Week 8- Module 7

Bonds, Liens, and Claims

Law, Ethics and Professional Practice - ENGI3500

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Introduction

- Engineers must possess a general knowledge of bonds, liens, and claims given the role they play within the industry.
- Understanding bonds, such as performance and payment bonds, is essential for engineers to ensure project integrity and completion, as these instruments provide financial guarantees and security.
- Liens represent potential legal claims on a property, and engineers need to be aware of any potential liens filed by subcontractors or suppliers, as these can impact project progress and financing.
- Additionally, a grasp of construction claims is vital for engineers to navigate disputes effectively, mitigate project delays, and address financial implications, contributing to successful project management and risk mitigation within the construction realm.

What is a Bond?

- A **Bond**, in the context of construction and contracts, refers to a financial guarantee provided by a third party, known as a surety, to ensure the performance and fulfillment of contractual obligations. Specifically, a performance bond is commonly used in construction projects. The bond serves as a form of insurance for the project owner, protecting them in the event that the contractor fails to complete the project or meet other contractual requirements.
- When a contractor is awarded a project, they may be required to obtain a performance bond. In the event of the contractor's default or inability to fulfill contractual obligations, the surety (bonding company) steps in to either complete the project or compensate the project owner for any financial losses incurred due to the contractor's failure. The bond provides assurance to the project owner that the work will be completed as agreed upon, even if the original contractor encounters difficulties.

The Role of the Surety

- The surety's primary role is to guarantee the performance of a party, often a contractor, for the benefit of a third party, typically the project owner.
- Sureties can extend their guarantees to various parties, such as subcontractors or those involved in specialized environmental clean-up work.
- The bond's purpose is to offer comfort and protection to the obligee, providing an alternative remedy if the principal (contractor) fails to fulfill their contractual obligations.

Obligations and Premiums

- Two separate agreements are involved when a bond is issued, each with distinct obligations: primary obligations in the contract between the principal and the obligee, and secondary obligations in the bond itself.
- The principal pays a premium to the surety, similar to an insurance premium, with factors like financial resources, bonding capacity, and asset base influencing the premium.
- The surety often requires indemnification from the principal and major shareholders, distinguishing bonds from insurance contracts. Written agreements and possession of the original bond are essential for enforcement.

Bid Bonds

- The bid bond is utilized in the tendering process, ensuring that if the principal's bid is accepted, they are obligated to enter into a formal contract with the obligee.
- In the event that the principal fails to fulfill the contractual obligation, the bid bond covers the difference in money between the principal's bid amount and the amount the obligee must pay another party for the work. The surety initially covers this cost but subsequently charges the total costs back to the principal.

Performance Bonds

- A performance bond serves to indemnify the obligee in case the principal fails to fulfill contractual obligations, with indemnity limited to the specified bond amount.
- The performance bond is typically issued when the formal contract is executed and specifies the contract the principal must fulfill, with wording that must be carefully reviewed and understood.
- The amount of the performance bond covers extra costs above the original contract price required to complete the contract in case of default. The surety's obligation applies to amounts exceeding the original contract price, and the bond typically responds in situations like contractor bankruptcy or insolvency, with the surety arranging for completion of the contract. Resolving disputes may involve legal processes to establish a default in performance.

Payment Bonds

- A payment bond acts as a guarantee for fulfilling payment obligations in a contract, addressing concerns about default.
- In a construction contract, both the owner and the contractor may have payment obligations, and failure to meet them could lead to issues such as liens and prejudice.
- Payment bonds are typically required in two scenarios: when an owner requires one from the contractor and when a contractor demands one from major subcontractors, aiming to protect against liens by unpaid parties in the contractual chain.

Labour and Material Payment Bonds

- A labor and material-payment bond guarantees payment to all claimants for labor and materials provided to the principal for the project described in the bond.
- In the traditional contractual arrangement, claimants are typically subcontractors and material suppliers, and the owner, acting as trustee for the benefit of claimants, is described as the obligee in the bond. The choice of bond form is crucial, and legal counsel should review bonds as needed.

Letters of Credit

- Letters of credit are increasingly used in construction and equipment-supply contracts, especially for projects outside Canada, as an alternative to performance bonds.
- Typically provided by banks or trust companies, letters of credit assure the availability of funds in case of contractor default, acting as a form of financial guarantee.
- The terms of letters of credit may vary, and obtaining legal advice is recommended, as they can function as "blank cheques" for the recipient and may impact the contractor's line of credit with the issuing bank or trust company.

What is a Lien?

- A lien is a legal right or interest that a lender has in the borrower's property, granted until a debt or obligation is satisfied.
- In the context of engineering/construction or property improvement, a mechanic's lien, also known as a construction lien or contractor's lien, is a claim against a property by contractors, subcontractors, or suppliers who haven't been paid for work or materials provided.
- The lien serves as security, allowing the claimant to seek legal remedies to recover the unpaid amounts by potentially forcing the sale of the property. The specific rules and regulations governing liens vary by jurisdiction.

Lien Legislation

Construction Lien Statutes in Canada: Each province in Canada has its construction lien statute with similar purposes. These statutes aim to provide security of payment for labor, material suppliers, and equipment renters in construction projects and facilitate credit in the industry.

Payment Flow in Construction Projects: Money in construction projects flows from the lender to the owner, then to the general contractor, and finally to workers, suppliers, and subcontractors. Payments are typically made based on progress draws, requiring evidence of work performed or materials delivered before funds are released. This payment structure is common in the construction industry.

Role of Construction Lien: Construction lien statutes, also known as Construction Lien Acts or Builders Lien Acts, use mechanisms like construction liens to secure payment. A construction lien is a charge or claim against real property that has been improved by construction. Registering the lien in the land registry makes the property difficult to sell or borrow against until the lien is resolved, providing an incentive for the owner to address the payment claim. In extreme cases, the lien claimant may force the sale of the property to satisfy the lien.

Lien Legislation in Ontario

- **Transition Provisions in Ontario Construction Law:** The Construction Act in Ontario, with transition provisions, applies to contracts entered into after July 1, 2018. Prior to this date the old Construction Lien Act was in effect.
- **Revisions in the Construction Act:** The Construction Act introduces mandatory release of holdback to contractors and subcontractors, unless a notice of "setoff" is provided within 40 days after achieving substantial performance. Other revisions include an extension of the preservation period for liens from 45 to 60 days and the perfection period from 45 to 90 days. Due to the complexity of procedural and notice provisions, seeking legal advice on compliance with Ontario's Construction Act is of paramount importance.

Who is Entitled to Lien a Project?

- The Construction Act in Ontario grants lien entitlement to anyone providing services or materials for an "improvement" to an owner, contractor, or subcontractor.
- The term "improvement" is broadly defined to include alterations, additions, capital repairs to the land, construction, erection, installation of equipment, and complete or partial demolition or removal of buildings, structures, or works on the land.

The Construction Act Explained

Holdback Percentage: Under the Construction Act in Ontario, the holdback is 10% of the price of services or materials supplied.

Two Holdbacks Defined:

- Basic Holdback: Retained until certification of substantial performance and expiration or satisfaction of liens.
- Finishing Holdback: Applicable to finishing work, securing 10% of the remaining contract value.

Certification of Substantial Performance:

- Statutory provisions determine when substantial performance occurs.
- Key trigger points for holdback release and lien rights expiration.
- Quantitative criteria for substantial performance and contract completion.

The Construction Act Explained

Substantial Performance:

2 (1) For the purposes of this Act, a contract is substantially performed,

(a) when the improvement to be made under that contract or a substantial part thereof is ready for use or is being used for the purposes intended; and

(b) when the improvement to be made under that contract is capable of completion or, where there is a known defect, correction, at a cost of not more than,

(i) 3 per cent of the first $1,000,000 of the contract price,

(ii) 2 per cent of the next $1,000,000 of the contract price, and

(iii) 1 per cent of the balance of the contract price. R.S.O. 1990, c. C.30, s. 2 (1); 2017, c. 24, s. 4 (1, 2).

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The Construction Act Explained

Damages for Non-Certification:

- Failure to certify substantial performance may lead to liability for damages.
- Certifier must comply with certification rules within a reasonable time.

Lien Entitlement for Design Services:

- Anyone supplying designs enhancing land value is entitled to a lien.
- Legislation prohibits waiver of lien rights.

Limits on Lien Claim Amount:

- Lien claims limited to the price of services and materials supplied before the claim.
- Provisions against frivolous or fictitious lien claims.

The Construction Act Explained

Preservation of Liens:

- Time limits for preserving liens based on contract status and certified dates.
- General summation of time limits for contractor and other lien claimants.

Perfection of Preserved Liens:

- A preserved lien expires unless perfected within 90 days by commencing an action and registering a certificate of action.

Priority of Mortgages:

- Lending institutions face challenges as lien claimants may have priority in certain situations, impacting holdbacks.
- No revisions to priority provisions under the Construction Act.

The Impact of Liens on Projects

- When an owner receives notice of a lien claim, statutory obligations require the retention of both the holdback amount and the claimed lien amount. Failure to comply may result in additional payments to satisfy the lien claim, and the court might order the sale of the owner's interest in the land if payment is not made.
- Lien legislation is complex, necessitating legal advice for contract administrators, like engineers, to navigate compliance, release holdback funds, and conduct searches to ensure no registered lien claims before fund release

The Impact of Liens on Projects

- The Construction Act in Ontario defines concepts, such as the ability to make annual payments of accrued holdback for contracts exceeding one year and phased holdback payments.
- Legal advice is important for engineers to understand and comply with these provisions, ensuring adherence to Act conditions and Regulations before relying on annual and phased holdback release mechanisms.
- Engineers may be tasked with arranging lien claims, requiring legal advice to ensure compliance with statutory limitations and provincial lien statutes. Timely filing and proper adherence to legal requirements are essential aspects to be addressed by the engineer in this process.

Delay and Interference Claims

- Contractors frequently file claims against owners for damages arising from delays and interference caused by the owner's representative in the current construction industry landscape. Delay-related claims may emerge when the contractor's inquiries go unanswered, compelling the contractor to postpone construction until receiving a response.
- Interference claims arise when subcontractors' work overlaps or project coordination is inadequate. The engineer-administrator plays a crucial role in minimizing such claims by ensuring prompt responses to contractor inquiries and effective overall project coordination.

Delay Claims Explored

Types of Delays:

- Compensable Delay: One party is entitled to recover damages from the delaying party, specified in the contract.
- Excusable Delay: Not attributable to any party's fault, allowing an extension of time for completion; may or may not be compensable.
- Contractor-Caused Delay: Non-excusable and non-compensable delay caused by the contractor or a party for whom the contractor is responsible.

Contractual Provisions:

- Contract terms determine if a delay is compensable, excusable, or both.
- CCDC 2 contract distinguishes compensable delays caused by the owner, consultant, or their employees, allowing an extension of time and reimbursement of reasonable costs for the contractor.
- Force majeure provisions cover events beyond the parties' control, providing an extension of time for excusable delays, but may not address contractor-caused delays.

Delay Claims Explored

Notice Requirements:

- Parties must adhere to notice provisions in the contract regarding delay claims.
- CCDC 2 delay section requires the contractor to give notice within 10 working days of delay commencement to claim an extension.
- Timely notice is essential for monetary claims, but specific definitions may vary; strict compliance with notice requirements is advisable to ensure entitlements.

Homework Before Next Class

- Complete assigned chapter readings in the Critical Path. Chapters 26 and 30.
- Review the Construction Act: Construction Act, R.S.O. 1990, c. C.30 (ontario.ca)
- Define Holdback and Substantial Performance.

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References

Marston, Donald L. 2019. *Law for Professional Engineers: Canadian and Global Insights*. 5th ed. New York: McGraw-Hill Education.