

CAN I SAFELY RELEASE HOLDBACK IN ONTARIO AFTER MARCH 16, 2020?

Posted on March 24, 2020

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On Friday, March 20, 2020, the Government of Ontario issued Ontario Regulation 73/20 further to the *Emergency Management and Civil Protection Act*, R.S.O. 1990 c. E.9. The Regulation suspended any limitation period under any statute, rule, by-law or order of the Government of Ontario. In addition, the Regulation suspended any provision of any statute which provides for any period of time to take a step in a proceeding or intended proceeding. The suspension of limitation periods and times to take steps is “for the duration of the emergency” and retroactive to March 16, 2020.

Undoubtedly, this measure is intended to protect the public from the expiry of legal rights in circumstances where the COVID-19 pandemic prevents parties from taking timely steps normally available to them to preserve those rights. However, this measure may have an unintended consequence: namely, it may prevent the release of holdback further to the *Construction Act*, R.S.O. 1990, c. C-30 (the “**Act**”). Quite simply, holdback can be safely released only when the underlying liens have expired. If liens do not expire, holdback cannot be released without the risk of the payor having to pay the same sums twice.

By way of background, every payor to a construction project (an “improvement” under the *Act*) is obliged to retain a 10 per cent holdback on all payments made to payees during the course of the construction of the improvement. The holdback in the hands of the payor is intended as a reserve fund for the benefit of all suppliers of labour and materials below the level of the immediate payee in the construction pyramid. If one such party is unpaid, they have a limited period of time to preserve a claim for lien, which will prevent the further payment of funds, including the release of holdback, until the lien is dealt with, either by discharge (payment) or by vacating the lien (paying security into court). If the lien period has expired and no claims for lien have been preserved, (or previously preserved liens have been discharged or vacated) then the payor can safely release the holdback to its payees, which can, in turn, distribute the holdback to their suppliers.

If a payor releases holdback prematurely, that is, before the liens rights of those who have an interest in the holdback have expired, then the payor risks paying that amount over again. Accordingly, payors take careful steps to ensure they do not release holdback funds until all liens in respect of that holdback have expired pursuant to the *Act*. More particularly, they rely upon sections 25 and 26 of the *Act* to release holdback without

jeopardy. Those sections are as follows:

25 Where a subcontract has been certified complete under section 33, each payer upon the contract and any subcontract may, without jeopardy, make payment reducing the holdbacks required by this Part to the extent of the amount of holdback the payer has retained in respect of the completed subcontract, **where all liens in respect of the completed subcontract have expired** or been satisfied, discharged or otherwise provided for under this Act. (emphasis added)

26 Subject to section 27.1, each payer upon the contract or a subcontract shall make payment of the holdback the payer is required to retain by subsection 22 (1) (basic holdback), so as to discharge all claims in respect of that holdback, **where all liens that may be claimed against that holdback have expired** or been satisfied, discharged or otherwise provided for under this Act. (emphasis added)

In virtually all cases, parties to a construction project rely upon the passage of time to ensure the underlying liens have expired before releasing holdback. Typically, parties wait 60 days (previously 45 days prior to the recent amendments to the Act) after the publication of the certificate of substantial performance to know with certainty, that if they search title on day 61 and find no registered liens, the lien period with respect to all underlying liens has expired. They can, with certainty and without jeopardy, release the holdback under section 26.

The expiry of liens is governed by section 31 of the Act which provides that liens will expire at the conclusion of the 60-day period next following the earliest of the events listed, which include the publication of the certificate of substantial performance or the day the contract was completed, terminated or abandoned or the last day of supply, in the case of a subcontract. The Act has mechanisms allowing payors to know when the lien period has expired and thus, when they can safely release holdback further to sections 25 or 26 set out above.

However, the new Regulation 73/20 provides as follows:

1. "Any provision of any statute, regulation, rule, by-law or order of the Government of Ontario establishing any limitation period shall be suspended for the duration of the emergency, and the suspension shall be retroactive to Monday, March 16, 2020."
2. "Any provision of any statute....establishing any period of time within which any step must be taken in any proceeding in Ontario, including any intended proceeding, shall....be suspended for the duration of the emergency, and the suspension shall be retroactive to Monday, March 16, 2020."
(emphasis added)

On a plain and ordinary reading of these provisions, it would certainly appear that the 60 day time limit to preserve a lien further to section 31 of the Act is suspended. If so, then construction liens no longer expire "for

the duration of the emergency.” If they do not expire, then there is no way to rely upon their expiration to safely release holdback further to sections 25 or 26 of the Act.

There are certainly counter-arguments to this analysis. For example, the Divisional Court of Ontario has consistently held, in reference to another section of the Act which provides for the expiry of perfected liens, that such a provision is not a limitation period.

“Section 37 extinguishes a lien. It is not a limitation period and cases such as *Basarsky v. Quinlan*, [1972] S.C.R. 380, 24 D.L.R. (3d) 720, giving the court power to grant relief from limitation periods, are not applicable.”^[1]

Arguably, there is no reason to distinguish section 31 and section 37 since they both use similar language. If section 37 is not a limitation period, neither is section 31. If so, then section 31 is not “any limitation period” and thus is unaffected by section 1 of the new Regulation.

The decisions of the Divisional Court which hold that section 37 is not a limitation period do not provide a lengthy analysis as to the distinction between a “limitation period” and the “time period for the expiry of a lien”. Some assistance in this regard is provided by the Ontario Court of Appeal in the context of another statutory lien scheme, namely the *Repair and Storage Liens Act*, R.S.O. 1990, c. R.25 as follows:

“A legal lien is a defence rather than a cause of action, although it will usually relate to a cause of action. Generally speaking, such liens are not subject to limitations periods, since under the law of Ontario limitation periods generally tend only to bar recourse to judicial remedies, rather than to extinguish rights. However, in the case of some statutory liens, the lien expires at the end of a relevant limitation period and ceases to exist as a right.”^[2]

Thus, a limitation period generally does not extinguish the underlying right: it simply prevents that right from being enforced. The statutory sections setting out when liens expire do extinguish rights, not merely bar the recourse to judicial enforcement of those rights. While this gives us some ability to distinguish between “limitation periods” and the “expiry of lien rights”, the same passage may muddy the waters in that it expressly describes the expiry of statutory liens (a construction lien is a statutory lien, there being no such lien at common law) as a “limitation period”. Thus, while the Divisional Court decisions may have rendered section 1 of the Regulations inapplicable to the expiry of construction liens, the Court of Appeal decision may, arguably, counter this.

Even assuming section 1 of the Regulation does not apply to the expiry of construction liens, what about section 2? This section suspends the time limit to take any step in any proceeding or contemplated proceeding. The Act provides that a claim for lien must be enforced within an action commenced further in the

Ontario Superior Court of Justice: that is within a “proceeding”. Thus, it may be argued that the preservation of a lien is a necessary step in an intended proceeding. If so, then the time limit to take that step is suspended for the duration of the emergency.

How the Regulation will be interpreted by the courts in the context of the preservation or expiry of liens may not be known for some months or years until it is authoritatively interpreted by the Ontario Divisional Court or the Ontario Court of Appeal. In doing so, the courts will have to consider the legislative intent of the Regulation in context. There is no doubt the intention of the Legislature, in the context of a pandemic where people are prevented from preserving their rights, is to preserve legal rights using very broad language and not allow those rights to expire under “any provision” of “any statute”. If so, it is certainly open to the courts to interpret these provisions as not allowing a lien claimant’s lien rights to expire during the emergency.

If liens can no longer expire, payors cannot release holdback without jeopardy and may (understandably) be reluctant to do so. Project financiers, which usually require proof of the expiry of the lien period prior to releasing or advancing the holdback, may (understandably) be unwilling to do so given such uncertainty. To put it another way, would the commentators who have opined that the Regulation does not suspend the expiry of lien periods be willing to provide a legal opinion to a financier that underlying liens have expired (after March 16, 2020) and it is safe to release holdback, without jeopardy?

It is true that both sections 25 and 26, as an alternative to the expiry of liens, also allow for the safe release of holdback if the underlying liens have been “satisfied, discharged or otherwise provided for” under the Act. This typically refers to circumstances where a party entitled to a lien has already been paid in full, or where a party’s claim for lien has been vacated by the payment of security into court. In the vast majority of cases, parties rely upon the expiry of the lien period for the safe release of holdback.

The inability to safely release holdback and get the holdback funds into the hands of small business and construction workers is certainly not what the Government of Ontario intended, but is, unfortunately, a consequence of this new Regulation, to anyone who is paying attention.

There are two immediate solutions to this problem that come to mind. The first is simply to exempt the *Construction Act* from the provisions of Regulation 73/20. This may be justified on the basis that the cure is worse than the disease. This manner of providing limitation relief to those entitled to liens will have the impact of delaying or preventing the release of holdback. In the absence of the new Regulation and notwithstanding the pandemic, it was still possible to preserve claims for lien by registration and to perfect claims for lien by electronically issuing actions to enforce. Using those mechanisms to preserve and perfect liens by the parties that need to do so is not nearly as onerous as slowing down or stopping the release of holdback to the vast majority of trades that do not need to preserve liens.

In the alternative, if the Government of Ontario still wishes to continue to suspend the limitations under the Act, then adjustments must be temporarily made to sections 25 and 26 of the Act to allow for the safe release of holdback notwithstanding the fact that liens can no longer expire. A potential solution is to look to the priority provisions of section 78 of the Act for guidance. At the risk of over-simplification, this provision allows ordinary payment draws (as opposed to release of holdback) to be released provided no liens have been registered, and no written notice of lien has been received, prior to the release of funds. If that criteria is satisfied, the project financier will have priority in respect of such ordinary draw advances and can safely release same.

Thus, sections 25 and 26 should be temporarily amended to allow a payor to safely release holdback (after the 60-day period) provided a title search reveals no preserved liens and that the payor has not received a written notice of lien prior to the release of holdback. The payor satisfying these criteria would not be in jeopardy of paying the holdback twice. It is true that a lien preserved *after* such release of holdback would likely be valueless as a lien. But in circumstances where a lien claimant was otherwise “late” in preserving the lien (because of the pandemic) but managed to preserve the lien before the release of holdback, the claimant would still benefit from the new Regulation.

To be clear, the two solutions set out above are not in force. They are suggested here to solve the problem identified. As it stands, payors cannot safely release holdback for the reasons explained.

by Glenn Grenier

[1] *Benjamin Schultz & Associates Ltd. v. Samet*, [1991] O.J. No. 1406 (Div. Ct.) at pg. 5. See also *Krypton Steel Inc. v. Maystar General Contractors Inc. et al.*, 2018 ONSC 3836 (Div. Ct.) and *Golden City Ceramic & Tile Co. v. Iona Corp*, 1993 CanLII 9364 (ON SCDC).^[ps2id id='1' target='']

[2] *Eden Agency Inc. v. Palinkas*, 2017 ONCA 421 at para 6, citing *CED (Ont 4th)*, vol 37, title 94 at §3.^[ps2id id='2' target='']

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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