed and upheld: *Shimco Metal Erectors Ltd. v. North Vancouver (District)* 2003 BCCA 193). For a discussion of *Shimco* see, British Columbia Law Institute," Consultation Paper on Builders Liens after the Shimco Case ", September 2003.

2. Separate Project Trust Accounts:

Other jurisdictions have introduced requirements for separate project trust accounts. We believe that a new *'Construction Act'* should introduce this concept to Ontario's construction industry.

For small projects, PPO acknowledges that it would be unduly cumbersome to impose an obligation to maintain separate project accounts for each project. Therefore projects with a permit or tender value of less than a specified amount (we suggest $250,000) should be exempt from requirements to maintain separate project accounts.

For all projects above a specified threshold (we suggest $250,000) in permit or tender value, a separate project account should be required.

3. Unqualified Duty of Prompt Remittance:

Arguably the duty of prompt remittance can be read into the duties of a trustee. However, as a practical matter, that has not been the practice in the construction industry. Part II of the current *Act* creates the trust *res* and identifies the trustee and the beneficiary. Part II also establishes when the trust arises and how the trust may be used. However, the current wording of Part II does not expressly stipulate *when* those funds should be remitted to the beneficiary. Consequently, PPO recommends that in a new *'Construction Act'*, the obligations of trustees should include a duty of prompt remittance in accordance with the prompt payment provisions otherwise being proposed, with failure to remit promptly being deemed a breach of trust and liability for the trustee and those identified in the current section 13 of the current *Act*.

4. Low-Rise Residential Sector:

Sec. 81 of the *Condominium Act* specifies that monies paid by a prospective purchaser must be held in trust. The same trust obligation does not apply to purchases in the low-rise sector, i.e., free-holds. PPO believes that prospective purchasers of newly constructed low-rise housing units should be entitled to the same protection as is afforded by sec. 81 of the *Condominium Act*.

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8. The Lien System and the *Bankruptcy Act* and *CCAA*

The *Bankruptcy and Insolvency Act* and the *Companies Creditors Arrangements Act* are both within federal jurisdiction. Several notable cases have established the principle that the priorities established under the Bankruptcy and Insolvency Act take precedence over any provincial statutes once bankruptcy proceedings have commenced. It is therefore possible that the priorities established under the *Construction Lien Act* (or the recommended new legislative model) will come into conflict with the *Bankruptcy and Insolvency Act*. A court-supervised business re-organization under *CCAA* might also affect lien claimants, although this is less likely.

Part XIV of the *Bankruptcy and Insolvency Act* and Part V of CCAA require as reviews of the respective Acts. The statutorily mandated reviews of both statutes are currently in progress. A report entitled *Fresh Start: A Review of Canada's Insolvency Laws* was tabled by the Minister in September of 2014. A parliamentary committee review will follow. The two Acts may be integrated and changes to the regimes established by the Acts may also be adopted. These changes could further impinge on the priorities established by Ontario's *Construction Lien Act*.

PPO believes that it makes no sense to wait for the federal review of the *Bankruptcy and Insolvency Act* and *CCAA* to be completed and for those statutes to be amended. It is highly likely that the new statutes will again provide for a mandatory review. In other words, the review process will be unending. There have been, and will continue to be, situations in which proceedings under the *Bankruptcy and Insolvency Act* or a court-supervised business re-organization under *CCAA* alter the priorities established by the *Construction Lien Act*. When that occurs lien claimants understand that they may be adversely affected. It is important to note, however, that the vast majority of lien claims are resolved without proceedings being initiated under the *Bankruptcy and Insolvency Act* or *CCAA.* More fundamentally, PPO expects that if the prompt payment, enhancements to the CLA and dispute resolution mechanisms it recommends are implemented, the magnitude of the potential harm resulting from insolvencies will be much reduced.

PPO recommends that Ontario's lien system reflect the principles and priorities deemed appropriate by Ontario public policy and that there be no attempt to align the lien system with the current or anticipated priorities under the *Bankruptcy and Insolvency Act.*

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9. Priorities

PPO supports the current structure of priorities set out in the *Construction Lien Act*. We do not believe that there is any need to alter or clarify these priorities.

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10. Public Private Partnerships

When the Construction Lien Act was adopted in 1983, there were few, if any public-private partnerships. Most commentaries date the commencement of P3s as a distinct procurement model from the 1990s.

Although individual P3 projects are often quite large, the portfolio of P3 projects under construction is not large in relation to the total volume of new construction. A recent review published in the *Public-Private Partnership Law Review* reported that between January 1, 2014 and February 1, 2015, there were 19 projects across Canada that reached financial close and 30 that were moving to pre-qualification stage.[11] Earlier this year, Infrastructure Ontario estimated that it had approximately $8.9 billion of projects under construction and a similar volume of work either in procurement or in planning. On an annual basis, the Infrastructure Ontario 'spend' would be around $2.0 to $4.0 billion. This annual 'spend' compares with approximately $75 billion of new construction in Ontario in 2014 and a further $10-12 billion (or more) in non-residential maintenance construction. This comparison is not intended to diminish the importance of P3 projects, but rather to place it in perspective. The volume of P3 construction work is likely to be in the range of 3-5% of total spending on new construction and non-residential maintenance.

It would be an error for the statutory design of security against default, prompt payment, and dispute resolution to disregard the P3 model and the complexities to which it gives rise. Equally, it would be an error for construction policy to jeopardize protections or introduce ambiguities in 95% of construction projects to accommodate the distinct needs of P3 projects. It is also important to bear in mind that the P3 model is still evolving. As experience accumulates, P3 business models may change. For all of these reasons, PPO strongly urges that P3s be addressed in a separate section of the new legislative model.

> P3s and other non-traditional delivery models should *not* be except from the prompt payment and lien provisions of a new 'Construction Act'. However, P3s and other non-traditional delivery models should be treated separately from mainstream delivery models which account for more than 95% of construction in Ontario.

[11] Nicholas Shkordoff, Helmut K. Johannsen and W. Thomas Barlow (Fasken Martineau DuMoulin LLP), 'Chapter Five: Canada', in Bruno Werneck and Mário Saadi, eds., *Public-Private Partnership Law Review*, Law Business Research Ltd.

In most P3s, a private sector consortium forms a 'special purpose vehicle' (SPV) to develop, finance, build, maintain and sometimes operate the asset for a contracted period. Formal ownership of the asset being constructed may be vested either in the government or in the SPV with reversion to government at the end of the contract period. The consortium usually comprises a general contractor, design firms, a maintenance company (which may or may not be related to the general contractor) and a lender or group of lenders. It is the SPV that signs the contract with the government and with subcontractors to build the facility and then maintain (and sometimes operate) it. Among the features of P3 projects that are relevant to security against default, prompt payment, and dispute resolution are:

- the separation of formal ownership of the constructed asset from the SPV,
- the impracticality of liening the constructed asset,
- potential ambiguity in roles of owner and general contractor,
- a strong preference in many P3 projects for payments to be structured in terms of milestones (and sometimes balloon payments) and for this principle to apply down the contracting chain,
- milestones that are defined in terms of stages of completion of the overall project rather than being specific to particular segments of work undertaken by trade contractors. Hence the trade contractors' payments may be delayed pending completion of work over which they have no control.
- the significance of immovable deadlines for some projects, necessitating substantial overtime costs to meet those deadlines (*e.g.*, the Pan Am Games projects).
- In the case of P3 projects falling under the recently adopted *Infrastructure for Jobs and Prosperity Act*, obligations to meet broader social objectives, including community benefits and apprenticeship training.

PPO believes that there should be a special section of the proposed new legislative model dealing with P3s and that the following principles should be reflected in that section:

1. The SPV should be required to maintain either a segregated project trust account to receive monies intended for execution of the project and to post a labour and materials surety bond. The surety

bond would be the lienable asset in place of the actual constructed asset.

2. Where financing for the SPV is based on milestones, the SPV may enter into milestone contracts with trade contractors rather than progress payment contracts. When contracts with trade contractors are structured on the basis of milestones, those milestones should be:

    a. set out in the tender documents and subject to change only by mutual agreement,

    b. pertain only to the work that is being contracted and which is therefore under the control of the trade contractor,

    c. structured so that payments are approximately commensurate with the labour and materials costs incurred by the trade contractor, thereby avoiding 'balloon payments',

    d. planned so that milestones are likely to be met at least quarterly, i.e., there should not be an expected period of more than 90 days between milestones, and

    e. subject to an overriding obligation that a reasonable progress payment can be invoiced after 90 days, notwithstanding any milestone requirement.

3. Holdbacks should be released upon the certification of completion of each contracted segment of work.

4. All P3 projects should be subject to adjudication.

5. No party or related party in the SPV should have priority over contractors with respect to the holdback trust.

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11. Non-Waiver

Sec. 4 of the current *Construction Lien Act* renders void any agreement to set aside the protections provided by the *Act*.

Sec. 5 requires that all construction contracts conform to the requirements of the *Act*.

PPO believes that these provisions must continue in any new legislative model that is adopted.

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12. Bidder Exclusion

There have been instances in which public authorities, general contractors, developers and owners have excluded a prospective contractor owing to a current or past dispute with that contractor.

PPO recognizes that any public authority should be free to reject a contractor's bid on the basis of that contractor's insufficient *technical* ability, the public authority's obligations under the *Labour Relations Act*, or other material, objective criteria, such as Fair Wage or clearly specified procurement policies. However, PPO does not believe that a public authority should be allowed to reject a contractor simply because that contractor sought to exercise its legal or contractual rights against the public authority on another project. To allow such bidder exclusions is discriminatory and profoundly offensive to the principle that everyone should be equal under the law and should have unfettered access to justice.

Furthermore, PPO believes that such exclusionary provisions afford public authorities that use them an indirect method of avoiding the very protections now under consideration (prompt payment, security for payment, and rights to adjudication). They inhibit the prosecution of meritorious claims and force contractors, whose livelihoods may depend upon a continuing ability to do business with that authority, to accept unfair and unlawful treatment at the hands of the authority.

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13. Expeditious Adjudicated Dispute Resolution

The Trade Contractor Survey found that disputes over alleged deficiencies are an important cause of payment delay, though far from the only cause of delay. Figure No. 4 summarizes trade contractors' perceptions of the risk of payment interruptions that are attributable to disputes over alleged deficiencies. This table also includes payment certifiers' delays as these delays are often related to disputes over alleged deficiencies. The survey data confirm that disputes over alleged deficiencies are viewed by trade contractors as an important contributor to late payment risk.

Figure No. 4
Trade Contractors' Perception of Disputes over Alleged Deficiencies or Payment Certifiers' Delays as Causes of Late Payment based on Experience
(Recapitulation of Data presented in Tables 16, 17 and 18)
(1-10 Scale where 1 = Not Important at All and 10 = Extremely Important)

	Low Risk (1-3)	Moderate Risk (4-7)	High Risk (8-10)
Public Sector Projects			
Disputes over Alleged Deficiencies	29.1%	28.5%	42.3%
Payment Certifiers' Delays	30.9%	27.8%	41.3%
Private, Non-Residential Projects			
Disputes over Alleged Deficiencies	26.2%	29.4%	44.3%
Payment Certifiers' Delays	26.2%	29.4%	44.3%
Residential Projects			
Disputes over Alleged Deficiencies	29.1%	28.5%	42.3%
Payment Certifiers' Delays	30.9%	27.8%	41.3%

<u>The current 'system' neither requires nor encourages expeditious resolution of disputes</u>. Indeed, the experience of many contractors, is that the opposite is true. It is common practice when a dispute leads to a lien registration to 'bond off' the lien claim and leave resolution of the dispute to the already over-loaded courts. The delays in the court system put too many trade contractors in the unenviable position of being compelled to choose between a settlement which significantly discounts their claim and an expensive court hearing that only proceeds after lengthy delay. Trade contractors are dependent on cash-flow for their survival. Few trade contractors can bear the cost of a lengthy delay, especially if the sums involved are substantial. Not surprisingly, the *Trade Contractor Survey* found that only 19.8% of contractors

that registered liens received 100 cents on the dollar. Rather than providing a framework for the fair and expeditious resolution of disputes, the current 'system' serves the interests of those who want to delay payments by alleging spurious defences and taking advantage of an over-loaded court system. PPO strongly supports the introduction of a statutory regime for the expeditious resolution of disputes in the construction industry.

There are a number of common law jurisdictions that have introduced expeditious dispute resolution in their construction industries. Significantly, no jurisdiction that has statutorily mandated alternative dispute resolution has ever subsequently repealed those provisions. PPO suggests that the adjudication model akin to that used in the U.K. and Australia should be seriously considered for implementation in Ontario, customized to suit the particular needs of Ontario's industry.

There are certain principles which a legislated system of adjudicated and expeditious dispute resolution should reflect:

1. any party to a construction contract should be able to initiate the adjudication procedure without the consent any other party to the contract within a short stipulated time after it reasonably became aware of the dispute,
2. there should be a requirement that the investigation commence within a short period following submission to adjudication, and that the adjudicator's decision be rendered within a similarly short period of time;
3. there should be no impediment to mediation of any claim otherwise before the adjudicator, but such should not delay the adjudication process unless the parties otherwise agree;
4. it should be clear that the jurisdiction of the adjudicator encompasses any trust funds (segregated or otherwise) and surety bonds established for the benefit of contractors who supply labour and materials to the construction project,
5. any party that is a supplier of labour and materials to the construction project should have standing before the adjudicator if their interest would be affected by the decision, even if they are not a party to the specific contract giving rise to the dispute,
6. decisions of adjudicators should be reviewable at the end of the project, but seeking such review should not delay or set aside implementation of the adjudicator's decision,

7. one or more adjudicators should be named in the construction contract. Named adjudicators should be members of one of the recognized arbitration institutes or associations.[12] The adjudicator should be free, of course, of any bias or any apprehension of bias, and should be entitled to receive the same immunity from suit as applies to a Justice of the Superior Court of Justice of Ontario.

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[12] These include: LCIA (formerly London Court of International Arbitration), Chartered Institute of Arbitrators (CIArb), Canadian Commercial Arbitration Centre (CCAC), International Council for Commercial Arbitration (ICCA), the College of Commercial Arbitrators (CCA), the International Centre for Dispute Resolution (ICDR), ADR Institute of Canada (ADRI) and ADR Chambers Canada.

14. Summary Procedure

PPO believes that the introduction of expedited and adjudicated dispute resolution will obviate the need for summary procedure.

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15. Surety Bonds

PPO has addressed the role of surety bonds in other chapters of this submission. In this chapter we will present a more complete outline of our views.

Holdback and Surety Bonding

When a payer remits to a payee, 90% of the payment should be remitted directly to the payee and 10% should be deposited in a segregated holdback trust. For some projects, such as public sector projects, it may be appropriate to allow a payer to post a surety bond in lieu of the segregated holdback trust, *but only if the surety bond is a perfect substitute for the segregated holdback trust*.

Surety Bonding and the Right to Stop Work

The issuers of surety bonds have expressed concern that the right to stop work could increase the underwriters' risk on performance bonds. In fact, PPO's recommendations, if adopted, will reduce surety risk.

Consider a situation in which a trade contractor has posted a performance bond. If the owner or general contractor fails to make the required progress payments, the prompt payment regime we recommend will expressly provide for the right to stop work, irrespective of any terms in the contract to the contrary or the absence of any contractual terms prescribing such right. Any suspension of work in the event of non-payment would be authorized by statute. This would effectively relieve the surety of any risk inherent in a finding that such suspension somehow constituted a breach of contract by its principle.

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16. Interest on Late Payments

The *Trade Contractor Survey* found that almost three-quarters (74.8%) of trade contractors reported that their contracts *never* provide for interest on overdue accounts. Only 6.9% of contractors reported that interest payment was stipulated at least 80% of the time. Notwithstanding the obligation to pay interest on overdue accounts in some contracts, the actual payment of interest to trade contractors under such contracts is rare. More than two-thirds (67.2%) of trade contractors indicated that they never received interest payments even when their contract provided for interest on overdue accounts.

PPO strongly urges that the new 'Construction Act' provide for the payment of interest on late payments. The appropriateness of interest payments is already recognized in the standard CCDC and CCA contract documents, although these provisions are frequently struck out.

There are three reasons for statutorily stipulating the payment of interest on late payments.

First, in the absence of a statutory requirement, many owners and general contractors will require the removal of such provisions from standard agreements or alternatively proffer their own standard agreements that do not include a requirement for interest on late payments.

Second, trade contractors are obliged to pay interest on their overdue payments of materials and on any overdue remittances to the Canada Revenue Agency, the Workplace Safety and Insurance Board and employee trust funds as well as on lines of credit which may be drawn to support operations pending the receipt of payment.

Third, in the absence of an obligation to pay interest, a payer has an incentive to delay payment.

PPO regards the principle of interest on late payments as fundamental. We have no strong views on the benchmark that should be specified in statute, other than that the benchmark should be transparent and readily accessible.

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17. Unique Problems in Residential Construction

In other chapters of this submission, PPO has commented on the distinctive problems encountered by trade contractors in the residential sector. In this chapter, we will both summarize those comments and expand on the discussion of the residential sector.

1. General Lien to replace Lot-by-Lot or Unit-by-Unit Liens

The current *Construction Lien Act* allows the right of a trade contractor to register a general lien to be easily defeated, thereby requiring liens on a lot-by-lot or unit-by-unit basis. This is unduly onerous and expensive, and frustrates the exercise of lien rights that the *Act* intends to confer. The new 'Construction Act' should allow a claimant to register a general lien against the project in all cases.

2. Need to Encourage Standard Contracts

The CCDC and CCA standard contracts constitute an important benchmark, even though they are rarely used in an unaltered form. The alterations to these standard contracts flag a re-allocation of the risk from the regime intended by the standard contract. In residential construction, the CCDC and CCA standard contracts are generally not used in any form. Moreover, there is no comparable benchmark that reflects an industry consensus on the allocation of risk and responsibilities. While it is not feasible to legislate a standard contract, this review process would make a positive contribution to the residential construction industry by strongly recommending that stakeholders in the industry develop and use standard contracts. The provincial government could facilitate this process by appointing a special advisor to work with the industry.

3. Regulation of Milestone-Based Payments

The majority of construction contracts in the residential sector provide for milestone-based payments. In many cases, the contractor is not eligible for payment until the specified work is completely finished on a certain number of lots or units. PPO does not seek to disrupt this practice. Rather, PPO proposes that prompt payment obligations should be triggered by completion of units at month-end**.** In particular, this would end the current practice whereby payment is delayed until after the sale of the unit to the home buyer is completed. This practice is particularly objectionable since it places the financing burden for the project on the

shoulders of trade contractors and also effectively means that the trade contractors are not eligible for payment until after their lien rights have expired. If the contractor receives only partial payment, he has no remedy under the current *Act*.

4. Eliminating Abuse of Holdback

It is common practice in the residential sector for builders to retain the holdback for longer than 45 days. The *Trade Contractor Survey* asked contractors the average time they waited for payment of their holdback monies. Among trade contractors in the high-rise residential sector, the median waiting time was 90 days. In the low-rise residential sector, the median was also 90 days. The remedies recommended elsewhere in their submission should be applied without qualification to the residential sector. Holdback monies should be held in a segregated trust fund. There should be no comingling of these trust monies with other monies. And there should be a statutory duty to remit holdback monies promptly when lien rights expire and without set-off. Any delays should be both a breach of trust and should entitle the trade contractor to interest at a prescribed rate. Lien rights would only expire when the holdback monies are released.

5. Problem of No Third-Party Certification / No CSPs

In the residential sector, third party certification is generally not used. Nor is it common for trade contractors to receive a certificate of substantial completion (CSP). The common practice is for trade contractors to receive an acknowledgement that the work has been completed on particular units. Although this acknowledgement allows the trade contractor to submit an invoice, the acknowledgement does not imply that the owner (or general contractor) has waived its right to claim deficiencies. PPO advocates that where an owner does not certify substantial completion, but rather acknowledges that agreed work has been done for purposes of allowing an invoice to be submitted, the owner must specify any deficiencies within 21 days of the acknowledgement. The acknowledgement would serve the same purpose as a 'declaration of last supply' for the purposing of defining time limits and trigger dates in the lien system.

6. Liens must Survive the Sale of the Lot or the Unit to a Home Buyer

In some residential projects, the practice is to pay contractors following the closing of the sale to the home buyer. The difficulty that arises is that under the current *Act*, lien rights expire when the home buyer takes possession. In some cases, the proceeds from closing may be insufficient to pay the full amount of the invoice submitted by the trade contractor. The trade contractor has no recourse since lien rights expire when the property is transferred to a home

buyer. PPO advocates that lien rights on residential properties (including condo units) should survive the transfer or sale of the property. When the principle of enduring lien rights is incorporated into legislation, purchase agreements will provide whatever protections home purchasers may require against a lien caused by non-payment of a contractor or supplier during the construction process. These protections could include set-offs against the closing price or payment of the closing amount into trust funds or escrow accounts. If necessary to protect home buyers, these types of provisions could be deemed to be part of a purchase agreement. In any event, PPO believes it is entirely feasible to continue lien protection of contractors and suppliers without unreasonably encumbering new home purchasers.

7. Surety Bonding to Protect Against Negative Builder Equity

Some residential projects are developed primarily to realize profit from an investment in land and not to generate profit from construction of the housing units. In these circumstances, the builder owns the land through a separate company which sells the land (at a substantial profit) to the building company. In some cases the selling price of the housing unit will be less that the construction cost. Thus, the building company has negative equity. The proceeds from sale may not be sufficient to pay all contractors and suppliers. An action against the builder is futile, since the building company has negative equity. PPO recommends that all builders on projects with a permit value greater than $1.0 million be required to post a payment surety bond equal to at least 20% of the permit value.

8. Reasonable Financial Disclosure

Reasonable financial disclosure is essential in the residential sector so that trade contractors can make an informed assessment of the risk which they might bear if the project is commercially unsuccessful or if the builder is inadequately financed to complete the project.

9. Application of Payment-in-Trust Principle to Buyers of Low-Rise Housing

Sec. 81 of the *Condominium Act* specifies that monies paid by a prospective purchaser must be held in trust. The same trust obligation does not apply to purchases in the low-rise sector. PPO believes that prospective purchasers of newly constructed low-rise housing units should be entitled to the same protection as is afforded by sec. 81 of the *Condominium Act*. This would have the added advantage of ensuring that monies paid by a prospective home-buyer are used solely for the purpose of construction the housing unit and therefore for payment of contractors and suppliers.

10. Case Management of Lien Actions

The current practice in Toronto and Ottawa is to expedite the resolution of lien applications through a reference procedure similar to a 'case management' process. The procedure applies to all sectors. However, the procedure, which only operates through local practice directions from Senior Regional Justices, is especially relevant to residential construction which tends to be composed primarily of small contractors. This 'case management' procedure has not been extended to other regions. PPO believes lien claimants in other regions would benefit from the expedition of this 'case management' procedure and that it should be extended on a province-wide basis. This could be accomplished through an amendment to section 58(1) of the current *Act* allowing a reference to a Justice or Master as the case may be, who would act as the case manager for all litigation involving the same project. This would permit those jurisdictions that do not have Masters to benefit from case management in construction lien matters and would legislate the current practice directions to a province wide effect.

11. Prohibition against Comingling of Trust Monies

Residential builders are often engaged in more than one project. This can result in comingling of monies across projects. PPO recommend that a separate segregated account should be required for each trust established under the *Act*

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18. Unique Problems of Employee Benefit Trust Funds

Nature and Role of Employee Benefit Trust Funds

Employee Benefit Trust Funds, also known as Multi-Employer Benefit Plans, are trust funds established under collective agreements in the construction industry as well as certain other industries.

In most of the public and private sector, benefit plans pertain to only a single employer. However, in the construction industry, multi-employer benefit plans are more common. Typically these plans are established by collective agreements which require employers to make contributions on behalf of each employee, based on the hours that he or she works. These plans are established as trusts for the benefit of the employees. They ~~often~~ are normally managed by boards of trustees jointly appointed by unions and employers. There are trust funds for pensions, for employee health benefits (medical, dental, life insurance, *etc*.) and for vacation and holiday pay. There may also be trust funds to support training and education. All plans are subject to third party audit and applicable provisions of the *Income Tax Act* (Canada). Pension plan trusts are also subject to the *Pension Benefits Act*.

A canvass was undertaken of six representative trust plans in the unionized construction industry. These plans collectively received contributions form 1,714 employers. The total remittances in the last fiscal year was $114.9 million. The plans and the related unions incurred legal expenses pursuing delinquent employers in the amount of $345,000 over the past year. In addition, the plans and related unions also deployed the equivalent of three full-time staff persons to pursue delinquencies. The six plans were required to 'write off' over $280,000 that was uncollectible owing to the insolvency of contractors. All of these costs were a direct operating charge to the plans and, by implication, were funds that could not be used to support pensions, medical benefits or other types of benefits.

Implications of Late Payment of Remittances

1. In determining the level of benefits to be provided, the trustees of benefit plans rely on professional advice, including actuarial advice, which takes into account the demographics of the members, historic utilization rates of entitlement and projected remittances from employers. Failure by employers to make the required monthly remittances on a timely basis or uncertainty about whether remittances will be made, directly impacts the funded position of these benefit plans. For example, a pension plan relies on certain actuarial assumptions as to the rate of return on the invested assets. If the contributions are

remitted late, then obviously those funds are not available to earn investment returns and therefore, the actuarially assumed rate of return may be overstated. In regards to a health benefit plan, the trustees also assume that the contributions will be remitted when due and will set the level of dental, drug, disability and other benefits based on that assumption. If the employer does not remit contributions when due under the terms of the collective agreement, these assumptions may prove incorrect and the plan may not have sufficient assets to provide the promised benefits. The trustees may maintain a contingency reserve to deal with these delinquencies. However, this contingency reserve comprises funds that are essentially idle and not available to provide member benefits.

2. The late remittance of contributions may also have a direct impact on each member's eligibility for benefits. Typically, a pension plan will provide pension accrual based on contributions ~~actually~~ received. If the contributions are not received, then members in a defined benefit plan will not earn any pension accruals for that time period. For example, if an employer fails to make the required pension contributions to the defined benefit pension plan, the member will not earn any pension accruals for that time period and therefore, his or her ultimate monthly benefits upon retirement will be lower. If the contributions are remitted late, the member may receive pension accruals for the time period, depending on the plan terms, but it will be the pension plan that will suffer a loss since the plan was not able to invest the contributions on a timely basis.

   In a defined contribution pension plan or group RRSP, late contributions mean that the members will have less time for those contributions to earn investment income. The ultimate pension benefit must~~must~~ be correspondingly lower. For example, if pension or group RRSP contributions are remitted six (6) months later than required, the member will lose any interest or investment income that he or she could have earned during that six (6) month period. This will negatively impact the amount of the pension he or she can receive upon retirement.

   Similarly, in a health plan, a member's eligibility for benefits is based on meeting certain minimum work requirements which is evidenced by contributions received. If a member has not met those minimum eligibility requirements because the employer has not remitted the contributions on a timely basis, the member and his or her dependents could be denied benefit eligibility. These minimum eligibility requirements are typically based on meeting a minimum number of work hours for which contributions were remitted to the plan. Therefore, if a health plan does not receive the contributions on a timely basis, the member may no longer meet the minimum hourly contributory requirements in order to continue eligibility under the plan. As a result, a member and/or his or her dependents could be denied eligibility for benefits under the plan. This would include the member and his or her dependents not being eligible for prescription drugs or for dental and eye care expenses. It

would also mean that if a member becomes injured during this period, he or she could be denied eligibility for disability benefits.

3. The third implication of late payment for employee trust funds arises from their legal character as a trust. A fiduciary duty of the trustees of the trust fund is to take all reasonable steps to collect remittances that are due. A trust fund does not know if a remittance is late because payment to the contractor has been delayed or because there is a solvency problem with either the contractor or the project. Caution therefore dictates that trust funds promptly exercise lien rights and/or request that the union initiate a grievance to ensure that those rights are not prejudiced. By law, most grievances in the construction industry must be brought before the Ontario Labour Relations Board and any order of the Board is enforceable by the courts. Given the fiduciary duty of trustees, the current system therefore encourages the use of lien claims, non-payments suits, grievances and other costly and time-consuming collection procedures. All of these collection procedures increase the operating costs of employee trust funds and therefore the benefits available to members, the contributions that employers must make and ultimately the cost of construction.

4. The fourth implication of late payments in the construction industry relates to the fact that most unions have negotiated interest and penalty payments to deter delinquent payments. Although such payments will vary by collective agreement, a typical collective agreement in the construction industry reads:

> "Contributions, complete with a statement, shall be remitted monthly to the Administrator designated by the Board of Trustees and are due in the Administrator's hands no later than the fifteenth (15th) of the month following. Payments received by the Administrator after the due date shall be subject to an assessment of five (5) percent of the amount due except that remittances bearing a postal cancellation stamp dated on or before the eighth (8th) day of the month shall not be subject to penalty."

A trade contractor whose payment from a general contractor has been delayed may not have the funds on hand to make trust fund remittances and will thus incur interest charges as described above. In addition, collection procedures will commence. The trade contractor therefore bears a direct cost for delaying remittances. (This, of course, is also the case with delayed remittances to CRA and the WSIB.) However, in most cases, the interest or penalty costs borne by the trade contractor are not offset by the receipt of interest on the delayed payment from the general contractor.

Implications of Default on Remittances

The consequences for employee trust funds of payment default are even greater than the implications of late payment. Unless there is recovery in liquidation, payment default fundamentally undermines the financial viability of an employee benefit trust. While a reserve can be maintained to protect against a modest level of remittance default, a default by a significant employer or a spate of defaults forces an employee benefit plan to reduce benefits or require sharply increased employer contributions. Since the construction industry commonly negotiates three-year collective agreements, there may not be a timely opportunity to increase employer contributions. The only option may be to reduce the benefits for all members or to deny benefits to only those member directly affected by the remittance default. It is, therefore, of vital importance to employee trust funds that there be reasonable and accessible security in circumstances of remittance defaults.

There are no particular provisions needed in a new 'Construction Act' to protect the interests of employee benefit plans. Rather the point that the review process should appreciate is that the consequences of late and defaulted payments in the construction industry is not limited to contractors and suppliers. Workers and their families are also victims of the culture of late payment that has become embedded in the construction industry. Their health benefits may be jeopardized by late or defaulted remittances and their pension entitlements are certainly reduced. There is absolutely no justice in this. The only way to address this injustice is to incorporate stronger payment security and prompt payment into a new 'Construction Act'.

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19. Conclusion

This review process emerged following the successful (and unanimous) second reading received by Bill 69, a private member's bill short-titled *'Prompt Payment Act, 2013'*. The announcement of the review process stated that it was "commissioned in response to stakeholder concerns related to prompt payment and effective dispute resolution in Ontario's construction industry, such as encouraging timely payment for services and materials, and making sure payment risk is distributed fairly."[13] It is clear from both the context and from the text of the announcement that issues related to prompt payment and dispute resolution are not only central to the review, they are the raison d'être for the review.

The primary purpose of this review is *no*t to fix technical gaps in the *Construction Lien A*ct related to security for payment. The review process may identify some of these gaps and suggest solutions. However, recommendations in that vein are secondary to the primary purpose of the review. This review is first and foremost about addressing the problems of payment delays in Ontario's construction industry. Those delays have increased in both length and prevalence. They have become the number one problem in Ontario's construction industry. The success or failure of this review process will turn on the effectiveness of its recommendations to reverse this problem.

PPO has advocated that Ontario apply the same broad framework that has been successfully introduced in most other jurisdictions in the OECD, including virtually all common law jurisdictions. The essence of that framework is a legislated payment cycle, interest payments on overdue accounts, requirements for reasonable financial disclosure, a right to suspend work when payment is not received, and a mandated process for expeditious resolution of disputes over payments. Ontario's construction industry badly needs such a framework.

The current lien system was not designed to encourage prompt payment and, in fact, does nothing to promote or ensure it. Both the survey evidence and Statistics Canada's data on collection periods confirm this. Moreover, the current lien system is overly litigious, costly and often ineffective even in achieving its primary purpose of promoting security for payment. Ontario needs a new 'Construction Act'. A new 'Construction Act' would reform and subsume the current lien system. More importantly, a new 'Construction Act' would also add the essential elements of a more complete framework, namely a legislated payment cycle, interest payments on overdue accounts, requirements for reasonable financial disclosure, a right to suspend work when payment is not received, and a mandated process for expeditious

[13] Ministry of the Attorney General of Ontario, "Ontario Launches Expert Review of the Construction Lien Act", February 11, 2015.

resolution of disputes over payments. If this review process recommends a new 'Construction Act' of this type, then it will have made a singular and significant contribution to the industry and to public policy in Ontario. Prompt payment must be front and centre in a new 'Construction Act'.

The success or failure of this review process will turn on the effectiveness and comprehensiveness of the recommendations it makes to reverse the late payment practices that have become endemic in Ontario's construction industry and which have such serious cascading effects in the industry.

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Appendices

A: Consensus Draft on a Prompt Payment Act (February 2013) - OGCA and NTCCC

B: *Daily Commercial News* article on Consensus Draft

C: Membership of Prompt Payment Ontario

Appendix A

Consensus Draft on a Prompt Payment Act
(February 2013)

OGCA and NTCCC (Ontario Section)

AN ACT RESPECTING THE PROTECTION AND VIABILITY OF CONSTRUCTION CONTRACTORS

Consensus Draft 3]

PREAMBLE

People of Ontario and their Government:

Recognize the importance of the construction industry to the financial health of the Province of Ontario;

Recognize the contribution to that industry made by contractors and subcontractors;

Believe that contractors and subcontractors are particularly vulnerable as they must carry substantial upfront costs, including equipment, materials and employee salaries;

Recognize that carrying these costs have an obvious impact on all areas of a contractor's and subcontractor's business when payment is not forthcoming within a reasonable timeframe;

Recognize that payment for goods or services delivered in a prompt and efficient manner is necessary to ensure the success of contractors and subcontractors who operate important small businesses in the Province of Ontario; and

Believe it is important to facilitate regular and timely payments between the parties to a construction contract.

DEFINITIONS

1. In this Act,

"change" or **"changes"** means any variation to a construction contract which varies the price or the method of calculation of the price, adds to or deletes from the amount of construction work supplied or to be supplied, varies the method of performance, or varies the schedule for performance of construction work.

"construction contract" means a contract or agreement made between an owner or an agent of the owner, and a contractor, or a contract or agreement between a contractor and a subcontractor,

or a contract or agreement between a subcontractor and another subcontractor, under any of which one party undertakes with the other party to provide construction work in connection with an improvement;

"construction work" means the supply of labour, services and materials, or any combination thereof, in connection with an improvement;

"contractor" means any person performing construction work under a construction contract with the owner or an agent of the owner, and may include a material supplier;

"Crown" includes a Crown agency to which the *Crown Agency Act* applies;

"day" or **"days"** means calendar day or calendar days, as the context requires;

"final payment" means the payment to which a person is entitled under sections 5 or 6 of this Act, and includes payment or credit for any change. Any single or one-time payment for carrying out construction work under a construction contract shall be deemed to be a final payment;

"holdback" means the holdback prescribed by Part IV of the Construction Lien Act;

"**improvement**" means, in respect of any land,

(a) any alteration, addition or repair to the land;

(b) any construction, alteration, repair, restoration, maintenance, erection or installation on the land, including any temporary work, and also including the installation of industrial, mechanical, electrical or other equipment on the land or on any building, structure or works on the land that is essential to the normal or intended use of the land, building, structure or works; or

(c) the complete or partial demolition or removal of any building, structure or works on the land;

"material supplier" means a contractor or subcontractor who supplies every kind of movable property,

(a) that becomes, or is intended to become, part of the improvement, or that is used directly in the making of the improvement, or that is used to facilitate directly the making of the improvement; or

(b) that is equipment rented without an operator for use in the making of the improvement;

"owner" means any person, including the Crown, having an interest in real property at whose request and,

(a) upon whose credit, or

(b) on whose behalf, or

(c) with whose privity or consent, or

(d) for whose direct benefit,

an improvement is made to the real property.

"payee" means any contractor or subcontractor entitled to receive payments directly from a payer under a construction contract;

"payer" means any owner, contractor or subcontractor obligated to make payments directly to a payee under a construction contract;

"payment application" means any invoice, bill or other request for periodic payment, payment upon any change, final payment or release of holdback in relation to and in accordance with the terms of the applicable construction contract;

"payment certifier" means the person or entity identified in a construction contract responsible for the issuance of certificates for payment;

"progress payment" means a payment to which a person is entitled under sections 5 or 6 of this Act, and includes payment or credit for any change;

"regulations" means regulations made under this Act;

"**reasonable evidence of financial arrangements**" means evidence reasonably and accurately verifying the owner's ability to perform its financial obligations under a contract, and may include, as the circumstances require, commitment letters or credit agreements from lenders, bank verification letters, financial statements and verification of budgetary allocations or commitments.

"subcontractor" means any person performing construction work under a construction contract with a contractor or with another subcontractor, but not with the owner, and may include a material supplier;

"**temporary work**" means temporary supports, structures, facilities, services and other temporary items required for the execution of an improvement but not incorporated into the improvement.

APPLICATION

2. This Act applies to every construction contract entered into for construction work undertaken in Ontario after the effective date of this Act irrespective of whether or not the governing law of the contract is expressed as being the law of Ontario.

EXCLUSIONS

3. This Act does not apply to:

(a) a construction contract under which a party undertakes to carry out construction work as an employee of the party for whom the work is to be carried out; and

(b) any construction contract or class of construction contracts prescribed by the regulations for the purposes of this section.

NO CONTRACTING OUT

4. Any agreement by any person that this Act, or any portion thereof, does not apply to the person or that the remedies provided by it are not available for the benefit of the person is void.

OBLIGATION TO PAY CONTRACTOR

5. (a) The owner shall pay to a contractor progress payments and final payment for construction work in accordance with the terms of the construction contract between them on the dates provided for such payments in the construction contract, but no less frequently than monthly.

(b) Should no date for progress payments be provided in the construction contract, progress payments shall be made monthly. The contractor shall submit a payment application dated the last day of the first and each subsequent month, and each payment application shall claim for the value of construction work performed as at the date of the application. Payment upon each such payment application shall be made on or before 20 days following the later of the receipt by the owner, or the payment certifier on behalf of the owner, of the payment application or the last day of the monthly payment period for which the payment application is made.

(c) Should no date for final payment be provided in the construction contract, final payment shall be made 5 days following the issuance of any certificate for final payment issued by the payment certifier, or if there is no payment certifier or the payment certifier fails without sufficient cause to issue a certificate for final payment within 10 days of a request to do so, within 15 days after submission of the payment application for final payment.

(d) Notwithstanding subsections (b) and (c) hereof, if any progress payment or final payment includes payment of any holdback prescribed by the *Construction Lien Act*, such payment of holdback shall only be made one day after the expiration of the holdback period prescribed by the *Construction Lien Act*, provided that there are no preserved or perfected liens then registered on title to the lands and premises upon which the improvement was undertaken under which claims against the holdback may be made.

OBLIGATION TO PAY SUBCONTRACTOR

6. (a) A contractor shall pay to the subcontractor, and a subcontractor shall pay to another subcontractor, progress payments and final payment for construction work in accordance with the terms of the construction contract between them on the dates provided for such payments in the construction contract, but no less frequently than monthly.

(b) Should no date for progress payments be provided in the construction contract, progress payments shall be made monthly. The subcontractor shall submit a payment application dated the 25th day of the first and each subsequent month, and each payment application shall claim for the value of construction work performed as at the date of the application. Payment upon each such payment application shall be made on or before 30 days following the receipt of the payment application, or 10 days after the date of a certificate for such payment issued by the payment certifier, whichever is the later.

(c) Should no date for final payment be provided in the construction contract, final payment shall be made on or before 30 days following the receipt of the final payment application, or 10 days after the date of a certificate for payment issued by the payment certifier, whichever is the later.

(d) Notwithstanding subsections (b) and (c) hereof, if any progress payment or final payment includes payment of any holdback prescribed by the *Construction Lien Act*, such payment of holdback shall only be made one day after the expiration of the holdback period prescribed by the *Construction Lien Act*, provided that there are no preserved or perfected liens then registered on title to the lands and premises upon which the improvement was undertaken under which claims against the holdback may be made.

AMOUNT OF PROGRESS PAYMENT

7. The amount of the progress payment to which a person is entitled under a construction contract shall be:

(a) the amount provided for payment for construction work under the construction contract, including the payment or credit provided for any changes; or

(b) if the construction contract does not provide for payment of a specified amount, the actual value of the construction work performed, or related goods or services supplied, immediately prior to the date of payment for the particular payment period, relative to the value of the entire construction contract including the actual value of all changes.

DEEMED APPROVAL OF PAYMENT APPLICATION

8. (a) A payment application shall be deemed approved or certified for payment unless the party liable for payment, or the payment certifier on its behalf, within 10 days after receipt,

provides a written statement to the party delivering such payment application describing the reasons for any disapproval or amendment of such payment application.

(b) Receipt of the payment application by the payment certifier or agent of the owner shall be deemed to be sufficient for the purposes of establishing the date of receipt under subsection (a) hereof.

(c) The written statement prescribed by subsection (a) hereof shall contain full particulars of the reasons for any disapproval or amendment of such payment application, including relevant provisions of the construction contract being relied upon, and shall further contain a statement of the amount of such payment application for which payment is disapproved or amended.

(d) The portion of any payment application for which payment is disapproved or amended,

(i) shall be limited to a reasonable estimate of the direct loss, damage or cost of completion or correction of construction work for which payment is being disapproved or amended and which direct loss, damage or cost of completion or correction of construction work is otherwise recoverable under the construction contract; and

(ii) to the extent the disapproval of a payment application, or portion thereof, is limited to the valuation or method of valuation of any change, shall be further limited to the reasonable estimate of only such portion of the value of such change as is in dispute.

(e) Provided the party liable for payment provides the written statement as provided in subsection (a) hereof, that party may only withhold such amount from the progress payment as may represent the reasonable value of the disputed portion of the construction work.

(f) Payment shall be made upon any payment application:

(i) in respect of which the written statement prescribed by this section 8 is not given, or is not given in accordance with the provisions of this section 8; and

(ii) for the amount of any payment application for which payment is not disapproved or amended, as verified by the statement prescribed in subsection (c) hereof.

RIGHT TO SUSPEND PAYMENT

9**.** In the event a payer fails to make payment to a payee as prescribed by this Act:

(a) written notice of default shall immediately be provided as follows:

(i) if the payee is a contractor, the contractor shall provide written notice of default to the owner, and shall provide a copy of such written notice of default to all subcontractors

with whom the contractor has entered into a construction contract for that portion of the improvement under which subcontract payments are due or will become due;

(ii) if the payee is a subcontractor, the payee shall provide written notice of default to the payer, and a copy of such written notice of default shall be given to the owner, to all subcontractors with whom the payee has entered into a construction contract for that portion of the improvement under which subcontract payments are due or will become due, and provided the payer is not otherwise the contractor, to the contractor;

(b) should the payer not remedy the default within the time prescribed in the contract between the payer and the payee, or if such contract does not provide for a time to remedy the default, within 7 days of the date of delivery of the written notice of default, the payee may suspend performance of construction work and may also take such steps as are required to enforce the lien rights of the payee under the *Construction Lien Act*. If the payee suspends performance or takes steps to enforce lien rights, the payee shall provide to those persons to whom the payee provided the written notice stipulated by subsection (a) hereof a written notice of all such steps taken to enforce payment;

(c) provided the written notice of default has been given in accordance with subsection (a) hereof and provided the written notice of steps taken to enforce payment has been given in accordance with subsection (b) hereof, the time for payment prescribed by this Act to which the payee who provided such written notices is otherwise subject shall be extended to the earlier of:

(i) the date of final determination of the lien rights of such payee;

(ii) the date of expiry of the lien rights of such payee;

(iii) the date on which the default which is the subject of the written notice of default prescribed by subsection (a) hereof is corrected; or

(iv) the date on which the default which is the subject of the written notice of default prescribed by subsection (a) hereof is resolved by settlement or agreement.

and the amount of payment so suspended shall be then deemed payable as a progress payment or a final payment pursuant to this Act; and

(d) notwithstanding any suspension of the obligation to make payment under any subcontract, the contractor or subcontractor whose payment obligation is suspended shall be obliged to pay interest on the amount of payment so suspended from the date the payment was due but for the suspension to the date the payment finally becomes due pursuant to subsection (c) hereof, at the rate of interest prescribed in section 10.

INTEREST ON OVERDUE PAYMENTS

10**.** Interest is payable on the unpaid amount of any progress payment or final payment that becomes due and payable in accordance with this Act, calculated at the rate prescribed by the

Courts of Justice Act for prejudgment interest, or at the rate prescribed by the construction contract, whichever is the greater.

RIGHT TO SUSPEND CONSTRUCTION WORK AND TERMINATE A CONSTRUCTION CONTRACT UPON NON-PAYMENT

11. (a) If a contractor or subcontractor undertaking construction work does not receive payment to which such person is otherwise entitled pursuant to this Act, that contractor or subcontractor may suspend performance of construction work or terminate the construction contract, in accordance with the provisions of the construction contract.

(b) Should the construction contract contain no provisions for, or prohibit, the suspension of performance of construction work or termination of the contract for failure to make payments, the contractor or subcontractor who does not receive payment to which such person is otherwise entitled pursuant to this Act may, notwithstanding such construction contract, suspend performance or terminate the construction contract in accordance with the provisions of subsections (c) to (f) inclusive of this section 11.

(c) No suspension of construction work or termination of the construction contract pursuant to subsection (b) hereof shall be effective unless the contractor or subcontractor intending to suspend or terminate,

(i) provides written notice to its payer of such intention to suspend construction work or terminate the construction contract, which written notice shall provide that if the default is not corrected within 7 days following receipt of such written notice, the contractor or subcontractor shall suspend construction work or terminate the construction contract; and

(ii) the party receiving such notice fails to correct the default within such 7 days following receipt of notice.

(d) Without affecting any right to receive any payment otherwise due upon the construction contract, a construction contract upon which construction work has been suspended in accordance with the provisions of subsection (b) hereof may be terminated following 7 days written notice of termination provided by the contractor or subcontractor to its payer.

(e) No suspension or termination in accordance with the provisions of subsection (b) hereof shall be deemed to be a breach of the construction contract.

(f) Upon any resumption of construction work following a suspension thereof in accordance with subsection (b) hereof, the party resuming construction work shall be entitled to the payment of reasonable remobilization costs, in addition to such other amounts to which such party is otherwise entitled under the construction contract or under this Act.

(g) The rights and remedies prescribed by this section 11 shall in addition to those rights and remedies prescribed by section 9.

RIGHTS TO INFORMATION

12. (a) The owner, before entering into a construction contract, shall provide to the contractor reasonable evidence of financial arrangements to fulfill the owner's obligations under the construction contract.

(b) The owner shall further provide such updated reasonable evidence of financial arrangements at any time after entering a construction contract, forthwith upon written request of the contractor.

(c) Upon receipt from the owner of the reasonable evidence of financial arrangements provided under subsection (a) hereof, and upon receipt of any updated reasonable evidence of financial arrangements obtained upon written request pursuant to subsection (b) hereof, the contractor shall provide a copy thereof to any subcontractor forthwith upon written request of such subcontractor. .

(d) All reasonable evidence of financial arrangements required by this section 12 shall be provided by the owner and received by the contractor, and copies thereof shall be provided by the contractor and received by any subcontractor, in strict confidence, solely for the use by the contractor and any subcontractor to satisfy themselves as to the ability of the owner to fulfill the owner's financial obligations under the contract, and for no other purpose whatsoever.

(e) A subcontractor may, at any time, by written request, require its payer under a construction contract to disclose the due dates for payment of progress payments and final payment to such payer under a construction contract.

(f) Every payer under a construction contract shall provide notification to its payees of the date or dates of all monies or payments received by such payer on account of the construction work.

(g) The notification of payment received stipulated in subparagraph (f) hereof shall be made forthwith upon receipt of payment, and may be made in writing, posting on a website, or in any other manner as will reasonably allow access to such payees to the information contained in such notification.

(h) If the owner or contractor, as the case may be, fails or refuses to comply with the obligations prescribed in subsections (a) or (c) hereof, or if the payer fails or refuses to comply with the obligations in subsection (e), (f) or (g) hereof, or if any person knowingly or negligently mis-states the information provided, such person shall be liable to the person entitled to receive such information for any damages sustained by reason thereof.

(i) Upon application, the court may at any time order a person to comply with the obligations prescribed in subsections (b), (c), (e), (f) and (g) hereof, and, when making the order, the court may make any order as to costs as it considers appropriate, including an order for costs on a substantial indemnity basis.

(j) If a person receiving the reasonable evidence of financial arrangements stipulated herein fails or refuses to comply with the obligations of confidentiality stipulated in subsection (c) hereof, such person shall be liable to the owner for any damages sustained by reason thereof, and in addition the owner shall be entitled to injunctive relief upon such terms as the court considers just in order to remedy the consequences of any such breach of confidentiality.

LIMITATION ON HOLDBACKS

13. No construction contract shall provide any right to maintain any holdback or other withholding of funds other than such holdbacks as are prescribed by the *Construction Lien Act*.

ACT BINDS CROWN

14. This Act binds the Crown.

REGULATIONS

15. The Lieutenant Governor in Council may make regulations under this Act.

COMMENCEMENT

16. This Act comes into force on the day it receives Royal Assent.

SHORT TITLE

17. The short title of this Act is the Prompt Payment Act.

Appendix B

Daily Commercial News article on Consensus Draft
February 19, 2013

DAILY COMMERCIAL NEWS
AND CONSTRUCTION RECORD

February 19, 2013

Ontario prompt payment blueprint reached

PATRICIA WILLIAMS
staff writer

The Ontario caucus of the National Trade Contractors Coalition of Canada (NTCCC) and the Ontario General Contractors Association (OGCA) have reached agreement on a blueprint for what could ultimately become the basis for Canada's first legislation governing prompt payment.

"After more than a year of collaboration, we now have the groundwork for a workable piece of legislation that will see fairness from the sub-sub to the trade contractor and general contractor and right up to the owner," said OGCA president Clive Thurston.

He said the key to success was the fact that the parties involved in the negotiations "were actual general contractors and subcontractors who were willing to set aside their prejudices and beliefs and respect each other's points of view."

The draft legislation, called an act respecting the protection and viability of construction contractors, details in part the payment obligations of the respective parties.

"This is a total industry effort," said NTCCC director Richard McKeagan, president of the Mechanical Contractors Association of Canada.

"This is great for the relationship between the trades and generals with benefits for all concerned.

"Prompt payment legislation will help address problems in all sectors, and up and down the construction supply chain."

The proposed legislation was drafted by a joint task force of the OGCA and the national trade contractors' coalition.

"We had some real players at the table on both sides," said Eryl Roberts, executive vice-president of the Electrical Contractors Association of Ontario and one of the NTCCC representatives on the joint task force.

He said the most important structural aspect of the proposed legislation is that it is a consensus document.

“It includes all the parties in the construction chain from owners, generals and subs on down, each of which have the obligation to pay promptly and the right to be paid promptly. Unlike most other prompt payment legislation, this is more than just the subs versus the general contractors.”

The legislation has been drafted in accordance with the principles of CCDC2 and the Canadian Construction Association’s subcontract document.

From the perspective of the NTCCC, which represents 11 trade associations, Roberts said the most important provisions pertain to rights to information in the payment sphere.

“For the subtrades, it is the obligation of a general contractor to notify them of payment received from the owner,” he said. “This information is critical to managing prompt payment and agreement on it was key to reaching a deal.

“The discussions around this topic were most enlightening for both parties as it goes to the heart of the problem.”

Task force meetings were facilitated by Geza Banfai, a partner in Heenan Blaikie’s infrastructure and construction litigation practice group.

For its part, the OGCA said in a bulletin to its members that key benefits include the fact that:

— No owner would be able to contract out of the payment requirements in the proposed legislation, which are more balanced than those that many owners utilize.

— Payment certifiers would be held to the time limits proposed and face penalties if they do not process payments.

— If the payment certifier fails to issue certification within the time period, the submission would automatically be deemed certified and due.

— Only the actual value of a disputed amount or amounts involved with a deficiency could be held back. The value held back would be limited, no more 200 per cent of the value of the issue.

— The legislation still allows for deferral of payment to a trade if a contractor is not paid, but provides an incentive for generals to expeditiously pursue their claims. If the notification procedure and other processes are followed by the general contractor, he has the right to defer payment downstream.

— A CCDC clause allowing access to owners’ financial information would no longer be allowed to be deleted.

In addition, no holdbacks other than those prescribed under the Construction Lien Act are permissible.

OGCA chair David Blake said concerns over prompt payment are not new to the industry.

“Payment periods throughout the supply chain have been routinely getting longer, creating animosity and frustration on all sides,” he said. “This joint agreement will go a long way to address these concerns and ease tensions. It is a win for everyone involved.”

NTCCC Ontario caucus chair John Blair of the Canadian Masonry Contractors Association said research shows there is support from all three provincial parties for some sort of prompt payment legislation in the construction industry.

“Now that OGCA and NTCCC have agreed to what the proposed legislation could look like, relative to the terms and conditions, the Ontario industry has a good shot at being the first jurisdiction in Canada to introduce such legislation.”

The task force hopes to present its recommendations to the provincial government in early March.

Appendix C

Membership of Prompt Payment Ontario

- Acoustical Association Ontario
- Association of Millwrighting Contractors of Ontario
- Architectural Glass and Metal Contractors Association
- Brick & Allied Craft Union
- Canadian Automatic Sprinkler Association
- Canadian Concrete Masonry Producers Association
- Canadian Institute of Steel Construction - Ontario Region
- Carpenters District Council of Ontario Political Action / Promo Fund
- Concrete Forming Association of Ontario
- Council of Ontario Construction Associations
- Crane Rental Association of Ontario
- Electrical Construction Association of Hamilton
- Electrical Contractors Association of Ontario
- Electrical Contractors Association of Quinte - St. Lawrence
- Greater Toronto Electrical Contractors Association
- IBEW Construction Council Of Ontario
- I.B.E.W. Local 353 Welfare Plan c/o Toronto Electrical Industry Benefit Administration Services Ltd.
- Independent Plumbing & Heating Contractors Association
- Independent Unionized Landscape Contractors Association
- Interior Systems Contractors Association of Ontario
- International Brotherhood of Boilermakers
- International Union of Operating Engineers, Local 793
- Labourers' International Union of North America
- Masonry Contractors' Association of Toronto
- Mechanical Contractors Association of Ontario
- Ontario Association of Demolition Contractors

- Ontario Concrete & Drain Contractors Association
- Ontario Council of Painters/International Union of Painters and Allied Trades
- Ontario Erectors Association/Ironworkers Association Council of Ontario
- Ironworkers Association Council of Ontario
- Ontario Masonry Contractors Association
- (The) Ontario Pipe Trades Council
- Ontario Sheet Metal Contractors Association
- Residential Siding Contractors Association of Greater Toronto
- Residential Carpentry Contactors Association Of Greater Toronto
- Residential Tile Contractors Association
- Ontario Formwork Association
- Ontario Painting Contractors Association
- The Ontario Pipe Trades Council
- The Residential Low Rise Forming Contractors Association of Metro Toronto and Vicinity
- Toronto & District - Carpentry Contractors Association
- Trim Association of Ontario

Prompt Payment Ontario

Submission to the Construction Lien Act Review

NOVEMBER 2015