

December 2017

## Winter is coming – and so is Ontario's new *Construction Act*

On December 5, 2017, Bill 142 passed its legislative third reading and, on December 12, 2017, received Royal Assent, meaning Ontario's new *Construction Act* has become law.

The *Construction Act* renames Ontario's *Construction Lien Act* (the "CLA") and represents a thorough and intensive modernization of the CLA. The *Construction Act* will effect wide-sweeping change for Ontario's construction industry and impact every player in the construction pyramid – from lending syndicates of public infrastructure special purpose entities, to construction managers of condominium developments, to kitchen cabinet installers. The inspiration for most of these changes is one or a combination of the following objectives,

- 1) expedite payment for those performing the work;
- 2) expedite and streamline the dispute resolution process; and
- 3) better accommodate the realities of the present-day construction industry, of which condominiums and P3s are important parts.

The timing for the coming into force of the new Act's most significant changes and the finalization of its regulations and prescribed forms is not yet certain. However, proclamation, which will bring into force these changes in stages, is expected in early 2018.

What follows is an identification and summary of some of the most significant changes that Ontario's construction industry can expect with the *Construction Act*:

### Prompt Payment and Proper Invoices

The *Construction Act* creates a mechanism to trigger timely payment for work performed from the top of the construction pyramid through to the bottom. The contractor's submission of a "proper invoice" to the owner triggers the owner's obligation to pay the contractor. Unless the parties agree otherwise, proper invoices are to be submitted monthly.

A proper invoice must, among other things, describe the services or materials supplied, the period during which they were supplied, and the authority under which they were supplied. Parties may agree in their contract to require certain additional conditions to the submission of proper invoices, but any provision that makes a proper invoice contingent upon payment certification or prior approval by an owner will be of no force or effect.

An owner must pay its contractor within 28 days of receiving a proper invoice, unless the owner gives the contractor a notice of non-payment within 14 days of receipt of the invoice. This notice of non-payment must specify the amount the owner refuses to pay and the reasons for non-payment.

A contractor who receives payment from the owner of a proper invoice must then pay its subcontractors within 7 days of receiving such payment. If the owner has not paid the contractor, the contractor is required to pay subcontractors within 35 days of the contractor's delivery of the proper invoice to the owner. The contractor's payment obligations to subcontractors are, however, subject to the contractor's right to deliver a notice of non-payment. If the reason for the contractor's non-payment of subcontractors is that the contractor has not been paid by the owner, the contractor must refer the matter of the owner's non-payment to adjudication as a prerequisite to delivering such a notice of non-payment to its subcontractors.

Subject to delivery of notices of non-payment, subcontractors must, in turn, pay their subcontractors within 7 days of receipt of payment from the contractor, and so on through to the bottom of the construction pyramid.

## Adjudication

The *Construction Act* implements an adjudication process for payment and certain other prescribed disputes for owners, contractors, and subcontractors prior to completion of their contracts. This process is meant to be a swift and flexible mechanism of dispute resolution, whereby a qualified adjudicator determines the outcome of a construction dispute, instead of a master or judge. Adjudicators will be appointed by a to-be-created body designated under the new Act called the "Authorized Nominating Authority".

A party begins the adjudication process by notifying the other party with a prescribed form of notice. This notice must specify, among other things, the nature of the dispute, the remedy sought, and the proposed adjudicator. Once the adjudicator is appointed, the initiating party must deliver to the adjudicator the relevant contract and documents upon which it intends to rely.

Subject to permissible adjudication processes that the parties may stipulate in their contracts, adjudicators are afforded considerable discretion in how the adjudication process will thereafter proceed. Among other things, the new Act expressly gives adjudicators the power to issue directions regarding the conduct of the adjudication, conduct on-site inspections, draw inferences based on the parties' conduct, and obtain the assistance of any person the adjudicator considers fit to better determine any matter of fact in question.

Subject to certain limited circumstances, the adjudicator must render a decision within 30 days after receiving the initiating party's documents. The adjudicator's decision is binding, but subject to any subsequent determination that may be had through court or arbitration proceedings. An adjudicator has jurisdiction to

award costs only where a party is found to have engaged in bad faith or frivolous or vexatious conduct. Parties are otherwise required to pay their own costs. An adjudicator's decision may be judicially reviewed with leave, but only in narrow circumstances, which in some way generally involve a denial of natural justice.

### Holdbacks

The *Construction Act* imposes on payers a mandatory obligation to release holdback funds once the lien period has expired, so long as all liens that may have been claimed have been discharged or otherwise satisfied under the new Act. This mandatory obligation is, however, subject to an owner's right to publish a prescribed notice of non-payment no later than 40 days after publication of the certificate of substantial performance. In addition, contractors and subcontractors are not mandated to release holdback funds following the expiry of the lien period where they have not been paid their holdbacks due, referred such non-payment to adjudication, and provided notice of such non-payment to their payees.

Holdback funds can be maintained in the form of letters of credit or demand-worded holdback repayment bonds and may be released, where contracts so provide, on an annual or phased basis for projects that exceed amounts to be prescribed.

### Preservation and Perfection of Liens

The deadline to "preserve" a lien is extended from 45 to 60 days from the applicable triggering event for the expiry of liens. The list of applicable triggering events, which includes completion and abandonment of contracts and subcontracts, has been expanded to include contract and subcontract "termination". The deadline to "perfect" a lien has also been extended from 45 to 90 days after the last date that a lien could have been preserved. The two year expiry period for perfected liens remains unchanged.

## Monetary Thresholds

The monetary thresholds for substantial performance, completion, and for the posting of costs upon the vacating of a lien have all been increased.

A contract is now substantially performed when the improvement is ready for use or is being used for the purposes intended and if it is capable of completion at a cost of no more than 3 percent of the first \$1,000,000 of the contract price, 2 percent of the next \$1,000,000 of the contract price, and 1 percent of the balance. The \$1,000,000 thresholds were increased from \$500,000.

A contract is now deemed to be completed when the price of completion, correction of a known defect or last supply is not more than the lesser of 1 percent of the contract price and \$5,000. The \$5,000 threshold was increased from \$1,000.

The maximum amount required for security for costs in support of vacating a lien increases from \$50,000 to \$250,000.

## Accounting

In support of improving the trust remedy under the CLA, the new Act introduces more rigorous accounting requirements for contractors and subcontractors. Contractors and subcontractors are required to deposit funds received for work performed on a project into a bank account in their own names and maintain written records detailing amounts received into and paid out of the account. Contractors and subcontractors may maintain a single account for multiple projects so long as written records show the amounts received into and paid out of the account for each project. Funds "comingled" in this way are deemed traceable and a permissible way of maintaining construction trust funds.

## Condos

Lien claimants seeking to preserve liens against the common elements of a condominium must give notice of their intention to do so in a prescribed form to the condominium corporation and

each condominium unit owner. Unit owners are, in turn, able to vacate a lien registered against the common elements of their condominium in respect of their unit by posting security proportionate to their share of the common elements as specified in the applicable declaration registered under the *Condominium Act*.

### Landlords

Landlords are no longer permitted to give written notice to contractors disclaiming responsibility for improvements. Instead, landlords are now liable to lien claimants to the extent of 10% of any payments made to tenants for improvements. In addition, landlords must now give notice to any registered lien claimants when enforcing their rights of forfeiture or termination against tenants for non-payment.

In connection with the foregoing, landlords are subject to section 39 right of information requests. Within 21 days of a request of any person having a lien or a beneficiary of a construction trust, a landlord must provide the names of the parties to the lease, the amount of payment for all or part of the improvement accounted for under the lease, and the state of accounts between the landlord and tenant.

### P3s

Special purpose entities, each commonly known as "Project Co", that typically design, build, finance, and maintain a P3 project, are expressly deemed to be "owners" under the new Act in place of the authority or public sector organization. Holdback obligations and substantial performance are accordingly calculated on the basis of the contract between Project Co and the contractor.

Public contracts that exceed a prescribed amount will require a performance bond and a labour and material bond, regardless of other forms of security employed.

## Conclusion

While there are further changes under the new Act not considered here, the foregoing demonstrates that the *Construction Act* profoundly changes how construction contracts will proceed and how disputes will be resolved. Navigating through these changes will no doubt entail a period of some adjustment as the *Construction Act* moves to realize its goals of modernization, prompt payment, and a faster resolution of disputes.

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### a cautionary note

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