EXPERT REVIEW OF ONTARIO'S CONSTRUCTION LIEN ACT

Information Package

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A. INTRODUCTION

As the stakeholder community is aware, in February 2015 the Ministry of the Attorney General and the Ministry of Economic Development, Employment and Infrastructure (the "Ministries") retained Bruce Reynolds as Counsel to conduct an expert review (the "Review") of the *Construction Lien Act* (the "Act"), with Sharon Vogel acting as Co-Counsel. The Review involves a review of the effectiveness of the Act in achieving its policy objectives within the modern context, and is also to address the issue of promptness of payment and the effectiveness of dispute resolution under the Act. A fundamental aspect of the Review is its inclusion of broad industry consultation.

This information package (the "Information Package") is intended to provide the background necessary for the stakeholders to participate meaningfully in upcoming consultation meetings with Counsel and Co-Counsel.

By way of overview, in general the Act provides suppliers of services, materials and equipment to construction projects with:

1. security for payment, in the form of the lien itself, and in particular the 10% holdback;

2. protection against the diversion of funds that were committed to the project, in the form of trust remedies; and

3. a summary procedure for the enforcement of lien rights.

The Act has functioned reasonably well since its inception in 1983; however a number of significant developments have resulted in the need for its review and modernization, including:

- the increased sophistication of both standard form and bespoke construction contracts over the last three decades, including the widespread use of **phasing of projects** and of **different project delivery systems** such as EPC and design-build;

- the widespread adoption by contractors and major subcontractors of **"pay when paid" and "pay if paid" provisions** in their standard form subcontracts;

- the evolution of **"prompt payment" or fairness of payment legislation** in other common law jurisdictions, and the corresponding desire on the part of suppliers for similar rights to be adopted in Ontario;

- the international development and evolution of **statutory adjudication and Dispute Review Boards** as a means of promptly resolving construction disputes;

- the relatively recent advent of a **major infrastructure renewal program in Ontario**, which is now taking effect within the provincial transportation sector, including road-building, and regional and municipal mass rail, LRT and subway transit;

- the utilization of the **Public Private Partnership** method of project delivery for major public works, with its restricted rights to additional compensation for contractors and subcontractors, and its extended payment arrangements;

- the adoption by government entities and municipalities of procurement policies that allow the government entity or municipality to **exclude potential bidders** solely on the basis that the potential bidder has previously brought legal proceedings against them;

- the widespread use of electronic record keeping and communications on construction projects, resulting in **massive numbers of documents** that have to be "managed" within a significant construction lien litigation;

- the effect of quantitative easing on interest rates, diminishing the number of insolvencies in the construction industry and therefore the perceived importance of **the availability of 10% of the contract price as holdback**;

- the increased use of **mandatory arbitration provisions** in construction contracts at all levels, without providing for the consolidation of multiple arbitrations relating to the same dispute(s);

- the increased utilization by insolvent companies of the federal ***Companies Creditors Arrangement Act,*** **RCS 1985, c.C-36 (the "CCAA")**, which may render lien and trust rights unenforceable;

- the enhanced powers of the **Canada Revenue Agency** to make third party demands that take priority over lien and trust rights; and

- the potential abuse of the right to serve a **written notice of lien**.

Importantly, this Review is not the first of its kind. In the last twenty years, several common law jurisdictions have undertaken the review and reform of legislation governing security of payment and promptness of payment in an attempt to strengthen the construction industry. For example, in 1994, the "Latham Report"[1] was commissioned by the U.K. government to review procurement and contractual arrangements in the U.K. construction industry. A similar review was established in August 2009 by the state government of New South Wales in Australia, and the final report of the Independent Inquiry into Construction Industry Insolvency in New South Wales (the "Collins Inquiry") was published in January 2013. As well, on June 1, 2015, the Hong Kong Government proposed to introduce an ordinance on security of payment for the construction industry and to that end, launched three months of public consultation. The intended scope of the ordinance encompasses all Government projects and projects of certain public bodies, as well as private projects over $5 million[2]. These initiatives and various legislative

[1] Michael Latham, Sir (July 1994) *Constructing the Team - Final report of the government/industry review of procurement and contractual arrangements in the UK construction industry*, The Department of the Environment, HMSO.

[2] See the press release page on the website of the Hong Kong Development Bureau, The Government of the Hong Kong Special Administrative Region on "Public Consultation on Proposed Security of Payment Legislation" online: http://www.devb.gov.hk/en/publications_and_press_releases/press/index_id_8641.html.

initiatives in other jurisdictions[3] have, among other things, sought to balance competing interests in regards to payment issues and to implement effective methods to resolve payment disputes in the construction industry.[4]

In essence, the issue of security of payment and the associated issues of promptness of payment and expeditious dispute resolution, highlight the tension between freedom of contract, on the one hand, and legislative intervention on the other. In Ontario, the policy decision to regulate security of payment to a limited degree has been accepted for generations, as embodied in section 4 of the Act which makes void any effort to contract out of the Act. Accordingly, the task of the Review is to provide the Government of Ontario with legal advice as to the form and extent of a regulatory intervention for the future in order to better achieve sound policy outcomes for the construction industry of Ontario.

The material contained in this Information Package was compiled through research conducted by the Review and research provided by certain stakeholders, and is provided to assist the reader in understanding the issues to be addressed by the Review and to provide background knowledge for those who may be unfamiliar with a particular issue.

Importantly, at this stage of the Review the information being provided is preliminary. It is for consideration purposes only and is not intended to express a view, perspective, or conclusion. Rather, this preliminary information is intended to set the stage for an understanding of what the various positions and schools of thought are on the issues and to properly acclimate the stakeholders to the issues. Where applicable, various schools of thought will be explained by way of overview in order to stimulate discussion with the stakeholders.

The Review looks forward to the opportunity to meet with the stakeholders for the purpose of discussing the issues related to the potential modernization of the Act.

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[3] Including the implementation of building and construction industry payment legislation in Scotland (*The Housing Grants, Construction and Regeneration Act 1996* (Scotland) (Commencement No 5) Order 1998); Singapore (*Building and Construction Industry Security of Payment Act 2004*); New Zealand (*Construction Contracts Act* 2004); and the Isle of Man (*Construction Contracts Act 2002*). Security of payment legislation is currently at the proposal stage in South Africa.

[4] Jeremy Coggins and Steve Donohoe, "A Comparative Review of International Construction Industry Payment Legislation, and Observations from the Australian Experience" (2012), *International Construction Law Review* 29(2) at 195.

B. PROCESS

The Review

As the stakeholders have been previously advised, the Review will take place in three phases, described in the Terms of Reference as follows:

Phase 1

Phase 1 of the Review will include:

a. the finalization of a complete stakeholder list;

b. the research and preparation of a substantive issues list; and

c. the preparation of this Information Package that is designed to provide the background necessary for the stakeholders to participate meaningfully in the consultations in Phase 2.

Phase 2

Phase 2 will include:

a. the distribution of the Information Package;

b. the scheduling of a series of consultation meetings (the "Consultation Meetings");

c. the receipt of written submissions from stakeholders who wish to do so prior to their attendance before the Review. Any written submissions received from stakeholders will be made available to all stakeholders;

d. a Review Questionnaire to be completed by stakeholders that will be focused on the substantive issues under consideration; and

e. the Consultation Meetings themselves.

As well, the Review has formed a small subject matter expert Advisory Group that will meet over the course of Phases 2 and 3 to further the discussion of issues of relevance and to identify opportunities for consensus building. The discussions of the Advisory Group will be confidential in nature to encourage open communication.

Phase 3

Phase 3 will involve the writing and submission to the Attorney General and the Minister of Economic Development, Employment and Infrastructure of a Report, which will both report on the conduct of the Review and contain Mr. Reynolds' expert legal opinion. The

government will make the Report publically available promptly following its submission to the Ministries.

The Review is intended to proceed in a manner that is inclusive, transparent, and consultative.

The Information Package

This Information Package is divided in five sections, as follows:

1. Introduction;

2. A Description of the Review Process;

3. Issues to be Considered by the Review;

4. Background Information to Issues (which provides background information on the issues listed in Section 3); and

5. Conclusion.

The list of issues is based on stakeholder communications and suggestions received to date, and on the Review's own analysis. Importantly, the list of issues is not closed, such that additional issues identified by stakeholders, or the subject matter expert Advisory Group, may be added to the list.

C. ISSUES TO BE CONSIDERED BY THE REVIEW

1. **Lienability**

(a) Consider the effectiveness of the definitions of "improvement", "materials", "supply of services" and "owner".[5]

2. **Holdback and Substantial Performance**

(a) Consider changing the amount of holdback (from the current 10%);[6]

(b) Consider increasing the number of dates for the release/early release of holdback, for instance on phased projects;[7]

(c) Consider making the release of holdback mandatory/automatic after expiration of lien rights, unless there has been early release of holdback;[8]

(d) Consider eliminating the "holdback for finishing work";[9]

(e) Consider revising the minimum requirements for substantial performance;

(f) Consider whether or not to add further specifics to the requirements for a Certificate of Substantial Performance; and

(g) Consider introducing a new requirement for a mandatory Certificate of Intention to Release Holdback.

3. **Preservation, Perfection and Expiry of Liens**

Generally

(a) Consider whether the mechanics of preservation and perfection require any changes;

(b) Consider clarifying the release of liens and consider if there are any alternatives to release and discharge; and

(c) Consider the effect of posting security and vacating liens on lien claimants (s. 44 of the Act).

Preservation

(a) Consider the length of the preservation period;

(b) Consider the impact of written notices of lien;

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[5] *Construction Lien Act*, RSO 1990, c. C.30 ("CLA"), ss.1, 14
[6] CLA, ss. 22(1).
[7] CLA, ss. 2, 25, 33.
[8] CLA, ss. 22, 24, 26, 27, 31, 34.
[9] CLA, ss. 22(2) and 27.

(c) Consider the introduction of mandatory certification of subcontract completion rather than the elective option currently provided for under Section 33 of the Act;[10]

(d) Consider mechanisms to avoid potential abuse of lien rights; and

(e) Consider lien registration issues vis-à-vis specific types of properties.

Perfection

(a) Consider the potential burden that the requirement to perfect within a relatively short time imposes on the court system;

(b) Consider any alternatives or changes to the perfection requirements;

(c) Consider the length of the perfection period; and

(d) Consider the alignment of time limitations in the Act with payment time periods in the Ontario construction industry.

Expiry under Section 37 of the Act

(a) Consider whether the two year limitation is appropriate; and

(b) Consider improving alignment of the Act with the *Limitations Act, 2002*, including breach of trust actions.

Requests for Information Pursuant to section 39 of the Act

(a) Consider whether further clarity is required in relation to what information is required to be produced in response to a section 39 request for information for various participants.

4. **Prompt Payment or Timely Payment for Construction Work**

(a) Consider the causes of payment delays and how they can be addressed in the Act or other legislation,[11] including the potential effect of prompt payment provisions on the principle of "freedom of contract";

(b) Consider making the release of holdback mandatory/automatic after the expiration of lien rights;

(c) Consider the potential effects of prompt payment provisions and their alignment with the Act on industry lenders and sureties;

(d) Consider the applicability and/or adaptability of any prompt payment provisions to different types of contracts; and

[10] Ontario Construction Lien Masters, Master Sandler, Comments re: 2010 CLA Proposed Amendments.
[11] CLA, ss. 22, 24, 26, 27, 31, 34.

(e) Consider whether "pay-when-paid" and/or "paid-if-paid" clauses should be made unenforceable.

5. **Proof of Financing**

(a) Consider introducing access to proof of financing rights for owners, contractors and subcontractors.

6. **Trust Provisions**

(a) Review and consider either eliminating or clarifying and strengthening the requirements of the trust provisions in the Act;

(b) Consider introducing a mandatory holdback trust account or a mandatory project bank account;[12] and

(c) Consider the effectiveness of the trust provisions, the remedies and the actual chances of recovery they afford creditor contractors, subcontractors and suppliers, including in the context of bankruptcy of a debtor owner, contractor or subcontractor.

7. **Interrelationship with Insolvency Legislation**

(a) Consider conflicts between the Act and either the *Bankruptcy and Insolvency Act,* RSC, 1985 ("BIA"), c. B-3 or the *CCAA*;[13]

(b) Consider any potential statutory mechanism to regulate stay proceedings in the face of registered liens; and

(c) Consider Canada Revenue Agency's super priority.

8. **Priorities**

(a) Consider whether or not any amendments are necessary to clarify the rights intended to be conferred upon lien claimants and/or mortgagees; and

(b) Consider whether or not a new obligation should be imposed on mortgagees to expressly identify, as a pre-condition to registration, whether the mortgage is intended to finance the acquisition of the property or construction on the property (or both).

9. **Public-Private Partnerships ("PPP")**

(a) Consider the application of the Act in relation to such projects;[14] and

(b) Consider aligning the definitions and structure of the Act with the PPP projects delivery system.[15]

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[12] CLA, Part II.
[13] *Companies Creditors Arrangement Act* as defined above.
[14] CLA, s.1.

10. **Non-Waiver**

(a) Consider allowing waiver of lien provisions.[16]

11. **Bidder Exclusion Provisions**

(a) Consider regulating bidder exclusion provisions.

12. **Alternative Dispute Resolution**

(a) Consider the effectiveness of available procedures and remedies;

(b) Consider introducing an adjudication mechanism for construction disputes in Ontario;

(c) Consider providing for mandatory mediation of lien actions;

(d) Consider providing for an arbitration mechanism for construction disputes in Ontario; and

(e) Consider requiring Dispute Review Boards for certain types of projects.

13. **Summary Procedure**

(a) Consider whether or not any changes need to be made in respect of the "summary" nature of proceedings under the Act;[17]

(b) Consider how the efficiency of the procedure can be improved; and

(c) Consider amendments to the procedural provisions of the Act.

14. **Surety Bonds and Default Insurance**

(a) Consider requiring labour and material payment bond sureties to promptly pay undisputed amounts;

(b) Consider the potential for requiring labour and material payment bond payees to complete their subcontracts if in the best interests of the project;

(c) Consider mandatory labour and material payment bonding of all public projects;

(d) Consider requirements in respect of the adjusting of bond claims;

(e) Consider providing for the electronic delivery of surety bonds;

(f) Consider whether bond claims should be subject to adjudication;

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[15] CLA, s.1.
[16] CLA, s. 4.
[17] CLA, s. 67(2).

(g) Consider whether changes to the third party beneficiary rule are appropriate in order to enable payment by owners directly to subcontractors and suppliers; and

(h) Consider whether the Act requires any revisions in light of the existence of contractor and subcontractor default insurance.

15. **Miscellaneous**

(a) Consider providing for greater precision in setting out the technical irregularities that can be cured under the Act;[18]

(b) Consider the use of letters of credit with international commercial conventions in their terms;

(c) Consider utilizing security for costs to award interest;

(d) Consider clarifying the application of liens to subdivision lots; and

(e) Consider instituting a periodic review of the Act on a go forward basis.

[18] CLA, s. 6.

D. BACKGROUND INFORMATION TO ISSUES

1. Lienability

Background

The Review includes consideration of the concept of the lienability of materials, services and equipment. The creation of a lien and the moment when a lien arises are concepts that appear in Sections 14 and 15 of the Act, which state as follows:

> **Creation of lien**
>
> 14. (1) A person who supplies services or materials to an improvement for an owner, contractor or subcontractor, has a lien upon the interest of the owner in the premises improved for the price of those services or materials.
>
> Note: Subsection (1) applies to services and materials supplied by architects, holders of certificates of practice under the Architects Act and their employees under contracts made on or after November 28, 1997, and under subcontracts made under such contracts. See: 1997, c. 23, s. 4 (2).
>
> …
>
> **When lien arises**
>
> 15. A person's lien arises and takes effect when the person first supplies services or materials to the improvement.

The defined terms relevant to these provisions are "improvement", "materials", "services or materials", "supply of services", and "owner".

> "improvement" means, in respect of any land,
>
> (a) any alteration, addition or repair to the land,
>
> (b) any construction, erection or installation on the land, 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;
>
> …
>
> "materials" means 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,
>
> (b) that is equipment rented without an operator for use in the making of the improvement;

…

"services or materials" includes both services and materials;

"supply of services" means any work done or service performed upon or in respect of an improvement, and includes,

(a) the rental of equipment with an operator, and

(b) where the making of the planned improvement is not commenced, the supply of a design, plan, drawing or specification that in itself enhances the value of the owner's interest in the land,

and a corresponding expression has a corresponding meaning; ("prestation de services")

"owner" means any person, including the Crown, having an interest in a premises 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 premises but does not include a home buyer; ("propriétaire")

What is an Improvement?

Significantly, the definition of "improvement" was amended in 2010[19] to expressly include "the installation of industrial, mechanical, electrical and other equipment" where the equipment installed is "essential to the normal or intended use of the land, building, structure or works".[20]

The 2010 change in the definition of "improvement" affected in particular contractors and subcontractors who work in the electrical and mechanical sectors, and suppliers of machinery for manufacturing facilities.[21] Under the old definition of "improvement", it was sometimes difficult to predict whether or not the Act would apply where equipment was to be installed for use by a business, particularly if the equipment was "portable" and capable of removal from a building. Even if the equipment was supplied and installed in a building (such as an assembly line), this was not necessarily sufficient to qualify the installation as part of an "improvement" under the old definition, however the ambiguity was clarified by the new definition.[22] In this regard,

[19] Amendments to the *Construction Lien Act* made under the *Open for Business Act, 2010* omnibus Bill 68 (Royal Assent on October 25, 2010).
[20] Tammy Evans and Lea Nebel, Blaney McMurtry LLP, "Construction Lien Act Amendments, Benefit or Burden", 2011 http://www.blaney.com/sites/default/files/Construction-Lien-Act-Amendments_TAE.pdf.
[21] *Standing Committee on Finance and Economic Affairs*, August 3, 2010, http://www.ontla.on.ca/web/committee-proceedings/committee_transcripts_details.do?locale=en&Date=2010-08-03&ParlCommID=8858&BillID=2358&Business=&DocumentID=25147#P85_5728.
[22] See in particular *Kennedy Electric Limited v. Dana Canada Corporation*, 2007 ONCA 664.

however, it has been suggested that consideration should be given to a corollary amendment to add a definition of "equipment".

Who is an owner?

The issue of who is an "owner" for the purposes of the Act has been the subject of considerable attention in the case law. In particular, "ownership" has become more complex due to an increase in the types of contractual arrangements, for example in public-private partnership projects where varied and multiple parties may be imbued with the "powers" of the owner in certain circumstances as discussed below in Section 9. Also, construction is sometimes carried out under "licences" that purport not to grant an interest in the land, with the "licensee" then contracting for the supply of services, materials and equipment.

In addition to the increased complexity of contractual arrangements, the complexity of projects, particularly as discussed below (in relation to highway, transit and education projects), can further compound the issue of determining who the "owner" is for the purposes of the Act. Some commentators note that this issue compels subcontractors to, in effect, "lien everyone" to ensure compliance with the Act. While this may be an effective way to ensure that a subcontractor hasn't failed to preserve its lien, it can simultaneously create an administrative burden that places strain on the dispute resolution system. As a result, it has been suggested that clarification of who is an "owner" may be merited.

Who can lien?

The definition of "supply of services" includes "any work done or service performed upon or in respect of an improvement". Accordingly, design work performed by, for example, an architect or engineer, is also considered to be a "supply of services". Significantly, services rendered in connection with a planned improvement that did not proceed, other than the design work, may still possibly enhance the value of the owner's land.[23] Other services, such as feasibility studies, may or may not support a right to lien depending on the circumstances and how such services relate to the improvement.[24] Another issue raised by stakeholders has been the right of building managers to lien under the Act. There is some case law to support the assertion that in certain circumstances a building manager may be entitled to lien; however this is far from clear.[25] Accordingly, it has been suggested that further clarity may be required in relation to describing who can lien.

What can a lien claimant lien for?

A lien claimant can lien for "the price of those services or materials" supplied to a project. The issue of what constitutes the "price" of services or materials has been the subject of a significant amount of review in the case law, particularly in relation to the consequences of delay.

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[23] *1246798 Ontario Inc. v. Sterling (2000)*, (Ontario Divisional Court), 2000 CanLII 29031.
[24] Glenn Ackerley, "The Construction Lien Act, Tricky Situations", (2014) *Ontario Association of Architects, Continuing Education*, online: https://www.oaa.on.ca/oaamedia/documents/OAA%20Construction%20Lien%20Act%20CE%202014.pdf.
[25] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005).

Generally, delayed projects result in extra costs for all parties. The parties typically look to their respective contractual rights for relief. One form of contractual relief is a liquidated damages clause.[26] Some commentators question whether or not there should be lien rights in relation to costs arising from delays.

As noted above, to properly be the subject of a lien a claim must be reflective of the "price" of work done on the improvement. That is, it must come within the definition of "services or materials supplied to the improvement" and is limited to the "amount owing to the lien claimant in relation to the improvement.[27] Some jurisdictions allow a lien claimant to include damages or costs for delay if such damages or costs represent part of the price of work done or provided or material supplied, or if the damages for delay are closely connected to the work so as to be reasonable and proper within the claim for lien.[28]

The case law in Ontario however is divided as to whether additional costs incurred as a result of delay are lienable. Recent case law has suggested that additional costs incurred because a project takes longer than anticipated (such as labour costs, equipment rental and similar costs of remaining on the job) can be found to be the basis for a valid lien.[29] Conversely, one author notes that older cases state that such additional costs are not recoverable because they were not contemplated in the contract price, and are in the nature of damages.[30]

As well, some Ontario courts have found that damages at large, such as lost opportunity costs, loss of profits, or aggravated damages are not lienable. Additional costs incurred offsite such as administrative overhead or lost profit and even onsite office overhead costs have been found not to be lienable on this basis. Some commentators have suggested that it would be useful to clarify what can be properly included within a lien claim.

Complex Projects and Small Projects

Stakeholders have also identified difficulties in registering liens in certain circumstances, including, *inter alia,* the following:

- Municipal/Provincial transportation projects (e.g. highways, subways, light rail transit);
- Railway projects; and
- Universities/Colleges/Education projects.

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[26] Duncan W. Glaholt, *An Overview of Construction Liens (In Five Easy Pieces),* at p. 19, online: http://www.glaholt.com/files/028.pdf.

[27] Section 14 and 17 CLA; See also Ontario Superior Court of Justice decision *Structform v. Ashcroft*, 2013 ONSC 4544.

[28] John S. Logan & Robert W. DuMerton, What You Can Lien and What You Can Lien For', (April 18, 2012) *Jenkins Marzban Logan LLP*, Pacific Business & Law Institute, online: http://www.jml.ca/wp-content/uploads/What-You-Can-Lien-And-What-You-Can-Lien-For-FINAL.pdf.

[29] *Structform v. Ashcroft*, 2013 ONSC 4544.

[30] Duncan W. Glaholt, *An Overview of Construction Liens (In Five Easy Pieces),* at p. 19, online: http://www.glaholt.com/files/028.pdf.

The difficulties associated with certain of these types of projects tend to derive from the nature of the projects themselves. For example, a light rail transit project may cause logistical problems as the project is built over a large number of properties, thereby creating many "owners" for the purposes of the Act. However, for many of these types of projects, liens do not attach to the premises in any event, as they fall into one of the categories listed in section 16 of the Act as follows:

> **Interest of Crown**
>
> 16. (1) A lien does not attach to the interest of the Crown in a premises.
>
> **Interest of person other than Crown**
>
> (2) Where an improvement is made to a premises in which the Crown has an interest, but the Crown is not an owner within the meaning of this Act, the lien may attach to the interest of any other person in that premises.
>
> **Where lien does not attach to premises**
>
> (3) Where the Crown is the owner of a premises within the meaning of this Act, or where the premises is,
>
> (a) a public street or highway owned by a municipality; or
>
> (b) a railway right-of-way,
>
> the lien does not attach to the premises but constitutes a charge as provided in section 21, and the provisions of this Act shall have effect without requiring the registration of a claim for lien against the premises.

Difficulties may arise for subcontractors liening facilities based on either phasing of the work (as further discussed in Section 2) or on ascertaining the true structure of the ownership in order to lien properly. In addition, some types of projects involve interaction with a diverse set of legislation specific to the project type. As well, projects may involve the construction of multiple structures on a single property or more than one property. The amalgamation of all these factors may serve to 'muddy' the issue of lienability. Therefore, lienability issues related to unique projects will be considered as part of the Review.

Another concern raised by some commentators relates to home renovations and other small projects. Some have suggested that, due to the nature of home renovations and small projects, the Act is widely ignored, at least with respect to holdback and substantial performance. This will be further discussed in Section 3. Projects at both ends of the spectrum, being complex projects and small projects, will be considered in the Review process.

Issues to be Considered

The Review will consider several issues in relation to lienability including the following:

(a) Consider the effectiveness of the definitions of "improvement", "materials", "supply of services" and "owner" including:

- Consider whether the definition of "owner" should be expanded or clarified;

- Consider whether further clarity is required in respect of who can be a lien claimant;

- Consider whether further clarity is required in respect of other defined terms, such as "services or materials";

- Consider lienability related to projects for transportation, railways, universities, colleges and other education facilities;

- Consider whether the "price" that is lienable and/or the definition of "services or materials" should be clarified, including amending the definition of "supply of services" to specifically address the issue of damages for delay;

- Consider whether the definition of "improvement" needs to be further extended or whether doing so would extend the application of the Act to an excessive number of potential lien claimants; and

- Consider the inclusion and/or exclusion of home renovation and other smaller projects in the context of the Act.

2. Holdback and Substantial Performance

Background

Part IV of the Act provides that each payer on a contract (the owner) or subcontract (the contractor) is required to retain a basic holdback of 10% of the price of services and materials supplied. In reality, the money accumulates throughout the performance of the contract in the hands of the owner, or the owner's lender(s). The holdback must be retained until all liens that may be claimed have expired or have otherwise been satisfied or discharged. Part IV also provides for a "finishing holdback" of 10% for work supplied after the date of substantial performance of the contract.[31]

The holdback obligation is intended to create a fund to which lien claimants may look if they cannot recover from the contractor or subcontractor with whom they have a direct contract. Broadly stated, the statutory holdback is for the benefit of the subcontractors and suppliers who have no privity of contract with the owner.[32] The Act provides that the holdback represents 10% of the price of services and materials supplied to the improvement because, in 1983, it was believed that 10% generally reflected the margin of profit within the construction industry.[33]

Commentators have suggested that the 10% holdback ties up a significant portion of capital, in particular for early trades on complex, multi-phased and long-term projects. As a result, it has been suggested that the holdback should be reduced to 5%.[34]

Sections 25 and 26 provide for the release of holdback but these sections are permissive rather than mandatory. They set out the conditions under which a payer "may, without jeopardy" make payments reducing or discharging the amount of holdback required under the Act.

In practice, the release of holdback can be prevented where an owner asserts a set-off for alleged damages after the substantial performance liens have expired and no liens have been registered.

Phasing

The phasing of construction projects is an increasingly common practice within the construction industry, particularly with respect to larger-scale projects which span over a number of years, including public-private partnership projects. Phasing may involve multiple prime contracts for each phase of the construction process.

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[31] "Lien Holdback is not for Deficiencies or Incomplete Work", (December 1, 2012) *Ontario Association of Architects* online: www.oaa.on.ca/oaamedia/documents/JointOAAOGCAStatementreUseofHoldbackisnotfordeficienciesDecember2012.pdf. See also Neil S. Abbott & Erica Maidment, "When is holdback no longer holdback?", October 2014, online: www.gowlings.com/KnowledgeCentre/article.asp?pubID=3756.

[32] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005) at 4-1.

[33] Duncan W. Glaholt & John Margie, "Getting Paid: Holdbacks and Other Selected Topics" (1997) (Paper delivered at the Canadian Institute, 6th Annual Construction Superconference, Toronto, 1997) online: http://www.glaholt.com/files/047.pdf at 53.

[34] "Should the Holdback be Reduced to 5 percent?", *The GTA Construction Report,* May 2007, p. A5.

According to some stakeholders, such projects may benefit from phased certification of substantial performance to allow for the phased release of holdback following the completion of each phase.

Substantial performance of a contract may be determined by a certification or declaration to that effect. Section 2 of the Act sets out the mechanism for substantial performance as follows:

> **Contracts, substantial performance and completion**
>
> **When contract substantially performed**
>
> 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 $500,000 of the contract price,
>
> (ii) 2 per cent of the next $500,000 of the contract price, and
>
> (iii) 1 per cent of the balance of the contract price.
>
> **Idem**
>
> (2) For the purposes of this Act, where the improvement or a substantial part thereof is ready for use or is being used for the purposes intended and the remainder of the improvement cannot be completed expeditiously for reasons beyond the control of the contractor or, where the owner and the contractor agree not to complete the improvement expeditiously, the price of the services or materials remaining to be supplied and required to complete the improvement shall be deducted from the contract price in determining substantial performance.

Accordingly, substantial performance occurs when the improvement or a substantial part of it is ready for use or being used for the intended purpose, or when the improvement can be completed (or a defect corrected) at a cost of not more than three percent of the first $500,000, two percent of the next $500,000 and one percent of the balance, of the contract price.[35] These amounts and percentages have not been modified since 1983.

Following substantial performance, finishing holdback is maintained. Some stakeholders have suggested that such holdback is unnecessary and creates an additional administrative burden.

The concept of substantial performance does not apply to subcontracts, however at section 33, the Act provides for a voluntary system for the certification of "completion" of subcontracts which also establishes the time within which the completed subcontractor's lien expires[36]. This

[35] CLA, s. 2(1).
[36] See also Duncan Glaholt, David Keeshan, *The 2015 Annotated Construction Lien Act* (Toronto: Carswell, 2014) at p. 248.

voluntary system may give a subcontractor expedited access to holdback funds,[37] although some commentators have noted that the provision only applies if it is negotiated and contracted for, because it is not a mandatory provision.[38]

In this regard, and to the detriment of some contractors, Ontario courts have generally resisted finding that separate contracts for one project require separate holdbacks which could be released upon substantial performance of each contract. Rather, the courts have demonstrated a tendency to find that multiple contracts for the same project form a part of one general contract requiring only one holdback.[39]

While not currently permitted under Ontario law, other jurisdictions allow for phased partial release of holdback on larger construction projects. For example, Manitoba, Saskatchewan and Newfoundland and Labrador allow for early or progressive release of holdback to take place on larger projects, with Saskatchewan allowing for either progressive release or annual release of holdback for phased construction projects.[40] In Manitoba, release of holdback can occur when an individual subcontract is substantially performed, and partial release of holdback may occur when any identified project phase of the main contract is substantially performed.[41]

Some commentators have suggested that the consistent adoption of phased substantial completion or phased release of holdback across the provinces would be beneficial, particularly to those who perform early work packages. However, other considerations may prevail including the relevance of the minimum standards set out in section 2 of the Act, the implications of phased holdback release on milestone payments, and how the practice would affect trades that carry on through various phases of a project.

Issues to be Considered

The Review will consider several issues in relation to holdback, and substantial performance, including the following:

(a) Consider changing the amount of holdback (from the current 10%);

(b) Consider increasing the number of dates for the release/early release of holdback, for instance on phased projects;

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[37] CLA, s. 25. See also: Howard Krupat, "Holdback Can Be Released Early? Understanding Early Holdback Release Under Ontario's Construction Lien Act" (2014) *Mondaq*, online: http://www.mondaq.com/canada/x/339304/Building+Construction/Holdback+Can+Be+Released+Early+Understanding+Early+Holdback+Release+Under+Ontarios+Construction+Lien+Act.

[38] "Should the Holdback be Reduced to 5 percent?", *The GTA Construction Report,* May 2007, p. A5.

[39] *Sanderson Pearcy & Co v. Foster* (1923) 53 O.L.R. 519 (C.A.); *Bob Dionisi & Sons Ltd. v. F.J. Davey Home for the Aged* (Algoma) (1992), 3 C.L.R. (2d) 162 (Ont.Ct.Gen.Div.).

[40] Vince Versace, "Better understanding of holdbacks needed across the country" (June 11 2013) *Daily Commercial News*, online: http://dailycommercialnews.com/Associations/News/2013/6/Better-understanding-of-holdbacks-needed-across-the-country-DCN055701W/.

[41] Manitoba Association of Architects & Winnipeg Construction Association, "Proposed procedure for building takeover and completion of construction contract inspections, specific retention and Builders Liens holdback" (December 24, 2001) WCA / MAA Technical Bulletin Series – Technical Bulletin #8, online: http://www.mbarchitects.org/docs/TB-08.pdf.

(c) Consider making the release of holdback mandatory/automatic after expiration of lien rights, unless there has been early release of holdback;[42]

- Consider allowing or expressly not allowing the early release of holdback upon posting a holdback release bond or some other defined form of security;

(d) Consider eliminating the "holdback for finishing work";

(e) Consider revising the minimum requirements for substantial performance;

(f) Consider whether or not to add further specifics to the requirements for a Certificate of Substantial Performance; and

(g) Consider introducing a new requirement for a mandatory Certificate of Intention to Release Holdback**.**

[42] Howard Krupat, "Holdback Can Be Released Early? Understanding Early Holback Release Under Ontario's Construction Lien Act", online: http://www.mondaq.com/canada/x/339304/Building+Construction/Holdback+Can+Be+Released+Early+Understanding+Early+Holdback+Release+Under+Ontarios+Construction+Lien+Act.

3. Preservation, Perfection and Expiry of Liens

Background

1. Generally

As noted above, a construction lien arises when a person first supplies services, materials or equipment to an improvement. In order to enforce lien rights, it is necessary for a supplier to comply strictly with the requirements to preserve and perfect a lien.

2. Preservation

Preservation provides notice that a lien claimant intends to enforce its lien in the event of continued non-payment by its debtor(s), to the owner of the improved land or premises, to potential subsequent purchasers, to lenders and to any other interested parties.[43]

A lien must be formally asserted or "preserved" and the lien claimant must ensure that it complies with all statutory requirements. The Act stipulates the form and content of the documentation that must be completed and either registered on title or, in respect of certain types of properties, "given" in order to preserve the subsisting lien rights.[44] While strict compliance may not always be required in completing the claim for lien document, certain errors and omissions are fatal to the lien.[45]

Currently, Section 34 of the Act sets out how a lien is preserved. Section 34 provides as follows:

> **How Lien Preserved**
>
> 34. (1) A lien may be preserved during the supplying of services or materials or at any time before it expires,
>
> (a) where the lien attaches to the premises, by the registration in the proper land registry office of a claim for lien on the title of the premises in accordance with this Part; and
>
> (b) where the lien does not attach to the premises, by giving to the owner a copy of the claim for lien.

Subject to the exceptions set out in subsections 34(2), (3) and (4) (i.e. public highways, crown land and railway right of ways), the lien attaches to the premises and, the lien is preserved by registration in the proper land registry office of a claim for lien on the title of the premises. Where the lien does not attach to the premises, it is preserved by "giving" a copy of the claim for lien to the owner.[46]

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[43] Mark Adrian de Jong, "*Ontario's Construction Lien Act*: Examining Preservation and Perfection Deadlines in Geographical, Inter-Jurisdictional, and Commercial Contexts – The Case for Extended Deadlines", Journal of the Canadian College of Construction Lawyers, 2013 J. Can. C. Construction Law 133.
[44] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005) at 6-1.
[45] *Idem.*
[46] CLA, s. 34(1).

In contrast with the Act, several other North American jurisdictions currently provide for a preliminary step whereby a lien claimant must provide a notice prior to preservation. At least 22 states in the U.S. require such notices.[47]

In respect of preservation, Section 31 of the Act provides as follows:

> **Expiry of Liens**
>
> 31. (1) Unless preserved under section 34, the liens arising from the supply of services or materials to an improvement expire as provided in this section.
>
> **Contractor's liens**
>
> (2) Subject to subsection (4), the lien of a contractor,
>
> (a) for services or materials supplied to an improvement on or before the date certified or declared to be the date of the substantial performance of the contract, expires at the conclusion of the forty-five-day period next following the occurrence of the earlier of,
>
> (i) the date on which a copy of the certificate or declaration of the substantial performance of the contract is published as provided in section 32, and
>
> (ii) the date the contract is completed or abandoned; and
>
> (b) for services or materials supplied to the improvement where there is no certification or declaration of the substantial performance of the contract, or for services or materials supplied to the improvement after the date certified or declared to be the date of substantial performance, expires at the conclusion of the forty-five-day period next following the occurrence of the earlier of,
>
> (i) the date the contract is completed, and
>
> (ii) the date the contract is abandoned.
>
> …

Ontario's lien preservation period therefore sits at forty-five days. This timeframe has been noted by some to be relatively short when compared to other North American jurisdictions.[48] The mean preservation period in Canada is 44 days; the mean perfection period in Canada is 208 days. In Ontario, as described above, these numbers are 45 days and 45 days respectively. In the U.S., the mean preservation period is 120 days and the mean perfection period is 412 days.[49]

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[47] Mark Adrian de Jong, "*Ontario's Construction Lien Act*: Examining Preservation and Perfection Deadlines in Geographical, Inter-Jurisdictional, and Commercial Contexts – The Case for Extended Deadlines", Journal of the Canadian College of Construction Lawyers, 2013 J. Can. C. Construction Law 133.

[48] Ontario Construction Lien Masters, Master Sandler, Comments re: 2010 CLA Proposed Amendments.

[49] Mark Adrian de Jong, "*Ontario's Construction Lien Act*: Examining Preservation and Perfection Deadlines in Geographical, Inter-Jurisdictional, and Commercial Contexts – The Case for Extended Deadlines", Journal of the Canadian College of Construction Lawyers, 2013 J. Can. C. Construction Law 133, at Table II.

In addition, Section 31 provides that the time limit of forty-five days for preservation commences as of the earlier of the date of publication of the certificate of substantial performance or the date the contract is completed or abandoned. Some commentators have suggested that other dates should be considered in terms of what triggers the preservation period. For example, completion is set out in Section 2 of the Act and abandonment has been defined by case law, however it has been suggested that the lack of reference to termination may represent a gap in triggering the timeline for preservation.

Specific Circumstances

It has been noted that the process of preservation is increasingly difficult in certain circumstances including, among others, with reference to condominiums, leasehold interests, home renovations, small projects, and phased projects. Aspects of this particular sub-issue are also relevant to the issue of lienability, as discussed at Section 1.

With respect to condominiums, it has been suggested that the current preservation mechanism of the Act does not allow for the efficient registration of liens. In particular, it has been noted that such projects carry a disproportionate cost of registration, and of vacating liens, and that issues often arise with respect to title security.

Some commentators have also raised issues with respect to the enforcement of liens against leasehold interests. Under the definition of "owner" in the Act, an owner may be a tenant. Liens can attach to leases and leases can be sold to satisfy liens.[50] Situations where liens are registered against leasehold interests include those related to improvements to stores or restaurants within shopping malls, industrial units, floors within office buildings and similar improvements. It has been noted that contractors sometimes assume that an improvement for a tenant creates a right to lien against the landlord. However, this is not an accurate assumption. Unless the appropriate notice under section 19 of the Act has been given to the owner allowing the landlord the opportunity to address its potential liability, or the landlord's conduct has brought it within the definition of "owner" (which requires, among other things, a "request"), such a lien is not valid against the landlord's interest. A second issue that has arisen in the context of leasehold interests is that not all work done for a tenant may be lienable.[51]

Given these issues, contracting parties often look for creative ways to secure their interests, e.g. securing rights pursuant to the *Personal Property Security Act*, RSO 1990, c P.10, or attempting to have a landlord declared "owner" under the Act. Leasehold interests also carry an inherent difficulty with respect to searching title to locate the actual tenant for the purpose of registering a lien, as many tenants do not register their leasehold interest on title.

Some commentators have suggested that these issues require clarification. In addition, it has been noted that Section 24 of the Act does not cover payments made by a landlord towards leasehold improvements (although Part II does apply in such circumstances), nor does the right of information under Section 39 allow a lien claimant to obtain information about payments due to a tenant or regarding the standing of the lease.

[50] Duncan Glaholt, *Conduct of a Lien Action 2015,* (Toronto: Carswell, 2014) at 2.11, at 52.
[51] *Idem.*

In addition to the foregoing, other commentators have suggested that the cost of preserving, perfecting and pursuing a lien is disproportionate with respect to home renovation projects and other small projects. The process has been stated to be unnecessarily burdensome and it has been suggested that the exclusion of home renovations (and other small projects) from the Act might be appropriate. Conversely, others disagree with depriving persons of a right to lien in such circumstances based on difficulty and cost alone as it effects a denial of their access to relief available under the Act.

3. Perfection

As noted above, after a lien is preserved it must be "perfected", meaning that in respect of liens that attach to the premises the lien claimant must commence an action and (where the lien attaches to the premises) must register a certificate of action on title within the time prescribed by the Act, failing which the lien will expire.

The process in relation to perfecting a lien is set out in Section 36 of the Act, which provides as follows:

> **What Liens May be Perfected**
>
> 36. (1) A lien may not be perfected unless it is preserved.
>
> **Expiry of preserved lien**
>
> (2) A lien that has been preserved expires unless it is perfected prior to the end of the forty-five-day period next following the last day, under section 31, on which the lien could have been preserved.
>
> **How lien perfected**
>
> (3) A lien claimant perfects the lien claimant's preserved lien,
>
> > (a) where the lien attaches to the premises, when the lien claimant commences an action to enforce the lien and, except where an order to vacate the registration of the lien is made, the lien claimant registers a certificate of action in the prescribed form on the title of the premises; or
> >
> > (b) where the lien does not attach to the premises, when the lien claimant commences an action to enforce the lien.
>
> …

Concerns have been expressed that, given the typical industry payment periods, the limited time available to preserve and perfect causes difficulties for lien claimants.

Presently, as can be seen above, Ontario's lien perfection period sits at forty-five days. As was the case with preservation, the time period allotted for perfection has been noted by some to be relatively short when compared to other North American jurisdictions.[52]

[52] Ontario Construction Lien Masters, Master Sandler, Comments re: 2010 CLA Proposed Amendments.

Again, as noted above, concerns have been raised that the limited time available to preserve and perfect, causes difficulty for lien claimants. Conversely, extension of the time period may have negative effects on owners as it extends the period of uncertainty and potentially affects cash flow.

4. Expiration of Liens

A perfected lien may also expire under Section 37 of the Act. Section 37 provides as follows:

> **Expiry of Perfected Lien**
>
> 37. (1) A perfected lien expires immediately after the second anniversary of the commencement of the action that perfected the lien, unless one of the following occurs on or before that anniversary:
>
> 1. An order is made for the trial of an action in which the lien may be enforced.
>
> 2. An action in which the lien may be enforced is set down for trial.

Some consider this section of the Act to provide for a means to clear title of abandoned liens. As seen above, a perfected lien expires immediately after the second anniversary of the commencement of an action that perfected a lien, unless an order is made for the trial of an action in which the lien may be enforced, or an action in which the lien may be enforced is set down for trial.[53]

Others have raised concerns as to whether this period of time is satisfactory given industry practices. In the same vein, concerns have been raised regarding the lack of a mandated notification or communication protocol taking effect prior to the expiration of liens pursuant to section 37.

Finally, concerns have been expressed as to whether or not this section of the Act adequately aligns with the *Limitations Act, 2002.*

5. Requests for Information Pursuant to section 39 of the Act

Section 39 of the Act permits a person with a lien and/or trust claim to request information regarding the names of the parties to the contract, the state of accounts, substantial completion, and the existence of labour and material payment bonds, which is information they need to properly enforce their remedies.[54] The intent of section 39 is to encourage transparency.[55]

Issues to be Considered

The Review will consider several issues in relation to preservation and perfection including the following:

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[53] "Construction Liens", *Glaholt LLP*, online : http://www.glaholt.com/construction-liens.html.
[54] Duncan Glaholt, *Conduct of a Lien Action 2015,* (Toronto: Carswell, 2014) at 3.11 at 82-83.
[55] *Idem.*

1. Generally

(a) Consider whether the mechanics of preservation and perfection require any changes;

- Consider improving alignment with the *Land Registry Act;*
- Consider termination as a trigger for lien rights expiry;

(b) Consider clarifying the release of liens and consider if there are any alternatives to release and discharge; and

(c) Consider the effect of posting security and vacating liens on lien claimants (s. 44 of the Act).

2. Preservation

(a) Consider the length of the preservation period;

(b) Consider the impact of written notices of lien:

- Consider "notice of lien claim" on lenders when no lien is formally preserved. In such cases, the ability to pay funds into court may be hindered and affect project financing;
- Consider eliminating "written notices of lien";

(c) Consider the introduction of mandatory certification of subcontract completion rather than the elective option currently provided for under Section 33 of the Act;[56]

(d) Consider mechanisms to avoid potential abuse of lien rights;

- Consider requiring lawyers to endorse construction lien claims, representing that they have inquired into whether the claims asserted are bona fide, or reasonable, or consider having lawyers certify the "reasonable" value of liens;
- Consider the introduction of a new requirement for lawyers to sign a statement prior to the preservation of a lien certifying that the lawyer has inquired into and confirmed the reasonable and bona fide amount claimed in the lien;

(e) Consider lien registration issues vis-à-vis specific types of properties;

- Consider the difficulty in registering and enforcing lien rights in respect of registration under the *Condominium Act*, 1998, where the lien claimant either has not been given proper notice of the intention to register as required by statute or simply does not lien prior to registration;

[56] Ontario Construction Lien Masters, Master Sandler, Comments re: 2010 CLA Proposed Amendments.

- Consider addressing concerns in respect of enforcing lien rights arising from renovation or construction work performed to the common elements of an already registered condominium;

- Consider potential improvement in the process for registering liens against leasehold interests and home renovation projects;[57] and

- Consider the preservation of liens in the context of phased projects. This issue is discussed in Section 2 above.

3. Perfection

(a) Consider the potential burden that the requirement to perfect within a relatively short time imposes on the court system;

(b) Consider any alternatives or changes to the perfection requirements such as:

- changing the deadline to perfect and including mandatory steps to attempt settlement prior to perfection;

- Adjusting requirements for phased projects;

(c) Consider the length of the perfection period; and

(d) Consider the alignment of time limitations in the Act with payment time periods in the Ontario construction industry.

4. Expiry under section 37 of the Act

(a) Consider whether the two year limitation period is appropriate; and

(b) Consider improving alignment of the Act with the *Limitations Act, 2002*, including breach of trust actions.

5. Requests for Information Pursuant to section 39 of the Act

(a) Consider whether further clarity is required in relation to what information is required to be produced in response to a section 39 request for information for various participants.

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[57] Karen Groulx, "Landlord's and Tenant's Liability for Improvements Under the Construction Lien Act", 2012, Lexology, online: http://www.lexology.com/library/detail.aspx?g=96e4b0af-8f81-4528-a62b-7cb1a4778405 see also Andrew J. Heal, "Common Errors in Construction Litigation – Best Practices to Avoid Them and What to do When They Occur", presented at the OBA February 2011 Institute "Current Events in Construction Law" online: http://www.cba.org/CBA/sections_construction/pdf/2013-03-commonerrors.pdf ; Gasper Galati, "Don't Lien On Me! The *Construction Lien Act* within the context of commercial leasing", The Six Minute Commercial Leasing Lawyer, 2015, online: http://www.dv-law.com/publications/articles.

4. Prompt Payment or Timely Payments for Construction Work

Background

Prompt Payment

Two important and related concerns that have been identified by a number of groups within the construction industry are timeliness of payment and the efficiency of the mechanisms for the enforcement of payment for work done. Some commentators are of the view that the Act does not sufficiently protect contractors, subcontractors or suppliers from payment delays, and that proceeding to litigation to secure payment is both costly and protracted. It has been indicated by some that there is a need for a more practical solution in respect of late payment within the industry.[58] Commentators have suggested that these issues might be addressed in the Act or in another new Act.

Outside Canada, several jurisdictions have sought to eradicate unfair contractual provisions and practices through security of payment legislation.[59] A common objective of this type of legislation is to increase cash-flow down the tiered contractual structure that exists on commercial construction projects in a fair and reasonable manner.[60] This has generally taken the form of a legislated payment system including core provisions that, among other things, prohibit the use of "pay-when-paid" and "pay-if-paid" clauses,[61] establish a default right to progress payments whether or not this is included in the construction contract,[62] and establish a right to refer a dispute arising under the contract to adjudication.[63] As well, many states in the U.S. have implemented prompt payment legislation, which operates alongside established lien legislation.[64]

While late payment practices are not unique to the construction industry, it has been argued that the particular nature of the construction industry suggests a need for greater protection of vulnerable parties. Commentators point out that late payment practices affect employment, cause the reduction of investment in apprenticeship, and that the financial burden of concurrently carrying multiple projects to completion forces contractors and subcontractors to bid strategically and limit the amount of projects they take on, resulting in reduced bidding pools. In addition, the direct costs of late payment and associated risks are said to be incorporated into contract and

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[58] Howard Krupat, "Proposed Prompt Payment Legislation in Ontario: The Cure for Payment Problems on Construction Projects?" (2013) *Mondaq*, online: http://www.mondaq.com/canada/x/302604/Building+Construction/Proposed+Prompt+Payment+Legislation+In+Ontario+The+Cure+For+Payment+Problems+On+Construction+Projects.

[59] Including England and Wales, Scotland, Northern Ireland, New South Wales, Victoria, New Zealand, Queensland, Isle of Man, Western Australia, Singapore, Northern Territory and Malaysia.

[60] Jeremy Coggins and Steve Donohoe, "A Comparative Review of International Construction Industry Payment Legislation, and Observations from the Australian Experience" (2012), *International Construction Law Review* 29(2) at 198.

[61] See, e.g. s. 113 *Housing Grants, Construction and Regeneration Act 1996* (UK); s. 12 *Building and Construction Industry Security of Payment Act 1999* (NSW).

[62] See, e.g. s. 109 (1) *Housing Grants, Construction and Regeneration Act 1996* (UK); s. 8 *Building and Construction Industry Security of Payment Act 1999* (NSW).

[63] For more information on adjudication, see Part 12 of this Information Package.

[64] Jay M. Mann & Matthew W. Harrison, "How Prompt Payment Laws Affect the Surety" (2011) Surety and Fidelity Claims Institute, at 4.

subcontract prices.[65] It is also said that the purpose of prompt payment legislation is to level the playing field in the industry, to increase investment in the industry and its future, to reduce construction costs, and to limit conflict and litigation within the construction pyramid.[66] Although the contractual norm of payment terms is about 30 days from the date of receipt of an invoice, it is said in fact that trades may have to wait 120 days or more before they receive payment. In the last decade, the documented average collection period of receivables in Canada has increased from about 60 days to about 70 days. This increase in the average collection period does not reflect a 10 day increase for a typical receivable. Instead, it reflects an increase in the proportion of payments that are "significantly delayed payments".[67]

In 2013, Bill 69: *Prompt Payment Act* embodied the impetus for "prompt payment" legislation in Ontario, seeking to address payment delays within the construction industry. In 2014, however, the Ontario government opted for a broader review of the Act, including consultation with all stakeholders in the construction industry to consider a potential new statutory regime addressing payment between owners and contractors and between contractors, subcontractors and suppliers or "payers" and "payees".[68]

The argument in favor of the introduction of prompt payment legislation is met by some with the argument that contractors and subcontractors should simply refuse to enter into contracts that contain onerous payment provisions, and that, in effect, contractors and subcontractors are, to a degree, the authors of their own payment issues. However, in Ontario, tender documents generally include the General Conditions of "Contract B", the construction contract, including the payment provisions, such that some stakeholders take the position that, except for those construction contracts that are negotiated one-on-one between the owner and the contactor, in reality there is little freedom of contract in the marketplace, as owners unilaterally impose their chosen payment conditions, through the tendering process.

Other commentators have suggested that the implementation of a prompt payment regime would not only impact the freedom and flexibility of parties to negotiate flexible terms for projects, but it would also impose an overly cumbersome administrative burden on an already strained construction industry.

Perhaps the most significant aspect of the proposed prompt payment regime is the proposal for mandatory minimum time periods within which payment must be made, which according to some stakeholders would have the effect of eliminating the freedom to contract for milestone based payment mechanisms, as well as certain payment mechanisms used in conjunction with the private sector financing necessary to many PPP projects. Some commentators also argue that

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[65] *The Need for Prompt Payment Legislation in the Construction Industry,* Prism Economics and Analysis, April 2013 at p. 3.

[66] *Ibid.*

[67] "The Need for Prompt Payment in Ontario", Council of Ontario Construction Associations online: http://www.coca.on.ca/Page.asp?PageID=1226&SiteNodeID=436. See also Thermal Insulation Association of Canada (TIAC), "Promoting Prompt Payment" (2011) *TIAC Times*, online: http://tiactimes.com/feature-article/promoting-prompt-payment.

[68] Bill 69, An Act respecting payments made under contracts and subcontracts in the construction industry, online: http://www.ontla.on.ca/web/bills/bills_detail.do?locale=en&BillID=2791&detailPage=bills_detail_the_bill; see also "The Need for Prompt Payment in Ontario", Council of Ontario Construction Associations online: http://www.coca.on.ca/Page.asp?PageID=1226&SiteNodeID=436.

such a regime would prevent owners and general contractors from negotiating payment terms that are more favorable to them (potentially placing an increased a heavy financial burden on sub-trades, labourers and suppliers).

Concerns have also been raised in respect of imposing a positive statutory duty upon payers to release holdback within a particular time frame, particularly because of the effect this would have on the right of set-off. [69] The right of set-off is a key right relied upon by owners in relation to defective or deficient work.

Owners, contractors, and lenders have significant reservations regarding limiting the right of set-off. Where major problems arise in the performance of a contract or subcontract, the right to withhold payment pursuant to the right of set-off can be essential, particularly where performance issues are attributable to insolvency. However, experience also suggests that when a contractor raises a significant claim, the owner will frequently raise a significant claim for set-off in response. This can cause the flow of funds to stop entirely, adversely affecting subcontractors and suppliers, even if they are not involved in the dispute between owner and contractor. In other words, the assertion of a right of set-off, which can go untested for years as the litigation process proceeds, may prove an inviting strategy for a payer seeking bargaining leverage. Accordingly, the set-off issue has received particular attention in other jurisdictions, with forms of statutory adjudication having been adopted in some jurisdictions as a method of quickly resolving such impasses.[70] In Ontario, the right of set-off has already been limited, to a degree, by the case law in relation to section 12 of the Act (which addresses set-off by a trustee).

Paid-When/If Paid-Clauses

In order to control some of the financial risk of non-payment or late payment by the owner, general contractors may include a "pay-when-paid" clause in their standard form subcontracts. Such a clause is a means of transferring the risk of non-payment by the owner from the contractor to a subcontractor. In some provinces, courts interpret this type of clause liberally and in favour of subcontractors, implying a term into the subcontract to the effect that the general contractor is obligated to pay the subcontractor within a reasonable amount of time, even if the owner has not paid the general contractor. Canadian courts have been inconsistent in their interpretation of these clauses. In the past, courts in Ontario and Alberta have often enforced "pay-when-paid" clauses, recognizing their value in protecting contractors, and their usefulness as a timing provision, as well as upholding the principle of freedom of contract.[71] Conversely,

[69] Master Sandler, "COCA and OAA Construction Lien Act Proposals – Summary of Feedback" (April 11, 2011) *Council of Ontario Construction Associations and Ontario Association of Architects.*

[70] Commonwealth jurisdictions that legislate construction and payment disputes through adjudications include the U.K., Australia (NSW, Vic, Qld, NT, WA), New Zealand, Isle of Man and Singapore.

[71] Thomas Heintzman "Pay-When-Paid: When is the Contractor Not Obliged to Pay the Subcontractor", (June 2011) online: http://www.constructionlawcanada.com/building-contracts/payments/pay-when-paid-when-is-the-contractor-not-obliged-to-pay-the-subcontractor/; see also Andrea Beckwith, "Pay when Paid Clauses: Risk Allocation and the Need for Careful Drafting" Miller Thomson LLP (2004), online: The Canadian Bar Association online: https://www.cba.org/cba/newsletters/con2-2002/c4.aspx.

courts in Nova Scotia, Prince Edward Island, Manitoba and British Colombia have tended to interpret these clauses restrictively, in favour of subcontractors and suppliers seeking payment.[72]

In 1994, the U.K. government and the U.K. construction industry jointly commissioned the review of procurement and contractual practices in the industry by Sir Michael Latham as independent observer. Sir Michael Latham delivered a report entitled *Constructing the Team* (the "Latham Report"). Among other issues, the Latham Report addressed a request by trade contractors that "pay-when-paid" provisions be banned and rendered unenforceable by statute. Section 113 of the *Housing Grants, Construction and Regeneration Act 1996* prohibits "conditional payment provisions" such as clauses where payment is conditional on the payer receiving payment from a third party, except in cases of insolvency.

The use of contingent-payment clauses in subcontract forms has been the subject of debate within the construction industry internationally.[73] Various jurisdictions have since prohibited or substantially limited the use of such clauses, including Ireland[74], Australia[75] and several U.S. states,[76] including Massachusetts, Maryland, South Carolina, Illinois, Wisconsin, Missouri and North Carolina.[77]

Several practical considerations frame the issues which arise from the use of these clauses, mainly concerning the allocation of risk between owners, contractors and subcontractors.

"Pay-when-paid" clauses may shift all or most of the risk of an owner's default to subcontractors.[78] This risk, if it materializes on lengthy and complex projects, may potentially result in increased subcontractor defaults. The absolute effect of such clauses is to potentially

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[72] Andrea Beckwith, "Pay when paid clauses: Risk allocation and the need for careful drafting" (2002) *Miller Thomson LLP Summer Construction Newsletter*, online: http://www.millerthomson.com/assets/files/newsletter_attachments/issues/ConstructionSummer2002.pdf.

[73] Gerald B. Kirksey, "Minimum Decencies – A Proposed Resolution of the "Pay-when-Paid"/"Pay-if-Paid" Dichotomy" (1992) *Publication of the Forum on the Construction Industry* Vol 12 Number 1 Jan 92.

[74] Subsection 3(5) *Construction Contracts Act 2013*; Tristan Conway-Behan & Martin Cooney, "Goodbye to 'Pay-When-Paid'? Improving Cash Flow In Construction" (2012) *Mondaq*, online: http://www.mondaq.com/x/174322/Contracts+Deeds/Goodbye+To+Pay+When+Paid+Improving+Cash+Flow+In+Construction.

[75] Section 13 *Building and Construction Industry Security of Payment Act 2002* (VIC); Subsection 12(1) *Building and Construction Industry Security of Payment Act 1999* (NSW); Section 14 *Building and Construction Industry (Security of Payment) Act 2009* (ACT).

[76] The *Massachusetts Prompt Payment Act*, Mass Gen Laws, c 149, § 29E (a) (2010) limits the application of "pay-when-paid" clauses in projects worth over 3 million dollars or those that have more than four residential units; *Real Property Annotated Code of Maryland*, Md Stat Ann, § 9-113(a-c) (1996); *Subcontractors' and Suppliers' Payment Protection Act* (South Carolina) SC Stat Ann § 29-6-230 (1994); *Illinois Mechanic's Lien Act*, 770 Ill Comp Stat 60 § 21(e) (2009); Wis Stat § 779.135(3) (2001) [*Wisconsin*]; 770 Ill . Comp. Stat. 60/21(e) (1994); NC Gen Stat § 22C-2 (2003).

[77] In 1995, the New York Court of Appeals found that pay-when-paid clauses that operate as a true condition precedent to payment hinder a subcontractor's right to enforce a mechanic's lien because the debt must be due and payable before a mechanic's lien can be filed. The New York Court of Appeals concluded that this result conflicts with New York's "Lien Law", which voids any agreement to waive rights granted under the Lien Law and therefore such pay-when-paid provisions violate the public policy of New York. West-Fair Elec. Contractors, 87 N.Y. 2d at 159, 638 N.Y.S.2d at 399, 661 N.E.2d at 972.

[78] E. Jane Sidnell, "Pay-When-Paid" Clauses in Construction Contracts" online: http://www.rosellp.com/news/2014/9/26/presentation-regarding-pay-when-paid-clauses-in-construction-contracts.

absolve the general contractor from having to pay the subcontractor at all if payment is not forthcoming from the owner, despite the subcontractor's full performance of the subcontract work.[79]

Significantly, a subcontractor may not have the bargaining power to negotiate the clause out of a subcontract or to negotiate more favourable wording.[80] As well, subcontractors may not have the ability to assess the financial strength of the owner prior to commencing work in order to assess the risk of owner insolvency.

However, the removal of "pay-when-paid" clauses leaves the general contractor liable to pay from its own pocket for work that was performed by a subcontractor for the benefit of an owner who fails to pay, whether as a result of insolvency or otherwise.[81] In a major claim/counter-claim situation where an owner deploys the right of set-off to withhold payment for an extended period, the lack of a pay-when-paid right would leave the contractor in an exposed position. As well, the restriction of the use of such clauses impinges on the principle of freedom of contract.

Issues to be Considered

The Review will consider several issues in relation to prompt payment or timely payment for construction work, including the following:

(a) Consider the causes of payment delays and how they can be addressed in the Act or other legislation, including the potential effect of prompt payment provisions on the principle of "freedom of contract";

- Consider balancing all of the competing interests in the industry;
- Consider the alignment of any prompt payment provisions within the Act as a whole;
- Consider the possibility of providing for a form of security or protection mechanism for owners/lenders and contractors as payers when legitimate disputes arise related to the deficient work, delays and excessive change orders of payee contractors, subcontractors and suppliers;[82]

[79] J. Marc MacEwing, "Navigating the Perils of 'pay-when-paid" (September 23 2009) *Journal of Commerce,* online: http://journalofcommerce.com/Home/News/2009/9/Navigating-the-perils-of-pay-when-paid-JOC035426W/.

[80] Duncan W. Glaholt & John Margie, "Getting Paid: Holdbacks and Other Selected Topics" (1997) (Paper delivered at the Canadian Institute, 6th Annual Construction Superconference, Toronto, 1997) online: http://www.glaholt.com/files/047.pdf.

[81] Juan Pablo Alvarez, "Alberta Construction Industry Communiqué: Pay When Paid clauses" (2006) *Miller Thompson*, online: http://www.millerthomson.com/assets/files/newsletter_attachments/issues/AB%20Construction%20Comm%20Pay%20when%20Paid%20Clauses%20Feb06.pdf.

[82] "The Need for a Prompt Payment Act in Federal Government Construction", Prism Economics and Analysis, April 2015, National Trade Contractors Coalition of Canada; see also "The Need for Prompt Payment Legislation in the Construction Industry", Prism Economics and Analysis, April 2013 online: http://www.ntccc.ca/PDF%27s/Prompt%20Payment%20Report%202013.pdf.

- Consider the appropriate remedies in the event of breach of payment terms, such as, for instance, interest and suspension/termination of the work;[83]

- Consider whether or not prompt payment provisions should draw a distinction between public sector and private sector payers;

- Consider whether the objective of prompt payment provisions is to prevent situations of delayed payment rather than to confer certain rights and remedies once the payment delay has already occurred;[84]

(b) Consider making the release of holdback mandatory/automatic after the expiration of lien rights;

(c) Consider the potential effects of prompt payment provisions and their alignment with the Act on industry lenders and sureties;[85]

(d) Consider the applicability and/or adaptability of any prompt payment provisions to different types of contracts; and

(e) Consider whether "pay-when-paid" and/or "paid-if-paid" clauses should be made unenforceable.

[83] Yonni Fushman, "Prompt Payment, Where do we go from here?", April 15, 2014, online: http://www.oba.org/Sections/Construction-Law/Articles/Articles-2014/April2014/Prompt-Payment-Where-do-we-go-from-here.

[84] Raymond Chabot Grant Thornton, "Etude d'impact des retards de paiement dans l'industrie de la construction au Québec", February 26, 2015, online : http://cetaf.qc.ca/wp-content/uploads/2015/04/%C3%89tude-dimpacts-%C3%A9conomiques_RCGT.pdf.

[85] *Ibid.* See also Howard Krupat, "Proposed Prompt Payment Legislation in Ontario: The Cure for Payment Problems On Construction Projects?", September 17, 2013, online: http://www.mondaq.com/canada/x/302604/Building+Construction/Proposed+Prompt+Payment+Legislation+In+Ontario+The+Cure+For+Payment+Problems+On+Construction+Projects.

5. Proof of Financing

Background

The concept of proof of financing and financial disclosure is not unidimensional, but can be made available to either the owner or the contractor, depending on the context.

With respect to financial disclosure by contractors to owners, research on this subject indicates that at least 37 states in the U.S. require some form of financial evaluation or disclosure from contractors as a form of pre-qualification. In 2009, the U.S. Transportation and Research Board prepared a report entitled "NCHRP Synthesis 390 Performance-Based Construction Contractor Pre-qualification"[86] which indicated that several pre-qualification factors could be grouped into four subcategories to be used as criteria. One of the key factors identified included the requirement to disclose financial statements.[87]

At the same time, the American Institute of Architects standard form document A201-2007 contains provisions allowing a contractor to request that the owner provide reasonable evidence of financial arrangements to fulfill payment obligations.[88]

It has been suggested that there is a need for a statutory scheme requiring owners to provide financial information demonstrating the financial ability of the owner to make contract payments and requiring contractors to forward it to their subcontractors. The nature of the construction pyramid is such that any issue with an owner's ability to finance the project will have highly prejudicial effects on every entity below. Therefore, contractors have often lobbied for some form of proof that the owner is able to "carry the weight" of the proposed project.

Under CCDC 1994, Appendix A of CCA 50 requires a form to be filled out by the owner with respect to Project Financial Information. This form, and similar form, serves to confirm that a project is adequately financed. In reality, however, it is often the case that parties contract out of such a form using supplementary conditions to the construction contract.

Issues to be Considered

The Review will consider several issues in relation to proof of financing including the following:

(a) Consider introducing access to proof of financing rights for owners, contractors and subcontractors;

- Consider whether financial pre-qualification may address certain issues with contractors being under financed and being unable to adequately pay their sub-contractors;

[86] NCHRP Synthesis 390 Performance-Based Construction Contractor Pre-qualification, 2009.
[87] *Ibid* at p. 18.
[88] American Institute of Architects, "AIA Document Commentary: A 201-2007 General Conditions of the Contract for Construction", www.aia.org/groups/aia/documents/pdf/aisas076835.pdf, see para.2.2.1.; See also CCDC-2 2008 at GC 5.1.

- Consider whether such pre-qualification may be overly onerous on certain contractors and subcontractors;

- Consider whether the surety bonding process may eliminate the need for financial pre-qualification; and

- Consider whether contractors should be entitled to proof of financing from owners.

6. Trust Provisions

Background

As noted above, in addition to creating lien rights, the Act creates a statutory trust. Part II of the Act – Trust Provisions – offers powerful remedies to unpaid contractors, subcontractors and suppliers not only against the corporate owner, contractor or subcontractor but also personally against their directors, officers and any employees or agents who have effective control of the corporation. Sections 7 and 8 of the Act require an owner, contractor or subcontractor to maintain a trust from all amounts received (or owing) on account of the contract price of an improvement. Courts have held that the construction trust is intended to protect beneficiaries from insolvent or unscrupulous owners or contractors, to give contractors security for work done by them, and to impress with a trust all funds received on account of work done at the project.[89] Breach of the statutory construction trust can have both civil and criminal implications.[90]

The statutory trust remedy may still be available even if no construction lien subsists, as long as the intended beneficiary supplied services or materials incorporated into an improvement – even if there was no subjective intent on the part of the beneficiary to supply services to a specific improvement.[91]

Importantly, although funds imposed with the trust are referred to as "the trust fund",[92] the Act does not impose a specific obligation on the payer trustee (owner or general contractor) or a successor receiver to segregate trust funds into a separate trust account.

As a result, it has been observed that in practice, owners, contractors or subcontractors co-mingle trust funds with non-trust funds or with money held in trust for different projects in their general bank account. This practice places the trust funds at risk in the event of insolvency and may compromise the protection the Act intends to provide to the trust beneficiaries.

Issues to be Considered

The Review will consider several issues in relation to trust provisions including the following:

(a) Review and consider either eliminating or clarifying and strengthening the requirements of the trust provisions in the Act;

(b) Consider introducing a mandatory holdback trust account or a mandatory project bank account;

- Consider whether or not a mandatory holdback trust account or a project bank account requirement should be limited to contracts with a price greater than a specified amount; and

[89] Duncan Glaholt, *Conduct of a Trust Action,* (Toronto: Carswell), 2011 at p. 5.
[90] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005) at 9-1.
[91] Duncan Glaholt, *Conduct of a Trust Action,* (Toronto: Carswell), 2011 at pp. 5, 7 and 8.
[92] CLA, s. 7(4), 8(2).

(c) Consider the effectiveness of the trust provisions, the remedies and the actual chances of recovery they afford creditor contractors, subcontractors and suppliers, including in the context of bankruptcy of a debtor owner, contractor or subcontractor.[93]

[93] Duncan Glaholt & Markus Rotterdam, "Managing Trust Funds: The New York Model", *Construction Law Reports,* (2003) 21 C.L.R. (3d) 74. See also Karen Groulx, "Construction Industry Insolvencies and the Impact of RBC v. Atlas – Lessons to be Learned", December 9, 2014, online: http://oba.org/Sections/Construction-Law/Articles/Articles-2014/December-2014/Construction-Industry-Insolvencies-and-the-Impact; and David Ward, "The Atlas Block: CLA Deemed Trust Meets Bankruptcy" September 17, 2014 online: http://www.casselsbrock.com/CBArticle/The_Atlas_Block__CLA_Deemed_Trust_Meets_Bankruptcy.

7. Interrelationship between the Act and Insolvency Legislation

Background

When creditors preserve and perfect lien rights before insolvency or bankruptcy proceedings are initiated, and then subsequently such proceedings are commenced, generally the maximum expected recovery is the amount of holdback, to be distributed to all lien claimants on a pro rata basis.[94]

However, when an owner or a construction company initiates insolvency proceedings, under federal insolvency legislation (the *BIA*[95]*)*, lien claimants and/or trust claimants (subcontractors and suppliers of the insolvent company) may lose the benefit of some of the rights and remedies otherwise afforded to them by the Act.[96] A number of factors may limit the lien claimants' potential recovery.

First, stay provisions preclude creditors from preserving and perfecting lien rights and from commencing breach of trust actions absent court approval.[97]

Second, both liens and the statutory deemed trusts may be defeated by the Canada Revenue Agency's super-priority (s. 224 of the *Income Tax Act,* RSC 1985, c. 1 (5th Supp.)), which may leave no amount for distribution to the lien claimants.[98]

Third, both liens and statutory deemed trusts may be defeated by the super-priority of post-filing debtor-in-possession financing or receiver's interim financing.[99]

As noted above, the statutory trusts contained in the Act do not currently impose a specific obligation on the payer trustee (owner or general contractor) or a successor receiver to segregate trust funds into a separate trust account. It has been successfully argued that when the trust funds are co-mingled with other funds held by the insolvent or the bankruptcy trustee and are not segregated before the date of the insolvency, the funds should become part of the estate of the insolvent company and in the event of bankruptcy, should be available for distribution under section 136 of the BIA.[100]

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[94] John Margie, "Comstock Canada Ltd. (Re), A Model of Efficiency", *Journal of the Canadian College of Construction Lawyers,* 2015, J. Can. C. Construction Law.

[95] *Bankruptcy and Insolvency Act,* as defined above.

[96] In accordance with the legal doctrine of paramountcy, when there is a conflict between federal legislation (BIA) and provincial legislation (the Act), the federal legislation will take precedence and the provincial legislation is inoperative to the extent that it conflicts with the federal legislation.

[97] John Margie, "Comstock Canada Ltd. (Re), A Model of Efficiency", *Journal of the Canadian College of Construction Lawyers,* 2015, J. Can. C. Construction Law.

[98] *Ibid.*

[99] Michael McGraw, "Priorities of Construction Liens and Interim Financing in Insolvency Proceedings", Parts I and II, April 9, 2014, www.oba.org/Sections/Construction-Law/Articles-2014/April-2014.

[100] Karen Groulx, "Construction Industry Insolvencies and the Impact of RBC v. Atlas – Lessons to be Learned", December 9, 2014, http://oba.org/Sections/Construction-Law/Articles/Articles-2014/December-2014/Construction-Industry-Insolvencies-and-the-Impact; see also David Ward, "The Atlas Block: CLA Deemed Trust Meets Bankruptcy" September 17, 2014. http://www.casselsbrock.com/CBArticle/The_Atlas_Block__CLA_Deemed_Trust_Meets_Bankruptcy.

Issues to be Considered

The Review will consider several issues in relation to the interrelationship between the Act and insolvency legislation including the following:

(a) Consider conflicts between the Act and either the BIA or the CCAA;

(b) Consider any potential statutory mechanism to regulate stay proceedings in the face of registered liens; and

(c) Consider Canada Revenue Agency's super priority.

8. Priorities

Background

Part XI of the Act codifies the priorities between owners, mortgagees and lien claimants and recognizes that lien claimants have financed all or part of the improvements to a property.[101] This part of the Act currently addresses two principles: (a) the value of improvements to real property should be preserved for the benefit of the lien claimants who created that value with the supply of services and materials, but only to the extent of that value; and (b) the interests of secured lenders should be protected to the extent of the value of the land before the improvements[102].

The lien is a form of security granted by statute to a restricted class of creditors and the security for the lien must be considered along with competing security rights. Accordingly, priority issues arise between lien claimants and also between lien claimants and other classes of creditors.[103] The priority scheme in the Act is intended to protect the 10% holdback in order to balance the interests of the owner and each of the secured creditors and to ensure a fair allocation of risk and benefit in the construction process because it recognizes the fact that construction is financed both by mortgagees and unpaid trades.[104] With respect to mortgages, for example, without this priority regime, in the event of insolvency of the owner a mortgagee would take possession of the property under a power of sale with the benefit of the services and materials of the unpaid suppliers.[105]

The current priority regime in the Act is described briefly below.

In order to understand the priority rules codified in Part XI of the Act, it is important to remember a key concept, which is "when a lien arises". As noted above, this concept is defined at section 15 of the Act:

> **15. When lien arises –** A person's lien arises and takes effect **when the person first supplies services and materials** to the improvement. [Emphasis added]

Section 77 provides that liens arising from an improvement have priority over all judgements, executions, assignments, attachments, garnishments and receiving orders in respect of the improvement, unless they were executed or recovered upon before the first lien arose.

Section 78 provides for priorities between construction liens and other secured interests. The general rule, in subsection 78(1), provides that the liens arising from an improvement have priority over all conveyances, mortgages or other agreements affecting the owner's interest in the

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[101] Karen Groulx, "Competing Priority Claims in the Construction Lien Act", March 9, 2010, online: http://www.dentons.com/en/karen-groulx.
[102] Duncan Glaholt, *Conduct of a Lien Action 2015,* (Toronto: Carswell, 2014) at p. 195.
[103] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005) at 8-1.
[104] Duncan Glaholt, David Keeshan, *The 2015 Annotated Construction Lien Act* (Toronto: Carswell, 2014) at pp.509-510.
[105] *Ibid.*

premises. There are exceptions to this general rule, the most significant of which are provided for in subsections 78(2) to 78(6).

Subsection 78(2) provides that liens arising from an improvement have priority over a building mortgage but only to the extent of any deficiency in the statutory holdback. Courts have determined that to qualify a mortgage as a building mortgage, the intention of the mortgagee is relevant, not the intention of the mortgagor.[106]

Subsection 78(3) provides that a mortgage registered and fully advanced prior to the time when the first lien arose in respect of an improvement (a prior mortgage) has priority over the liens but only to the extent of the lesser of the actual value of the property at the time the first lien arose and the total amount of all advances up to the time when the first lien arose. This provision is intended to take into account the fact that any increase in the value of the property is attributable to the improvements financed by the unpaid trades.

Subsection 78(4) provides that a mortgage registered and partially advanced prior to the time when the first lien arose in respect of an improvement (also a prior mortgage) has the same priority over subsequent liens as provided for at subsection 78(3), unless an advance is made in the face of preserved or perfected liens.

Subsequent mortgages are registered after the first lien arose, and subsection 78(5) provides for a special priority of liens against subsequent mortgages, but only to the extent of any deficiency in the holdback. Subject to subsection (5) regarding any deficiencies in the holdback, subsection (6) provides that subsequent mortgages have priority over liens unless, at the time the mortgage advance was made, a written notice of lien had been delivered to the owner or there was a preserved or perfected lien.[107]

Issues to be Considered

The Review will consider two issues in relation to priorities including the following:

(a) Consider whether or not any amendments are necessary to clarify the rights intended to be conferred upon lien claimants and/or mortgagees;[108] and

(b) Consider whether or not a new obligation should be imposed on mortgagees to expressly identify, as a pre-condition to registration, whether the mortgage is intended to finance the acquisition of the property or construction on the property (or both).

[106] *Northway Developments Inc. v. 1200946 Ontario Inc.,* [1998] O.J. No. 3082 at para 8.
[107] Duncan Glaholt, *Conduct of a Lien Action 2015,* (Toronto: Carswell, 2014) at pp. 202-205.
[108] *Northway Developments Inc. v. 1200946 Ontario Inc.,* [1998] O.J. No. 3082 at para 8.

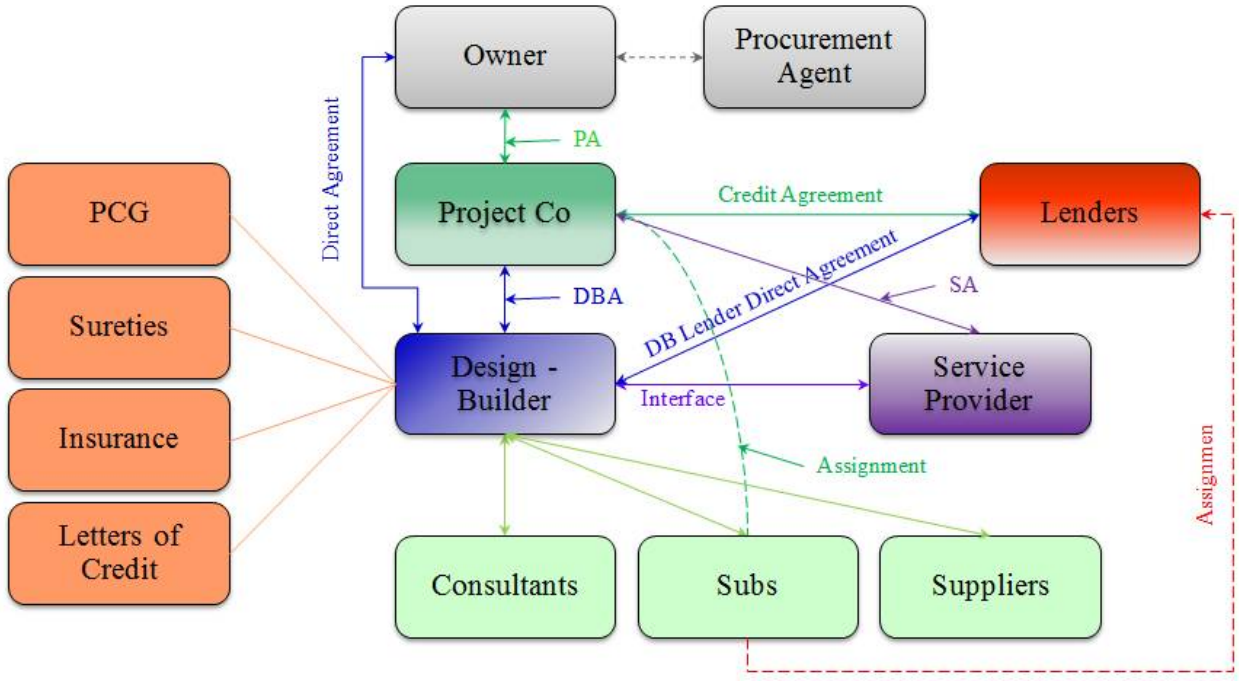
9. Public-Private Partnerships

Background

When the *Act* was enacted in 1983, there were no public private partnership projects in Canada. Over the intervening decades, however, the concept of Public Private Partnerships ("PPP") has developed worldwide, and specifically has taken root in Ontario (for example, Terminal 3 of Toronto Pearson International Airport was constructed as part of a PPP exploratory model in 1988).

While there is no single definition of what constitutes a PPP, the Organisation for Economic Co-operation and Development (OECD), an international organization comprising 34 member countries that are among the most developed in the world, defines a PPP as "an agreement between the government and one or more private partners according to which the private partners deliver the service in such a manner that the service delivery objectives of the government are aligned with the profit objectives of the private partners and where the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners."[109]

The traditional definitions and structure of the Act weren't designed to accommodate the PPP project delivery model. A PPP model may look something like the following:



The addition of a "Project Co" corporation which is created as an integral part of the PPP gives rise to what some say is an ambiguity as to who the "owner" is and who the "contractor" is for

[109] OECD, "Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money" (2008: OECD), 17.

the purposes of the Act. Typically, Project Co is a special purpose vehicle capitalized by debt, through construction financing, with a small percentage of equity. Project Co contracts with a design builder and with an operations and management entity.

However, based on the current definitions under the Act, Project Co is properly the "contractor" and the design builder (general contractor) is a "subcontractor". Some commentators suggest that this has the potential to cause serious ramifications for the lien and trust rights of the general contractor while also creating a logistical issue for many of the subcontractors. The role of Project Co, either as an "owner" or as an express agent of the "owner" for the purposes of the Act (or otherwise), is a potential issue that requires consideration by the Review.

Furthermore, the Act does not take into account the phasing of PPPs, which is a frequently cited concern, given the typically lengthy durations of such projects (like other complex projects). This issue is further conflated with the notion of milestone or balloon payments that occur on such large projects. There is also a risk of significant disputes as to what constitutes substantial performance. For some design build finance projects, full payment may be expected at such a milestone, which significantly raises the stakes in determining when substantial performance has occurred.

As mentioned in Section 2, other jurisdictions have considered certain solutions to the phasing problem. Some of the solutions are particular to larger projects. For example, in Saskatchewan, projects that meet certain criteria such as a contract price of over $25 million and that take more than one year require release of holdback annually.[110] In other circumstances, parties to PPP contracts have attempted to provide for early release of holdback with varied results. Some commentators in Ontario have suggested minimum lien value amounts for PPP projects.

Another alternative to address phasing issues in PPP projects has been an attempt to certify subcontracts upon completion on a discrete basis. What is apparent, according to some, is the need for some clarity as to how to address the unique conditions of the PPP environment. To address these concerns, consideration of holdback, certification and phasing with respect to PPPs will be considered as part of this Review.

Issues to be Considered

The Review will consider several issues in relation to PPP projects including the following:

a) Consider the application of the Act in relation to such projects;

b) Consider aligning the definitions and structure of the Act with the PPP projects delivery system;

- Consider generally what parts of the Act are and are not well-aligned in relation to the PPP project delivery model and what unique features of the PPP model need to be addressed with reference to the Act*;*

[110] *The Builders' Lien Act*, SS 1984-85-86, c B-7.1 at 46(1).

- Consider how the PPP model works in the context of phasing of projects. Specifically, consider how holdback functions with respect to the complex PPP framework. The concept of phasing is also considered in Section 2;

- Consider whether there should be specific definitions that apply to PPP projects;

- Consider prompt payment in the context of PPP projects. This issue is also considered in Section 4;

- Consider issues relating to substantial performance and certification as they relate to PPP projects; and

- Consider alternative dispute mechanisms as they relate to PPP projects. This issue is also considered in Section 13.

10. Non-Waiver

Background

Currently, the lien and trust rights of suppliers are imposed notwithstanding any agreement to the contrary and are enforceable against persons with whom the supplier of services, materials or equipment has no contractual relationship, whether owner, in the case of lien rights, or persons complicit in a breach of a statutory trust.[111]

As noted above, section 4 of the Act provides as follows:

> **No Waiver of Rights**
>
> 4. An agreement by any person who supplies services or materials to an improvement that this Act does not apply to the person or that the remedies provided by it are not available for the benefit of the person is void.

Viewed from a common law perspective, these rights constitute a strong public policy initiative to support suppliers to construction projects.

In contrast, lien waivers in the U.S. operate in many states as an instrument to waive any rights to lien once payment is due to be received.

Issues to be Considered

The Review will consider the following issue in relation to the non-waiver provision:

(a) Consider allowing waiver of lien provisions.[112]

[111] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005) at 8-1.

[112] Howard Krupat and Sarah Willis, "Canada: Recent Court Decision Reiterates That The Construction Lien Act Determines Lien Rights – Regardless of The Contract Terms", October 27, 2013, online: http://www.mondaq.com/canada/x/271132/Building+Construction/Recent+Court+Decision+Reiterates+That+The+Construction+Lien+Act+Determines+Lien+Rights+Regardless+Of+The+Contract+Terms.

11. Bidder Exclusion Provisions

Background

In Ontario, an issue that has become significant in recent years is the use by public owners of bidder exclusion provisions in their procurement policies. The use of such provisions by public owners has expanded in recent times for various reasons including, for example, to avoid the reoccurrence of perceived undesirable contractor behaviour.

However, access to justice is a fundamentally important common law right within the Canadian legal system,[113] and bidder exclusion provisions have been characterized as restricting the access of contractors to the courts.

Issues to be Considered

The Review will consider the following issue in relation to bidder exclusion provisions:

(a) Consider regulating bidder exclusion provisions:

- Consider limitations on the use of exclusion provisions by specific legislation, regulation, policies or guidelines; and

- Consider the use of exclusion provisions in various domestic and international jurisdictions.

[113] *Vilardell v. Dunham,* 2014 SCC 59.

12. Alternative Dispute Resolution

The Review will consider the effectiveness of available dispute resolution procedures. Currently, lien claimants can pursue their claims under the Act before a master or judge, or they can agree to submit their claim to a chosen method of alternative dispute resolution. In this regard, it is important to keep in mind that statutory lien remedies can be expensive, complex and take an extended period of time to reach a resolution when pursued by way of a lien action.[114]

In conjunction with the review of the effectiveness of available procedures, particularly the issue of timing, the Review will consider different alternative dispute resolution mechanisms (which are not mutually exclusive) and specifically, the following alternative dispute resolution methods: adjudication, mediation, arbitration and dispute review boards ("DRB").

Adjudication

Adjudication was developed in the 1990's in the U.K. As noted above, in 1993, Sir Michael Latham was commissioned to prepare a joint government/industry report on aspects of the construction industry in the U.K. This resulted in two distinct reports: *Trust and Money* (December 1993) and *Constructing the Team* (July 1994). The reports were commissioned initially given concerns expressed by the construction industry.

In response to the issues and recommendations in Latham's reports, remedial legislation came into force in the U.K. in part II of the *Housing, Grants, Construction and Regeneration Act of 1996*. The legislation, which some considered revolutionary at the time, provided for construction disputes to be submitted promptly to an "adjudicator" for an initial decision that would be binding until completion of the project.

The basic scheme of the legislation was as follows:

1. Enactment of minimum procedural requirements enabling the parties to a construction contract to provide for reference of "disputes" to an "adjudicator" for summary determination according to a set timetable and within a very short period of time (28 days in the U.K.), while work on the project continues;

2. Any party to a written "construction contract" may seek adjudication by serving a "notice of adjudication", appointing an adjudicator, and serving a "referral notice" on both the other party and the adjudicator;

3. If agreement is not possible, the adjudicator is nominated by a nominating body. The adjudicator is selected within a week and the dispute is "determined" within four weeks. The adjudicator hears one dispute at a time and has 28 days from referral to

[114] Courts have commented on the arcane nature of lien legislation. *In Ross Gibson Industries Ltd. v. Greater Vancouver Housing Corp.* (1985), 16 C.L.R. 136 (B.C. C.A.), for example, the British Columbia Court of Appeal called that province's Builders Lien Act "in many ways a difficult and confusing piece of legislation". The Alberta Court of Appeal, *in Crown Lumber Co. Ltd. v. Stanolind Oil & Gas Co.* (1958), 13 D.L.R. (2d) 635 (Alta. C.A.); aff'd [1959] S.C.R. 592 (S.C.C.), commented that the "draftsmanship of the Mechanics' Lien Act [...] leaves much to be desired".

make a "determination" which is binding and enforceable for the life of the project, i.e. is binding on an interim basis;

4. The courts may be enlisted to assist in the implementation of any adjudicator's determination; and

5. As it was initially conceived and enacted, contracts with residential occupiers, PFI (PPP) projects, process plants, supply-only contracts, extraction of natural gas, oil and minerals contracts, and purely artistic works were excluded. This is likely to change, and the scope of the Act is likely to broaden, as discussed below.[115]

Essentially, the Act sought to achieve two objectives:

1. To ensure cash flow improving efficiency and productivity; and

2. To allow swift resolution of disputes by way of adjudication without wasted profit and time in litigation.[116]

Adjudication has been used as a dispute resolution mechanism in a range of construction contract dispute contexts. While sometimes used as a measure to resolve interim payment disputes only,[117] such legislation can allow for a broader scope of construction contract disputes to be resolved through adjudication. Security of payment legislation in the U.K.[118] and New Zealand[119] both allow for any differences under the contract to be brought to adjudication, meaning that potential legislation need not be constrained in its application.

An issue identified within the context of the Ontario construction industry is the incidence of the use of set-off. In several jurisdictions, set-off disputes are regularly the subject of adjudication, in which the nominated adjudicator reviews the decision to withhold payment and determines on an interim binding basis whether any amount is payable.[120]

Claims under a construction contract may also be determined by an adjudicator, as seen in the Australian "East Coast" security of payment legislation,[121] in which a valuation of work calculated on a *quantum meruit* basis may be claimed.[122]

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[115] Duncan Glaholt, "The Adjudication Option: The Case for Uniform Payment & Performance Legislation in Canada" (2006), 53 C.L.R. (3d) 8.
[116] *Ibid.*
[117] The Security of Payment legislation in the states of New South Wales, Victoria, and Queensland in Australia (known as the "East Coast" legislation) provides solely for the recovery of progress payment claims: Brand, M.C & Davenport, P. "A proposal for a 'Dual Scheme' of statutory adjudication for the building and construction industry in Australia" (2010) *Proceedings of the Royal Institution of Chartered Surveyors COBRA Conference*, Paris.
[118] *Housing Grants, Construction and Regeneration Act,* 1996 (U.K.) c 56.
[119] *Construction Contracts Act 2004* (WA).
[120] See *Housing Grants, Construction and Regeneration Act* 1996 (U.K.) c 56, Part II Subsection 111(4); and the arguably more complicated measure of the *Building and Construction Industry Security of Payment Act 1999* (NSW) in submitting 'Payment Claims' and a 'Payment Schedule' in response for an adjudicators determination.
[121] Building and Construction Industry Security of Payment Act 1999 (NSW); Building and Construction Industry. Security of Payment Act 2002 (VIC) Building and Construction Industry. Security of Payment Act 2009 (ACT);

While not currently in operation under adjudication schemes internationally, the potential for surety bond claims to be determined by adjudication may also be worthy of consideration.

Adjudication rules generally allow an adjudicator to exercise the widest discretion permitted by law in order to ensure a just, expeditious and economical determination of disputes.[123] With certain modifications to existing models, adjudication could be a potential alternative dispute resolution mechanism to address many of the concerns identified with the current lien dispute resolution regime. Accordingly, the possible structure, modifications, advantages and disadvantages related to adjudication will be considered as part of the Review.

Mandatory Mediation

Since the Ontario Mandatory Mediation Program was introduced in 1999 on a test basis, mediation has taken root in the litigation landscape of Ontario. Mandatory mediation has demonstrated success in civil and family litigation cases. While this program has benefited civil litigation generally, under Rule 24.1.04(2)(e) of the Ontario *Rules of Civil Procedure,* construction lien actions are exempt from mandatory mediation (although breach of trust actions are not).

The Review will consider whether the mandatory mediation program would be beneficial to the effective resolution of construction lien disputes.

Arbitration

In 1988, Ontario adopted the *International Commercial Arbitration Act* and in January 1992 the *Arbitration Act*, *1991* came into force for domestic arbitrations.[124] Since this time, construction disputes under the Act have regularly been resolved through arbitration.

When used appropriately, arbitration can be an efficient alternative to litigation of construction disputes. In principle, arbitration is less adversarial than a traditional court process, due to the appointment of a neutral and mutually acceptable qualified arbitrator or panel of arbitrators, with a privately determined outcome.[125] In addition, arbitration procedures can be adapted to shape the needs of the parties, allowing for more efficient resolution of disputes without being limited by the rules of civil procedure.[126]

Building and Construction Industry Security of Payment Act 2009 (SA) Building and Construction Industry Security of Payment Act 2009 (TAS).

[122] Brand, M.C & Davenport, P. "A proposal for a "Dual Scheme" of statutory adjudication for the building and construction industry in Australia" (2010) *Proceedings of the Royal Institution of Chartered Surveyors COBRA Conference*, Paris, 78-79.

[123] Edwin H.W. Chan, Charles K.L. Chan & Martyn J. Hills, "Construction Industry Adjudication: A Comparative Study of International Practice" (2005) *Journal of International Arbitration* 22(5), 367.

[124] Randy A. Pepper, "Why Arbitrate?: Ontario's Recent Experience with Commercial Arbitration." *Osgoode Hall Law Journal* 36.4 (1998) : 807-845.

[125] Andrew Heal, "Arbitration a Good Tool in Resolving Construction Contract Disputes" (2009) Blaney LLP, *Commercial Litigation Review* Volume 7 Number 1, online: http://www.blaney.com/sites/default/files/Arbitration-Good-Tool-Resolving-Construction-Contract-Disputes_feb09.pdf.

[126] "Choosing Arbitration" (2012) *Glaholt LLP*, online: http://www.glaholt.com/files/choosing_arbitration.pdf.

Currently, many construction contracts or subcontracts contain provisions for arbitration of construction disputes.[127] Arbitration may provide benefits to parties who tailor their arbitration clauses effectively. However, concerns are expressed by some about the expense and timeliness of arbitration, as well as restrictions in regards to consolidation.

Dispute Review Boards ("DRB")

Many construction contracts contain a mechanism for the determination of disputes. Whereas mediation, arbitration and litigation are typically used for the final determinations of issues, projects often use project consultants, architects or other bodies for intermediate resolution of issues. By way of example, the 2008 revisions to the Canadian standard form CCDC 2-2008 issued by the Canadian Construction Documents Committee calls for the early appointment of a neutral, independent 'project mediator' to supplement the dispute resolution function.[128]

For more complex construction disputes however, a panel of "standing neutrals" is often considered more beneficial to provide preliminary rulings upon disputes as they arise. Where the panel is mandated to provide a non-binding opinion on the merits of a dispute, it is typically referred to as a Dispute Review Board ("DRB").[129]

According to The Dispute Resolution Board Foundation, which was established in 1996, a DRB consists of "a board of impartial professionals formed at the beginning of the project to follow construction progress, encourage dispute avoidance, and assist in the resolution of disputes for the duration of the project."[130]

The practice of using a DRB (also sometimes called a Dispute Resolution Board or Dispute Advisory Board) is a practice that has been employed frequently in civil projects in the U.S. as well as on many major projects throughout the world. The concept is also used by major international organizations such as the ICC[131] and FIDIC.[132] The cornerstone values of DRBs are said to consist of independence, impartiality and fairness, in terms of procedures and protocols; as well as dispute avoidance and the promotion and maintenance of good project relationships.

While this practice has been more frequently undertaken in other jurisdictions, DRBs have been applied to a limited degree in Canada. Further, an argument exists for this methodology to be standardized or uniformly applied, it does carry with it certain concerns including, for example:

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[127] Leonard Ricchetti & Gina Rogakos, "Construction Lien Act" (2008) *McMillan* Construction Law Group, online: http://www.mcmillan.ca/Files/Construction_Liens.pdf.

[128] Harvey J. Kirsh, "The Ins and Outs of Dispute Review Boards" (2010) Glaholt LLP, online: http://www.glaholt.com/files/ins_and_outs_of_dispute_review_boards.pdf.

[129] *Ibid.*

[130] See "*DRBF Practices and Procedures* Manual (January 2007)", Chapter 1, Section 1, page 1 (at http://www.drb.org/manual/1.1_final_12-06.pdf).

[131] International Chamber of Commerce ("ICC"), based in Paris, employs three types of dispute resolution procedures for large construction and engineering projects. See also ICC "Dispute Boards": http://www.iccwbo.org/court/dispute_boards/id4528/index.html.

[132] FIDIC (International Federation of Consulting Engineers / Fédération Internationale des Ingénieurs-Conseils) is an international organization, based in Geneva, whose "rainbow" suite of standard forms of contracts for engineering construction are widely used throughout the world.

- While parties typically comply with a DRB's recommendations, these findings are not immediately enforceable as a judicial remedy;
- No legislated regime exists in Canada to impose DRBs or require them in contract;
- No legislative scheme exists to enforce DRB recommendations;
- The strength of the decision depends on the credibility, knowledge and expertise of the DRB members;
- The DRB does not rely on rules of legal procedure; and
- Lawyers typically do not sit on DRB panels, which can raise later issues if a decision is based in law.[133]

Given the foregoing, consideration will be given as to whether DRBs may be effectively utilized in Ontario.

Issues to be Considered

The Review will consider several issues in relation to dispute resolution including the following:

(a) Consider the effectiveness of available procedures and remedies;

- Consider adding clarifying language or methodology to address the complexity of construction disputes (multi-party disputes with many parties in proximity, and no privy of contract in many of cases);

- Consider the expense of pursuing legislated procedures and seeking legislated remedies;

- Consider the timing of available procedures and remedies vis-à-vis the progress of the project, particularly with respect to phased projects. Phased projects are discussed further in Section 2;

- Consider clarifying the process for coordinating and scheduling interlocutory proceedings;

- Consider dispute resolution as it relates to preventing the holdup of cash flow during construction disputes;[134]

- Consider issues with consultants (e.g. mechanisms to avoid perceived bias or unfairness in consultant determinations or expert evaluations);

- Consider requirements that would effectively improve the uptake of ADR methods including mediation, dispute review boards and arbitration;

[133] Harvey J. Kirsh, "*Where Dispute Resolution Boards Do Not Work"*, Journal of Canadian College of Construction Lawyers, 2014 J. Can. C. Construction Law. 25.
[134] Michael Latham, Sir (July 1994) *Constructing the Team - Final report of the government/industry review of procurement and contractual arrangements in the UK construction industry*, The Department of the Environment, HMSO, paragraph 9.13 and footnote 87.

- Consider enhancing harmonizing dispute resolution mechanisms with the domestic surety bonding and insurance industries (particularly as the methods espoused by such entities add further contractual rights and remedies that overlap the judicial process of the Act);

- Consider issues regarding monies being captured and redistributed to secured creditors on the insolvent debtor's reorganization under the CCAA;

- Consider access to justice issues for small to medium size businesses who undertake contracting work or supply materials and services associated therewith;

- Consider clarifying who holds disputed funds until such time as a dispute is finally resolved;

- Consider dispute resolution regarding small lien claims (under $50,000) and lack of inexpensive/quick alternative dispute resolution (similar to small claims court);

- Consider issues of delay and inflexibility in lien litigation;

(b) Consider introducing an adjudication mechanism for construction disputes in Ontario;

- Consider providing for adjudication of set-offs;

- Consider providing for adjudication of progress payment claims;

- Consider providing for adjudication of performance bond claims;

(c) Consider providing for mandatory mediation of lien actions;

(d) Consider providing for an arbitration mechanism for construction disputes in Ontario;

- Consider providing the courts of Ontario with the jurisdiction to consolidate multiple arbitrations relating to the same project;

- Consider providing further clarity to court intervention in arbitral proceedings, particularly with respect to providing a stay of court actions in favour of arbitration, as well as mechanisms for joinder and third party intervention;

- Consider the effectiveness of the current arbitration model; and

(e) Consider requiring Dispute Review Boards for certain types of projects.

13. Summary Procedure

Background

The Act was intended to provide an expeditious forum for the summary resolution of disputes involving suppliers of labour, services and materials against the owner of the improved property, with whom they have no privity of contract.[135]

In this regard, Section 67 provides as follows:

> **Procedure Generally Summary Procedure**
>
> 67. (1) The procedure in an action shall be as far as possible of a summary character, having regard to the amount and nature of the liens in question.
>
> **Interlocutory Steps**
>
> 67. (2) Interlocutory steps, other than those provided for in this Act, shall not be taken without the consent of the court obtained upon proof that the steps are necessary or would expedite the resolution of the issues in dispute.[136]

To that end, Part VIII of the Act provides a set of procedures unique to construction lien actions, which only adopt the *Rules of Civil Procedure* and the *Courts of Justice Act* where they are consistent with the provisions of the Act.[137] Interlocutory steps such as documentary discoveries and examinations for discovery or any motion for interlocutory relief not expressly provided for in the Act cannot be taken without leave of the Court, even if the parties otherwise consent. To obtain leave to conduct discoveries, the party seeking leave must demonstrate that discoveries are necessary or would expedite the resolution of the matters in dispute.[138]

Section 37 provides for the automatic expiration of the lien for failure to set the matter down for trial or for failure to fix a date for trial of the action no later than two years after the action was commenced. The rationale for this section is explained as follows:

> […] It is not unreasonable to require lien claimants to proceed expeditiously with their actions. The two year period provided under this section is a reasonable balancing of interests. It provides lien claimants with sufficient time to prepare their actions and bring them to trial. At the same time, it protects the interests of owners from stale lien claims that are registered on the title to their property.[139]

Since the 1983 *Construction Lien Act* was enacted, the construction lien litigation landscape has changed. The increasing complexity of projects and the emergence of new project delivery models affect the complexity and the scale of construction disputes today. The availability of interlocutory proceedings, notwithstanding the provisions of subsection 67(2) cited above, the

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[135] David Bristow, Duncan Glaholt, Bruce Reynolds, Howard Wise, *Construction Builders' and Mechanics' Liens in Canada*, 7th ed, looseleaf, (Toronto: Carswell, 2005) at 11-1.
[136] See also CLA ss. 37, 51, 56, 59(2), 60, 61 and 86(2).
[137] Duncan Glaholt, David Keeshan, *The 2015 Annotated Construction Lien Act* (Toronto: Carswell, 2014) at p.367.
[138] *Ibid.* at p.450.
[139] "Report of the Attorney General's Advisory Committee on the Draft Construction Lien Act", 1982, Appendix A to Duncan Glaholt, David Keeshan, *The 2015 Annotated Construction Lien Act* (Toronto: Carswell, 2014) at p. 797.

use of new modes of communication on projects even since 1990, such as emails and texting and the adoption of eDiscovery guidelines, have exponentially expanded the number of documents to be produced and analysed during discoveries and at trial, placing a significant burden on construction litigants, both financial and in terms of time before any recovery can be envisaged.

It is necessary to review the procedural provisions of the Act in light of these changes.

In addition, the Act's unique procedural regime does not apply to breach of trust actions which must proceed in accordance with the *Rules of Civil Procedure* and the *Courts of Justice Act*. This is, in part, why a trust claim cannot be included with a lien claim, despite the fact that trust claims and lien claims have the parties, the project and the facts in common.[140] The legislature feared that the joinder of trust claims into a lien action would unduly complicate the lien action.[141]

Issues to be Considered

The Review will consider several issues in relation in respect of the summary procedure under the Act including the following:

(a) Consider whether or not any changes need to be made in respect of the "summary" nature of proceedings under the Act;

(b) Consider how the efficiency of the procedure can be improved;

(c) Consider amendments to the procedural provisions of the Act;

- Consider eliminating or amending subsection 67(2) to permit some interlocutory steps such as discoveries, affidavits of documents and appeals from interlocutory orders in a lien action; and

- Consider eliminating subsection 50(2) which prohibits the joinder of trust claims and lien claims.

[140] Duncan Glaholt, *Conduct of a Lien Action 2015,* (Toronto: Carswell, 2014) at p. 218 and CLA s. 50(2).
[141] "Report of the Attorney General's Advisory Committee on the Draft Construction Lien Act", 1982, Appendix A to Duncan Glaholt, David Keeshan, *The 2015 Annotated Construction Lien Act* (Toronto: Carswell, 2014) at p. 613.

14. Surety Bonds and Default Insurance

Background

Surety Bonds

As part of the procurement process, the owner may require a Bid Bond as part of the contractor's tender package, to establish the contractor's financial and technical pre-qualification by the surety.

Surety bonds are "on default" instruments providing different forms of guarantees against the risks associated with a contractor's potential default under the underlying contract. First, when a contractor defaults, the project will come to a halt if the contractor stops performing its obligations under the contract and is not proceeding with the work. Second, the contractor will fail to pay its subcontractors who will likely register liens against title to the project. To address these risks, the owner will require that the contractor obtain from a surety a performance bond (to address the first risk) and, frequently, a Labour and Material Payment Bond or "L&M Bond" (to address the second risk).

An L&M Bond constitutes a promise by the surety to the obligee (the owner or the person in whose favour the bond is delivered) that if the principal (the contractor or the person whose performance of the underlying contract is guaranteed) fails to pay suppliers of services or materials (subcontractors) with respect to a specific contract or project, that the surety will pay the undisputed claims of those unpaid subcontractors, subject to limits and conditions.[142] The owner benefits from a payment bond because a payment by the surety to the subcontractors will help avert the registration of liens. It also benefits the subcontractors directly as they will be paid instead of having to seek recovery from a potentially insolvent contractor.

A contractor's obligation to obtain an L&M Bond is provided for in the underlying contract between the owner and the contractor. As a result, subcontractors may not always be aware that an L&M Bond was issued with respect to the project. This is addressed in the current section 39 of the Act, which provides that a lien claimant or trust claimant is entitled to request a copy of any L&M Bond issued in respect of the contract.[143]

A surety's liability to a claimant can be no greater than the liability of the principal, which means that a surety is not liable unless its principal is liable and the surety may raise any defence otherwise available to the principal.[144] For example, if the subcontract between the principal and a claimant contains a "pay-when-paid" clause, then the labour and materials surety will not be liable to the claimant under the bond if the clause is operative.[145] The use of "pay-when-paid" clauses will be considered by the Review as part of Issue 4 - Prompt Payment or Timely Payment for Construction Work.

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[142] Kenneth Scott, Bruce Reynolds, *Scott and Reynolds on Surety Bonds,* looseleaf (Toronto:Carswell, 1994) at p. 11-2.1.
[143] *Ibid.* at pp. 11-10.8 and 11-10.9.
[144] *Ibid.* at p. 11-18.13.
[145] *Ibid.* at p. 11-18.18(3).

Before making any payment under a bond, a surety is entitled to a reasonable amount of time to investigate the claim. The surety's investigation includes a number of steps, including ensuring that the original executed bond is in the obligee's possession, notifying its indemnitors in writing of the claim(s), reviewing the bonded contracts, the progress certificates and the accounting related to the contract(s), ensuring that no changes were made to the underlying contract without the surety's approval. Based on such factors, the surety will determine whether it is liable to pay the claimant(s) or not.[146] The surety is entitled to a reasonable amount of time to investigate even if the obligee attempts to press the surety into a quick decision.[147] The decision to accept or deny liability must be carefully considered.[148] It has been suggested that to a degree, a lack of clarity in respect of the best practices for surety adjusting gives rise to inconsistent expectations.

Default Insurance

Default insurance offers an alternative to performance and payment bonds but it is entirely different from performance and L&M Bonds. Default insurance can be obtained by an owner as a form of insurance (not a bond) against default by the contractor or by the contractor against default by a subcontractor.[149] Default insurance transfers an initial portion of the risk of loss to the insured through non-qualifying losses and a deductible. It also transfers a portion of the remaining risk to the insured with a co-payment percentage clause, up to the limits of the policy.[150] In addition, the insured is required to complete the work itself rather than rely on a surety under a performance bond.[151]

Issues to be Considered

The Review will consider several issues in relation to sureties and default insurance including the following:

(a) Consider requiring labour and material payment bond sureties to promptly pay undisputed amounts;

(b) Consider the potential for requiring labour and material payment bond payees to complete their subcontracts if in the best interests of the project;

(c) Consider mandatory labour and material payment bonding of public projects;

(d) Consider requirements in respect of the adjusting of bond claims;

(e) Consider providing for the electronic delivery of surety bonds;

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[146] *Ibid.* at pp. 13-8 to 13-14.
[147] *Ibid.* at p. 13-14.
[148] *Ibid.* at pp. 13-14.10 to 13-14.12.
[149] Helmut K.. Johannsen, P. Eng., C. Arb. "Contractor/Subcontractor Default Insurance", Journal of the Canadian College of Construction Lawyers, 2012 J. Can. C. Construction Law. 115. See also Ian Houston "Use of Subcontractor Default Insurance During the Global Financial Crisis—A Practitioner's Perspective", Journal of the Canadian College of Construction Lawyers, 2011 J. Can. C. Construction Law. 27.
[150] Helmut K.. Johannsen, P. Eng., C. Arb. "Contractor/Subcontractor Default Insurance", Journal of the Canadian College of Construction Lawyers, 2012 J. Can. C. Construction Law. 115.
[151] *Ibid.*

(f) Consider whether bond claims should be subject to adjudication;

(g) Consider whether changes to the third party beneficiary rule are appropriate in order to enable payment by owners directly to subcontractors and suppliers; and

(h) Consider whether the Act requires any revisions in light of the existence of contractor and subcontractor default insurance.

15. Miscellaneous

Issues to be Considered

The Review will consider several miscellaneous issues including the following:

(a) Consider providing for greater precision in setting out the technical irregularities that can be cured under the Act;

(b) Consider the use of letters of credit with international commercial conventions referenced in their terms;[152]

(c) Consider utilizing security for costs to award interest;

(d) Consider clarifying the application of liens to subdivision lots;[153] and

(e) Consider instituting a periodic review of the Act on a go forward basis.

[152] Chris M. Stanek, "Canada: Posting Letters of Credit to Bond Off Construction Liens in Ontario", July 8, 2013, online: http://www.mondaq.com/canada/x/249132/Financial+Services/Posting+Letters+of+Credit+to+Bond+Off+Construction+Liens+in+Ontario.

[153] Thomas G. Heintzman, "What is the Priority Between Building Mortgages and Construction Liens in Respect of Holdback Amounts Greater than the Statutory Holdback?", July 9, 2013, online: http://www.constructionlawcanada.com/building-contracts/what-is-the-priority-between-building-mortgages-and-construction-liens-in-respect-of-holdback-amounts-greater-than-the-statutory-holdback/.

E. CONCLUSION

As will be apparent from the review of the above Background Information to Issues, the issues that the Review will consider are complex and varied. During the process of consultation, the Review looks forward to receiving input from stakeholders on all of these issues.

As noted above, at this stage of the Review the information being provided is preliminary. It is for consideration purposes only and is not intended to express a view, perspective, or conclusion.

Importantly, the Review would like to acknowledge the support and encouragement received from stakeholders to date. In particular, we would like to recognize the helpful preliminary submissions received from the Ontario Bar Association, Construction and Infrastructure Law Section, the Ontario General Contractors Association, the Council of Ontario Construction Associations, Prompt Payment Ontario, the Ontario Association of School Business Officials, and the Ontario Public School Board's Association.

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Bruce Reynolds
Sharon Vogel
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2. Holdback and Substantial Performance

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