

Constructive Construction – Serious Legal Changes

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Sweeping reforms to the Construction Lien Act received Royal Assent in December 2017. The law of construction liens and payments has been modernized and updated and a “prompt payment” system has been adopted to get cash flowing more quickly. A substantial number of the changes came into effect on 1 July 2018.

Even the name of the Act has been changed to the Construction Act to further underscore that the changes go well beyond traditional construction liens. It is however quite safe to say that lien issues have not become any simpler under these amendments and arguably more complex.

In order to allow members of the construction industry time to adjust to the changes, Ontario has scheduled the changes to take effect in two stages; July 2018 and October 2019

Changes in force as of 1 July 2018

Construction Lien and Holdback Rules

The following important amendments to the construction lien and holdback rules are now in effect:

- Holdback amounts will remain at 10% of the value of the improvement. However, security in the form of a holdback bond or letter of credit can be given rather than cash alone.
- Contractors and subcontractors have 60 days to register a lien and 90 days to start a court action;
- A contract will now be deemed “completed” at an earlier stage as the threshold for completion will be increased to the lesser of 1% or \$5,000 of the contract price, rather than the previous \$1,000.
- Release of the holdback is mandatory once the time to register a lien has passed. Holdback is released 45 days after substantial completion. An owner can set off or withhold but has to publish a notice of non-payment or set off within 40 days after substantial performance.
- Holdback release can also be staged; either on an annual basis for longer term projects, if the project is over \$20 million and the early release of holdback is set out in the contract; or on a phased basis, for projects with different stages of completion.
- Contractors and subcontractors have to follow specific bookkeeping rules to protect subcontractors in the event of bankruptcy. On new projects post 1 July 2018, trust funds are to be dealt with by way of separate accounting unless the project payments are kept in a segregated bank account.
- Public sector owners, such as the Crown, municipalities and broader public sector organizations, will be required to have a surety bond on public contracts above \$500,000, and alternative financing and procurement arrangements (AFPs) will be subject to a minimum coverage limit (50% of the contract if the contract is less than \$100 million - \$50 million if the contract price is above \$100 million) to protect subcontractors and workers if the general contractor files for bankruptcy;
- Condominium unit owners will be allowed to remove liens from their unit that are related to improvements to the common elements, such as corridors, lobbies, the garage and the roof;
- Parties may request that a judge refer construction lien claims under \$25,000 to the small claims court;
- Project owners and other payers will be required to pay contractors and subcontractors holdbacks once the timeline to file liens has passed (the 60 days). This helps contractors and subcontractors plan, accept contracts for new work and have more certainty about when the holdback will be paid;
- On termination of a contract, the terminating party publishes a “notice of termination” in a construction trade newspaper. A copy of the notice is to be sent by the contractor to its subcontractors;

- Liens for under \$25,000 can be dealt with in the Small Claims Court. Appeals are also changing. Now interim type orders can be appealed with permission of the court and final orders can be appealed as of right without have to seek court permission;
- If a contractor is working on a tenant's premises and the work is being paid for by the landlord, the contractor will now have an automatic lien right against the land (not the tenant's interest). As a result, if a Landlord pays for a tenant's improvements, the landlord has lien exposure to the extent of the usual holdback; and
- The amount of security for costs that must be posted to vacate a lien has increased.

Changes in force as of 1 October 2019

Prompt Payment System

The new prompt payment system will require that everyone involved in a project, from owners to subcontractors be on their toes. It will probably put considerable pressure on smaller contractors and subcontractors who may have little in the way of administration.

The following amendments to paying for construction services will come into effect on 1 October 2019. These are significant.

- The contractor must submit invoices to the owner on a monthly basis, unless the contract specifies otherwise;
- Subject to holdbacks, owners must pay general contractors within 28 days after receiving the invoice. The parties to a contract can set their own payment schedules, or other payment structures but it must be clearly laid out in their contract. The 28 day deadline will start once an invoice is submitted per the payment structure;
- General contractors must pay subcontractors seven days after receiving payment from the owner. This is going to put a lot of pressure on the GC's accounting department;
- Subcontractors must pay their subcontractors within seven days of receiving payment from whomever hired them for the project and so on; and
- Contractors and subcontractors will have a right to charge mandatory interest on late payments beginning when the amount is due. Interest would be the prejudgment rate determined under the Courts of Justice Act (approximately 3% or so now) or the rate set out in the contract or subcontract, whichever is higher.

Payment Disputes

Running in parallel with prompt payment is prompt dispute resolution. The following amendments to payment disputes will also come into effect on 1 October 2019.

- Owners may deliver a notice of non-payment to the contractor within 14 days of receiving the invoice from the project owner;
- Contractors may deliver a notice of non-payment within seven days to the subcontractor; and
- Subcontractors may deliver a notice of non-payment within seven days to other subcontractors they hire.

Adjudication Process for Resolving Disputes

The following amendments to resolving payment disputes will come into effect on 1 October 2019. This may over time become the normal mechanism for resolving lien issues rather than the courts which are slow and expensive.

- The Construction Act implements a new adjudication process to give people and businesses in the construction industry an alternative to the court system to resolve disputes. The key features of the system are;
 - Adjudicators will be experts with extensive experience in the construction industry and experience or training in dispute resolution;
 - A private body, known as an Authorized Nominating Authority (ANA), will develop and oversee training and qualification for adjudicators, maintain a registry of qualified adjudicators, and perform other functions outlined in the legislation and a new adjudication regulation;
 - Disputes will be heard by an adjudicator from the registry of adjudicators, who may be selected by the parties themselves or by the ANA if they can't agree;
 - The parties and the adjudicator may agree to the fees of the adjudicator. If they cannot agree, the fees will be determined by the ANA;
 - The adjudicator will issue a determination in approximately six weeks, which will be binding on the parties, on an interim basis, until the dispute has finally been resolved in court or arbitration, or by agreement of the parties. If the parties are satisfied with the determination, they may agree to treat it as final.
- If, after adjudication, the party owing money refuses to comply with the determination, the party that is owed the money is entitled to:
 - Stop work under the contract;
 - Charge mandatory interest on late payments;
 - Enforce the adjudicator's determination by filing a certified copy in the Superior Court of Justice (ie effectively a judgment). (Once filed the creditor can file a writ of seizure and sale with the Sheriff which in the case of dispute with the owner will attach to the property).



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- The adjudicator's determination cannot be appealed but may be challenged on certain limited grounds (i.e. adjudicator bias).

Transition Rules

The Act's changes won't be felt immediately. The amendments that took effect on 1 July 2018 will apply to all contracts entered into on or after that day, unless:

1. The procurement process for the improvement was commenced before that day; or
2. The premises is subject to a leasehold interest and the lease was entered into before that day.

In the above two situations, the old Act still applies.

Amendments taking effect on 1 October 2019 apply to all contracts entered into on or after that day, with no exceptions.

What's Next?

The Ministry of the Attorney General is developing a system to select a private body to be designated to act as the ANA. This process should be completed by the fall of 2018 and the body selected will undertake preparatory work in order to begin regular operations of the ANA on 1 October 2019.

For businesses involved in work in buildings and construction projects these changes need to be considered and understood. Staff, particularly in accounting departments, will need to be familiar with the prompt payment scheme when it comes into effect.

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP).

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