



Getting ready for Ontario's new *Construction Act*

Understanding the key changes and
how to prepare for them

Howard Krupat

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Overview

Industry observers in the Province of Ontario are now well aware of the scope of the changes introduced through the amendments to the old Ontario *Construction Lien Act*, giving us what is a dramatically different piece of legislation – the *Construction Act*. However, becoming familiar with these significant changes and implementing them in practice are two very different undertakings. With prompt payment and adjudication now around the corner, a refresher is therefore in order.

For ease of reference, it is convenient to divide the *Construction Act* changes into two buckets:

1. the lien modernization provisions; and
2. prompt payment and adjudication.

In addition, it is important to remember that subject to the application of the *Construction Act*'s transition provisions, the lien modernization provisions took effect on July 1, 2018, while the prompt payment and adjudication provisions take effect on October 1, 2019. This variation in timing alone will require your organization to pay close attention to the implementation of the *Construction Act*. It is equally important to understand that the transition provisions mean that we will concurrently have: (a) contracts governed by the old *Construction Lien Act*; (b) contracts governed by the lien modernization provisions; and (c) contracts governed by both the lien modernization provisions and the prompt payment and adjudication provisions.

How do the transition provisions work?

Sorting out which version of the *Construction Act* applies to a particular construction contract requires a careful analysis. The key factors are as follows: ²

1. The old *Construction Lien Act* will apply where:
 - a. a contract³ for the improvement⁴ was entered into before July 1, 2018; or
 - b. a "procurement process"⁵ for the improvement was commenced before July 1, 2018 by the owner.
2. If neither of the above conditions is met, the lien modernization provisions will apply; and

¹ Howard leads DLA Piper's Canadian construction disputes practice and served on the Province of Ontario's Advisory Committee for the review of the *Construction Lien Act*.

² See Section 87.3 of the *Construction Act* for a full understanding of how the transition provisions work.

³ For the purpose of the *Construction Act*, a "contract" is an agreement entered into directly with a project owner for an "improvement" (which is, very loosely, the *Construction Act*'s term for a construction project).

⁴ See above.

⁵ The *Construction Act* includes a very specific definition of a procurement process. It means: (a) a request for qualification; (b) a request for quotation; (c) a request for proposals; or (d) a call for tenders (Section 1(4)).

3. If a procurement process is not commenced until after October 1, 2019, or a contract that does not involve a procurement process is entered into after October 1, 2019, both the lien modernization provisions and the prompt payment and adjudication provisions will apply.

Refresher: The lien modernization provisions

The lien modernization provisions are detailed and technical in nature, so there is no pithy way to capture them in a short paragraph. However, the key revisions include the following:

1. the deadline to preserve a construction lien has been increased from 45 days to 60 days from the applicable trigger date;
2. the deadline to perfect a lien by commencing an action has been increased from 45 days after the last date the lien could have been preserved to 90 days after the last date the lien could have been preserved;
3. holdback release is now mandatory unless the payer first publishes, within the time prescribed by the *Construction Act*, a notice specifying the amount the payer refuses to pay;
4. provided the proper contractual arrangements are in place and the threshold contract price prescribed by regulation is met, holdback will be permitted to be released either on an annual basis or on a phased basis, for appropriate projects;⁶
5. permissible forms of holdback include a letter of credit or holdback release bond, in a prescribed form;
6. termination of a contract is formally recognized as one of the trigger dates to be considered in determining the applicable construction lien deadline. Further, where a contract is terminated, a notice of termination is required to be published in a form prescribed by the *Construction Act* regulations;
7. landlords who provide tenant inducements under a lease have exposure to construction lien claims, to a maximum of ten percent of the value of the inducement;
8. the formulas for calculating both substantial performance and completion of a contract have been modified to account for inflation since the *Construction Lien Act* was implemented in 1983;
9. the maximum amount of costs required to be posted to vacate a construction lien has been increased from \$50,000 to \$250,000, in addition the amount of the lien itself;
10. rigorous accounting requirements have been implemented for trust funds received by a contractor or subcontractor on a project to ensure that all such funds can be traced (although dedicated project accounts will not be necessary). Further, it is specifically noted that the depositing of funds into a single account in accordance with the applicable provisions does not constitute a breach of trust;
11. as of October 1, 2019, construction liens for municipal projects will be required to be served rather than registered, as is presently the case for projects owned by the Provincial Crown;⁷

⁶ As of the date of this paper, the minimum contract price, as prescribed by regulation, is \$10,000,000. However, pursuant to s. 26.2(3) of the *Construction Act*, this threshold requirement is **not** a prerequisite for contracts permitting holdback release on a phased basis where it is only a specified design phase at issue.

⁷ Note that this is an exception to the July 1, 2018 date upon which most of the lien modernization provisions took effect.

12. specific accommodations have been made to fit project structures commonly known as alternative financing and procurement (AFP) or public-private-partnership (P3) projects more clearly into the *Construction Act*, with deeming provisions establishing which contracts within the P3 structure are to be used for determining, among other things, holdback obligations, substantial performance and lien rights; and
13. a significant change that doesn't really fall within the "lien modernization" category provides that contracts for public projects which exceed a value prescribed by regulation require both a performance bond and a labour and material payment bond.⁸

As a practical matter, the foregoing can be reduced even further into the following key elements: (a) the critical and unforgiving deadlines for which construction liens are known have changed and the new deadlines must be understood; (b) there are important new requirements and forms that must be followed and used with respect to contract and holdback administration and the enforcement of lien rights; (c) there is an onus on contractors and subcontractors to ensure they are in compliance with strict new accounting obligations; and (d) almost all public contracts require both performance and labour and material payment bonds.⁹

While the lien modernization provisions are essential to understand from an operational perspective, the impact they will have on contract drafting is likely limited, particularly when taking into consideration that all contracts and subcontracts are deemed to be amended as may be necessary to conform to the *Construction Act*.

However, the same argument is unlikely to present a workable practical approach to contract drafting in the context of prompt payment and adjudication. First, many existing forms of contract have detailed provisions addressing both payment requirements and dispute resolution provisions. Leaving these provisions in place on the basis that these contracts will be deemed to conform to the *Construction Act* will only create confusion. Second, there are certainly strategies that industry participants at all levels of the construction pyramid will wish to employ in drafting and negotiating contracts to manage the new processes and risks introduced by prompt payment and adjudication.

Any organization considering how it is going to handle the prompt payment and adjudication amendments from the perspectives of contract negotiations, contract administration, operations and dispute resolution will first need to have an understanding of what these changes entail.

Refresher: Prompt payment and adjudication

Prompt payment and adjudication are, to a certain extent, directly linked. Although adjudication will capture much more than payment disputes, adjudication can also be considered the "teeth" for ensuring compliance with the pending prompt payment requirements.

⁸ The current contract price threshold has been set at only \$500,000. Importantly, the requirement for bonds does **not** apply to either architecture or engineering contracts.

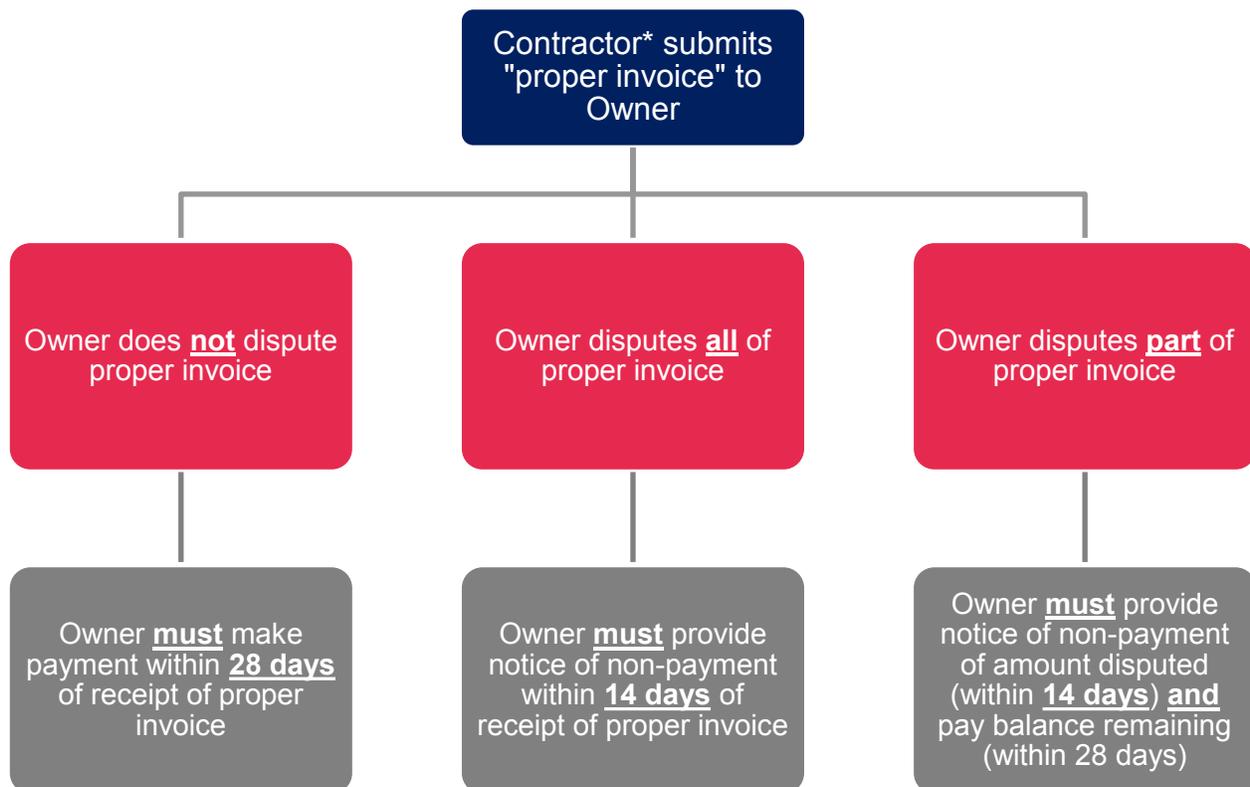
⁹ This requirement is qualified for P3 projects.

The essence of the prompt payment provisions is a set of statutory deadlines for payments on construction projects, all built around the submission by a contractor to an owner of a “proper invoice”. The *Construction Act* prescribes the minimum information that a proper invoice must include, leaving it to the parties to add additional requirements, provided that these contractual requirements do not conflict with the legislation. In addition, the *Construction Act* crucially permits parties to agree within their contract upon the schedule for the *submission* of proper invoices but notably also prescribes a default requirement for proper invoices to be submitted monthly if the contract doesn’t state otherwise. This means, for example, that it is open to parties to incorporate a milestone schedule for the delivery of proper invoices into their contract. Again, however, if there is no contractual schedule for the delivery of proper invoices, the parties will be stuck with the monthly schedule prescribed by the *Construction Act*.

On the other hand, there is no freedom to contract out of the deadlines that flow down the construction pyramid for *payment* once a proper invoice is delivered. Subject to the right to deliver a notice of non-payment, as depicted in the graphics below, payments must be made within the prescribed deadlines. Even a contractual provision that makes the giving of a proper invoice contingent upon payment certification or the prior approval of an invoice by an owner is prohibited by the *Construction Act*.¹⁰

The following graphics show the basic operation and statutory deadlines for prompt payment:

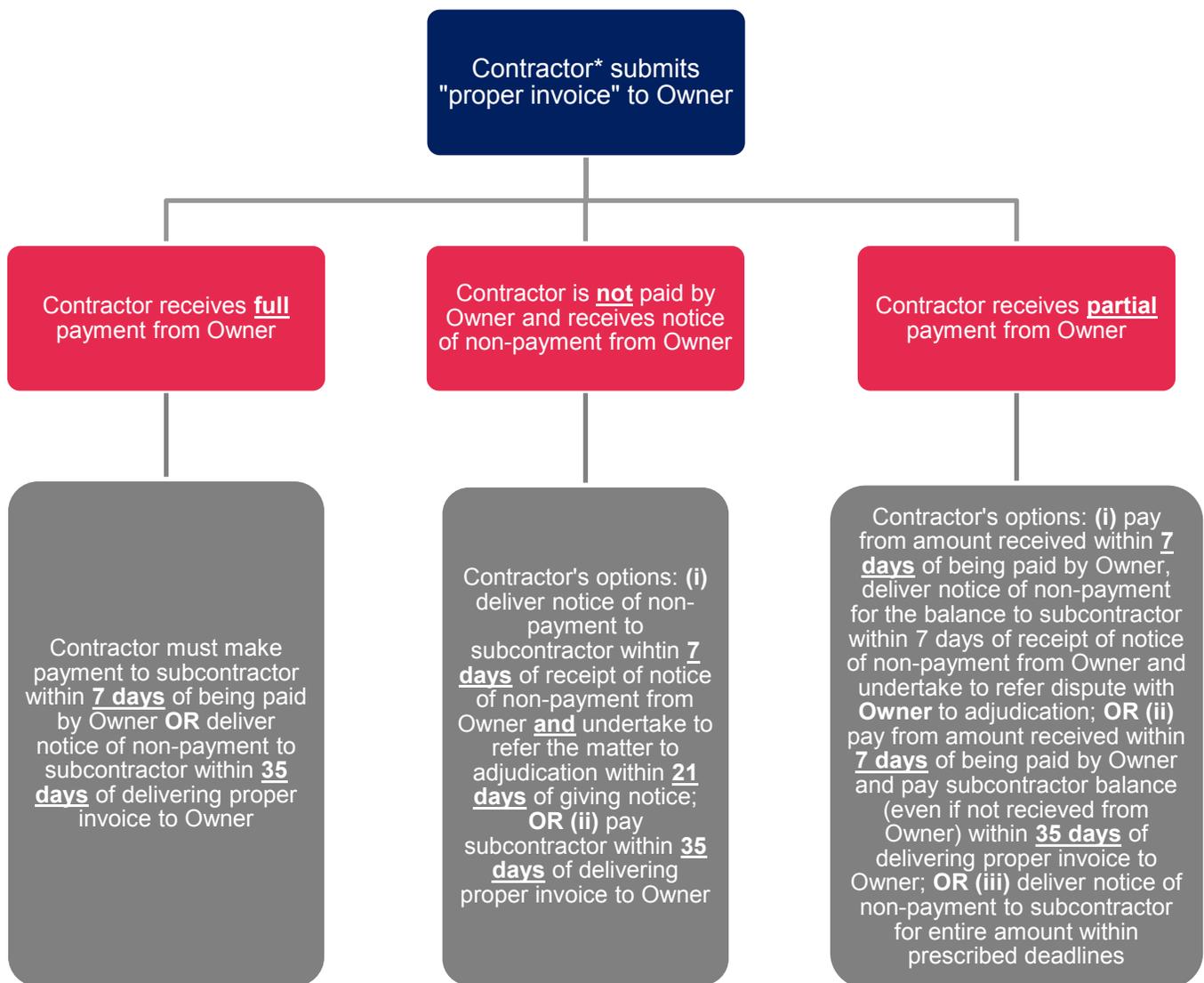
Tier One – Contractor¹¹ and Owner



¹⁰ This prohibition does not apply to P3 projects.

¹¹ Under the *Construction Act*, Contractor means an entity contracting directly with the Owner, including through an agent. A Contractor therefore includes a design consultant hired directly by the Owner.

Tier Two - Contractor* and Subcontractor^{12 13}

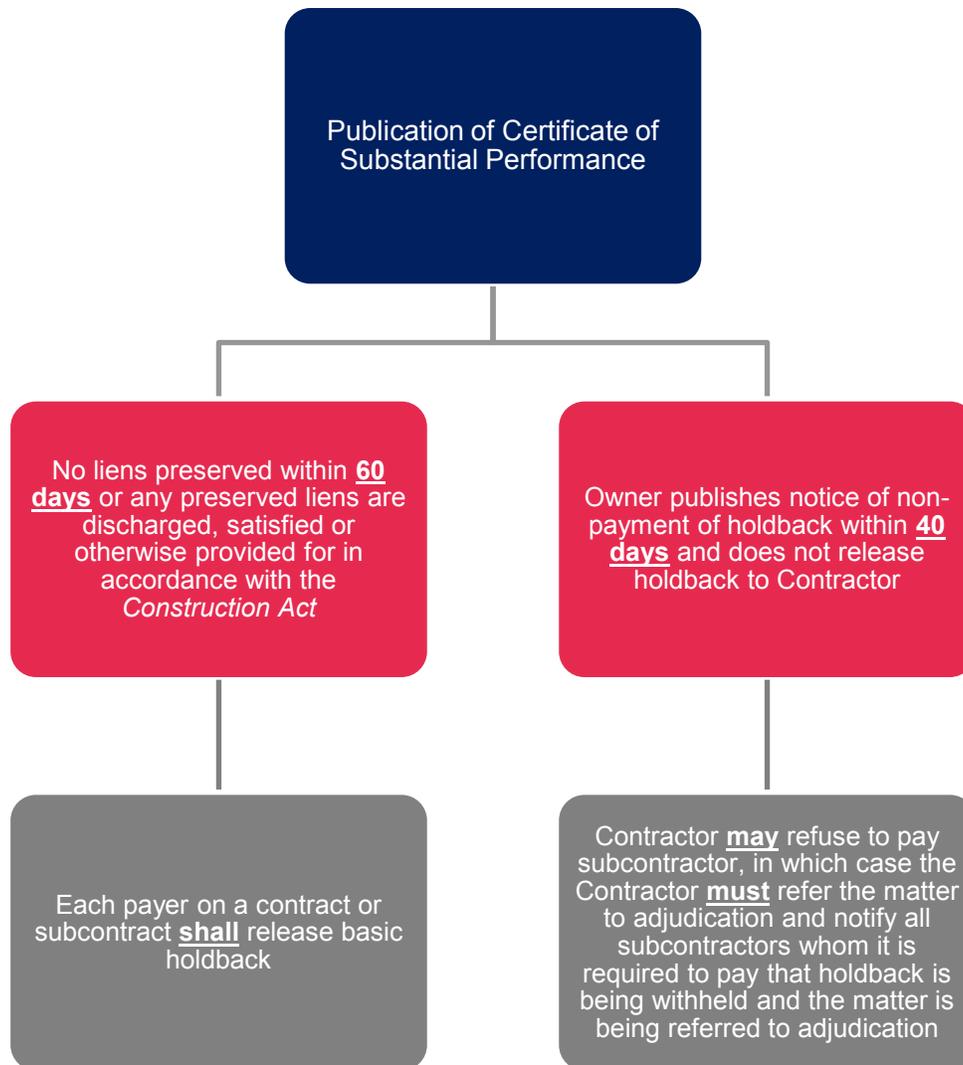


¹² Prompt payment continues to apply to each tier of the construction pyramid. The Act should therefore be consulted for the deadlines applicable at each tier. For example, a subcontractor who receives full payment from a Contractor in respect of a proper invoice is required to pay its own subcontractor or supplier within 7 days of receipt of payment or, if it chooses not to pay, must deliver a notice of non-payment within 42 days of the date the proper invoice was given to the Owner. If a subcontractor has received a notice of non-payment from the Contractor, it must deliver its own notice of non-payment within 7 days of receiving the notice from the Contractor or otherwise must pay its own subcontractor or supplier within 42 days of the date the proper invoice was given by the Contractor to the Owner. If a subcontractor chooses not to pay its own subcontractor based upon receipt of a notice of non-payment, it must refer the matter to adjudication within 21 days of giving the notice of non-payment.

¹³ Note that, in addition to required referrals to adjudication in the event of a notice of non-payment, any party to a contract or subcontract is entitled to refer a dispute to adjudication, including any disputes arising from non-payment under the prompt payment rules.

Holdback

It is also useful in reviewing the prompt payment timelines to demonstrate how the new holdback deadlines in the owner/contractor relationship under the lien modernization provisions fit into the picture, using for simplicity a scenario where the applicable holdback trigger date is the publication of a certificate of substantial performance (as opposed to the trigger dates that are applicable where there is no certificate of substantial performance or where these events come earlier than substantial performance - being completion, abandonment or termination of the contract):



A failure to abide by the prompt payment provisions triggers various remedies, including the requirement to pay a prescribed rate of interest and the potential referral of the dispute to adjudication. Notably, if the basis for a contractor deciding not to pay its subcontractor is the contractor's receipt of a notice of non-payment from the owner, or if the basis for the contractor refusing to release holdback to the subcontractor is the receipt of a notice of non-payment of holdback from the owner, then the contractor is *required* to refer its dispute with the owner to adjudication.

The *Construction Act's* new adjudication process, described below, is anticipated to have a sweeping impact upon the way typical construction contract disputes are resolved.

Further refresher: Adjudication

Adjudication is essentially an interim dispute resolution process that is binding upon the parties. The outcome of adjudication is a “determination” made by the appointed adjudicator. Subject to the very limited ability to have the adjudicator’s determination set aside through a judicial review process, the parties must then abide by that decision and carry on with the project. Should either party wish to re-litigate the issue through a court action or arbitration down the road, they are entitled to do so. However, one of the objectives for *the Construction Act* changes is for such a scenario to be rare.

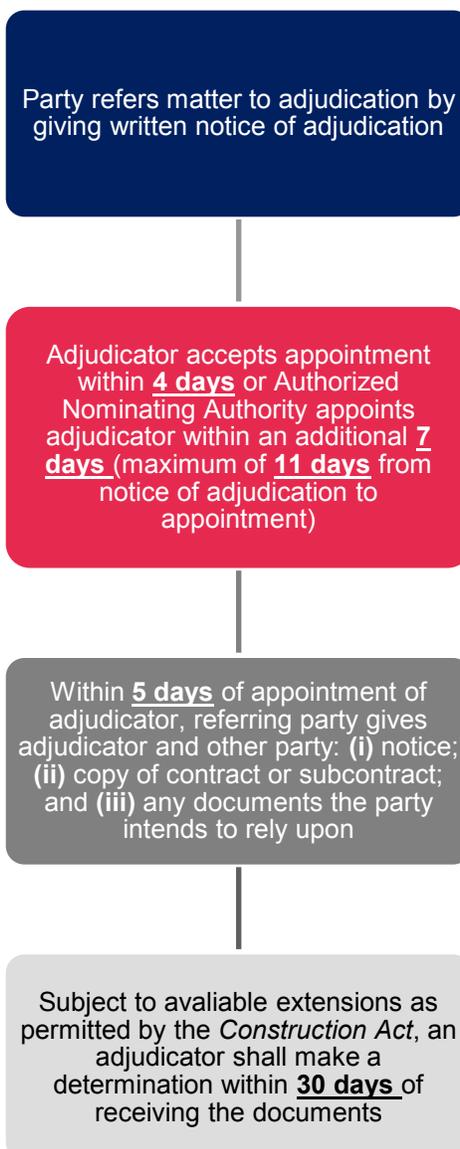
The following is an updated summary of the adjudication process that was included in my September 2017 bulletin on this topic:

1. a party to a contract or subcontract may refer to adjudication a dispute with the other party to that contract or subcontract;
2. matters may only be adjudicated by a person who has been identified as a qualified adjudicator by an entity called the Authorized Nominating Authority (“ANA”), a body which will be designated by the Ontario government. As set out in the current regulations, adjudicators will come from a broad range of fields of expertise within the construction industry including accounting, architecture, engineering, quantity surveying, project management, arbitration and law;
3. adjudication is only available for disputes relating to matters that are prescribed by the statute or the regulations issued thereunder or otherwise agreed by the parties. However, the prescribed list is sufficiently broad such that most disputes that may arise on a construction project will likely be captured;
4. parties are permitted to set out an adjudication procedure in their contract, if it meets the minimum requirements of the statute. However, they are not permitted to prospectively name an adjudicator in their contract – this step is to be taken when the adjudication process is commenced;
5. an adjudication will be commenced by the issuance of a notice of adjudication. The notice is required to contain prescribed information, including the name of a proposed adjudicator;
6. if the named adjudicator does not consent to be appointed within four days of a notice of adjudication being served, then the party giving the notice shall request that the ANA appoint an adjudicator. The ANA shall then have seven days to do so, subject to the adjudicator’s consent;
7. within five days of the adjudicator being appointed, the party initiating the adjudication shall provide the adjudicator with the documents it intends to rely upon for the adjudication;
8. while the adjudicator then has a fair bit of latitude to design the adjudication procedure, the adjudicator shall render a decision within **30 days** after receiving these documents. That decision is binding until a further determination of the same subject matter is made in a court process or arbitration (which is anticipated to be rare);
9. the 30-day deadline can be extended, but only with the written consent of both parties and the adjudicator;

10. a party who is required by the adjudicator's determination to make a payment shall do so within ten days of receiving the decision, failing which interest will be payable and a contractor or subcontractor who does not receive payment shall be entitled to suspend their work, with compensation for costs incurred in so doing;
11. although there are no restrictions on the authority of a court or arbitrator to rule on matters that were already the subject of an adjudication, there are only narrow circumstances in which a determination can successfully be set aside. The requisite process is a judicial review, which first requires a motion for leave. That motion must be brought within 30 days of the adjudicator's determination being communicated to the parties; and
12. the determination of an adjudicator may be enforced in court.

The timeline for adjudication can also be illustrated with a simple graphic:

Adjudication



As described in the above summary, adjudication is a quick process with significant consequences. While adjudication has been subject to criticisms that its outcomes will constitute “rough justice” and that some parties will seek to leverage the tight timelines to their advantage, the objective is for issues to be resolved as they arise so that they will not aggregate and result in lengthy and expensive litigation or arbitration proceedings. Further, recourse will nonetheless remain available to construction liens, arbitration and litigation. In fact, it is generally understood that Ontario will be the only jurisdiction around the world to have both a robust construction lien regime and adjudication running concurrently. Accordingly, it is difficult to accurately predict to what extent adjudication will reduce traditional forms of construction dispute resolution in Ontario. The one certainty is that it is essential for your organization to be prepared for these changes.

Be prepared: A *Construction Act* checklist

It should now be apparent that the *Construction Act* changes will impact every facet of the industry and that the time has now arrived to move from understanding what they are about to preparing your organization to implement them.

The following checklist is a starting point to assist you in preparing for the full range of *Construction Act* changes:

- ✓ critically, develop a decision tree for determining which version of the *Construction Act* applies. When in doubt, always take a conservative approach
- ✓ consider how your organization may benefit from the new flexibility for holdback release that can be negotiated into a contract, particularly on lengthy and complex projects
- ✓ consider the use of holdback release security and any financing arrangements that must be made to facilitate their use
- ✓ for public projects, ensure necessary bond arrangements are in place
- ✓ for contractors and subcontractors, ensure accounting systems comply with new trust provisions
- ✓ implement a clear system for monitoring applicable construction lien and holdback release deadlines
- ✓ ensure the relevant individuals in your organization are familiar with the new form that has been prescribed for a written notice of a lien
- ✓ ensure the relevant individuals in your organization are trained on the new thresholds for calculating substantial performance and the circumstances in which a portion of a contract can be “hived off” to have substantial performance certified early
- ✓ on every project, diarize holdback release dates and the deadline for delivering a notice of non-payment of holdback
- ✓ consider how current and future project structures may be impacted by *Construction Act* changes. For example, will your contracts need to be revised where milestone payments are used, in order to ensure they comply with the *Construction Act*?
- ✓ where custom contracts are used, ensure your terms and conditions are properly updated to reflect the *Construction Act* changes and manage the new processes that are prescribed. For example, how will your organization approach the content, timing and delivery of “proper invoices”?

- ✓ where standard form contracts are used, ensure your supplementary conditions are updated for the same purpose
- ✓ update accounting systems to clearly diarize new mandatory prompt payment deadlines
- ✓ if your organization is a payer, ensure all internal approvals and administrative procedures that are required for payment release facilitate compliance with the prompt payment deadlines
- ✓ review consulting contracts and corresponding payment certification function to ensure they facilitate compliance with the prompt payment deadlines
- ✓ familiarize your organization with the prescribed forms that will be both received and used for all prompt payment requirements, including notices of non-payment
- ✓ train employees on prompt payment deadlines and steps that must be taken where invoices are in dispute, noting that a missed deadline can result in a stranded risk. For example, a contractor who receives a notice of non-payment from an owner but doesn't deliver a notice of non-payment to a subcontractor will be required to make payment downstream, despite not receiving payment from the owner
- ✓ train key project employees on when and how adjudication process must be used and may be used, including essential deadlines
- ✓ implement clear system for tracking claims, whether your organization is the claimant or respondent, in order to ensure that you will be ready to proceed with adjudication when necessary and you will not be taken by surprise when a notice of adjudication is received

This checklist is not intended to be comprehensive and will inevitably require refinement depending upon the role of your organization in the construction pyramid and the nature of the projects in which you are involved. However, with October 1, 2019 around the corner and the lien modernization provisions already in place, it is critical to now take the necessary steps to ensure you are ready for these changes to be implemented.



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