Impact of Bill 142 Construction Act on Municipalities

Major amendments to the *Construction Lien Act* have passed and municipalities should be prepared for the new *Construction Act.* A review of the *Construction Lien Act* was undertaken with the intent of modernizing it by introducing legislation geared towards improving the efficiency and competitiveness of Ontario's construction sector. Lien and holdback processes have been updated and prompt payment rules for construction project payment systems have been introduced as well as the mandatory arbitration of disputes.

The implementation of the new rules were staggered to allow the industry time to set up any administrative support structures required to ensure compliance with new laws and regulations. Thus, the new rules were brought into effect in two phases:

- July 1, 2018 – For amendments that apply to existing provisions such as holdbacks, construction liens, trusts and bonding.
- October 1, 2019 – For amendments that require ramp-up time to allow affected stakeholders to develop appropriate support structures such as Prompt Payment, adjudication, and Liens against municipalities.

The changes will not apply to a project if:

1. The contract was entered into before July 1, 2018;
2. The procurement process (RFQ, RFP, tender call) was commenced (not concluded) before July 1, 2018. In other words, the trigger date will not be the closing date of the tender, but the date on which the tender call was issued by the municipality/ owner: or
3. The premises are being leased and the lease was entered into prior to July 1, 2018.

In force July 1, 2018

Mandatory Bonds

As of July 1, 2018, the new Act makes it mandatory that 50% Performance and Labour & Material Payment Bonds be required for public contracts over $500,000. Public contracts include municipalities and broader public sector organizations. This does not preclude a municipality from requesting bonds on projects under $500,000. Many municipalities will be accustomed to accepting letters of credit but these will no longer be permitted when the value of the project exceeds the $500,000 threshold.

The definition of "improvement" in the Act now makes reference to "capital repairs" and distinguishes them from maintenance. A repair is considered to be a capital repair if it extends the useful life of the land, building or structure. Maintenance work to prevent normal deterioration is not considered to be a capital repair and is not subject to the Act.

In keeping with the desire to promote cash flow, the requirement for bonds instead of letters of credit will assist Contractors by freeing up the cash that would be frozen by the bank when a letter of credit is obtained. When obtaining a bond, the Contractor is only required to pay a rate per thousand of the contract price.

Both performance and labour and material payment bonds are now mandatory at 50% of the contract price for each bond. Bonds are due when contract is entered into. The form of the bond is prescribed by regulation.

The performance bond assists Owners by providing more than just cash. The bond includes a mechanism for ensuring the project is completed. Performance bonds now allow for a Pre-Notice Meeting prior to default. If the Owner is considering declaring the Contractor to be in default, the Owner can make a request for a Pre-Notice Meeting, in the prescribed form by notifying the issuer of the performance bond (Surety) and the Contractor. The purpose of the meeting is to allow the Owner to express any concerns about the Contractor's performance and to allow the Contractor to respond. If the concerns are not addressed satisfactorily, the Owner still has the right to give Notice under the Bond.

Once the Notice has been received, Sureties are now required to respond in a meaningful way within a prescribed time period. The Surety is required to commence an investigation promptly and to request additional information.

Within 20 days, the Surety has three response options: accept liability, deny liability with reasons, unable to determine and may make a proposal. Necessary interim work is permitted after notice has been given if the Owner determines it is for safety, "in the public interest" or mitigation work. Owners do not have to notify the Surety or receive approval for the interim work; they can notify after the fact. The Act creates a clearer process for Owners. The Owner's direct expenses are now covered under the Bond as well as direct costs as a result of an extension of the duration of the contract. No liquidated, indirect or consequential damages are included unless agreed upon. Further details of the process are provided in Section 85.1 of the Act and in the actual Bond Form prescribed under the regulations.

A labour and material payment bond will ensure that all subcontractors and suppliers are paid for any labour and material provided to the project.

From January to April 2018, the Surety Association of Canada worked closely with the Attorney General and Ministry of the Attorney General staff to develop bond language which met these criteria and aligned with the spirit and intent of the legislation.

Some Owners have expressed concern that some of the smaller Contractors they use will not be able to provide bonds and this will narrow the market and increase costs. Contractors who cannot obtain that credit are higher risk and, even if costs are increased slightly, costs of dispute resolution and litigation and risk are expected to decrease.

Holdbacks

The *Construction Act* includes a mandatory release of holdback that cannot be contracted out of. Holdbacks must be released after the expiry of the lien period. If an Owner does not intend to release the holdback, Notice of Non-Payment, in the prescribed form must be served on the Contractor within 40 days of Substantial Performance. Regulations containing the forms were released in April, 2018.

Additional amendments to the holdback rules include:

1. Holdbacks can now be in the form of security instead of cash only.
2. Early release of holdback for project values in excess of $10 million.
3. Currently there is a 10% holdback obligation, finishing holdback and notice of lien holdback.
4. Payment is mandated to be released after the expiry of the lien period or if there are liens, after they have been satisfied or discharged

Bundling

Pursuant to the new Act, the procurement and contracting for multiple projects can be bundled if defined in the contract. Different projects on different lands, although they are bundled, will be treated as separate contracts. This could pose difficulties when a sub-contractor is providing services or materials for multiple projects. Municipalities should make it clear in bundled contracts that services for sub-contractors must be separated out for each project.

Trust Accounts

Trust rules for Contractors have been updated. While this does not directly affect municipalities, if an Owner is aware of a misappropriation of trust money and does nothing about it, they could be liable. Detailed records of accounting must be maintained that clearly detail which project trust money was received for and the amounts paid out. If trust accounting is not maintained, breach of trust claims could result. These new trust rules could create more trust claims where Owners are brought into the action. An Owner is only permitted to set-off against one specific project and not another project with the same Contractor. Amounts may only be set-off on the same improvement.

Claims

Previously, Contractors were required to file a separate claim for a lien, trust claim or contract claim. Now they can be combined into one claim and claims up to $25,000 can be brought in Small Claims Court.

Liens

The time for the preservation of a lien has been extended from 45 to 60 days. The time for the perfection of a lien has been extended from 45 to 90 days.

Service of a lien on municipalities must be delivered to the Clerk and not registered. Claimants with liens against a municipality are not permitted to force a sale of the land to satisfy the lien.

There are many prescribed forms included in the new regulations.

In Force October 1, 2019

Prompt Payment

Prompt Payment and adjudication rules took effect October 1, 2019. Payment by the Owner to the Contractor must be made within 28 days of receipt of a "proper invoice". Prompt Payment provisions cannot be contracted out of. Criteria for a "proper invoice" are provided in section 6.1. If payment is not made, interest will accrue and the Contractor may be permitted to suspend work. If an Owner disputes the amount of the invoice, Notice of Non-payment must be delivered within 14 days of receipt of a proper invoice. Notice must include the amount in dispute and the reasons for non-payment.

Contractors will be required to pay sub-contractors within 7 days of receiving payment unless they have commenced a dispute with the Owner.

Adjudication

Owners and Contractors will be required to refer disputes to an adjudicator. Timelines for adjudication will be very tight with the submission of documents being required within a week of receiving notice.

Owners can have unapproved contract changes adjudicated, however, decisions are "interim binding" meaning that you must pay within 10 days. Mandatory adjudication rules do not preclude parties from commencing court actions.

How Can Municipalities prepare?

These amendments may result in increased costs and additional resources for Owners. More risk will be borne by Owners who are now at the top of the payment pyramid, but, if contract issues are managed on the front end, it should result in fewer formal disputes. Some issues that municipalities should be preparing to deal with are their internal approval processes, policies and procedures and streamlining payment and certification processes.

Steps Municipalities can take to be compliant with the Act:

1. Review the Regulations that are enacted by the Act.
2. Ensure that your forms are updated to comply with the Regulations.
3. Review contract templates to ensure they are compliant with the Act. Contracts should also be amended to reflect the new substantial performance threshold of $1M and the fact that lien periods have been extended from 45 to 60 days.
4. Ensure bundled contracts include a provision that makes it clear that services for sub-contractors must be separated out for each project.
5. Ensure processes are in place for reviewing invoices, filing notices, paying invoices and meeting deadlines.
6. The definition of price does not include liquidated, indirect or consequential damages unless agreed upon. If this is important, ensure it is covered in the contract.
7. Develop a policy for reviewing bonds for compliance.
8. Train staff to review invoices and determine if they are "proper invoices" pursuant to the Act.
9. If Owners adjudicate unapproved contract changes, decisions are "interim binding" meaning that you must pay within 10 days but you are permitted to litigate as well. Consider where your Municipality will get this money.
10. Develop a document management system to ensure that documents are available and processes are in place. Where are the documents? Who can access them?
11. Consider forming a committee or hiring a Consultant to conduct a review of Bill 142 and the regulations to devise a plan.
12. If you hire outside Consultants, can you access their documents?
13. Confirm that smaller contractors will be bondable. Owners should be diligent with the process and following timelines and have good systems in place.
14. Consider hiring a Construction Compliance Project Manager.

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