

Construction Lien Act changes: A primer for real estate practitioners

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Authors: [Roger Gillott](#), [Jeff St. Aubin](#)

Overview

Ontario's *Construction Lien Act* (the Act) has implications that extend far beyond the parties to a construction contract. Its influence on real property necessitates that real estate practitioners must have a working knowledge of how their clients' assets and transactions can be impacted by construction liens.

The Act is currently in the process of transformation, as sweeping reforms have been introduced by Bill 142, the *Construction Lien Amendment Act, 2017* (the Bill) which received Royal Assent on December 12, 2017. These reforms will modify and expand upon the Act, reflected by its name changing from the *Construction Lien Act* to the *Construction Act*, which is appropriate given that its scope will be significantly broader than traditional liens.

This paper explores the primary amendments to the Act, which include the introduction of regimes addressing prompt payment and mandatory interim adjudication, as well as technical amendments that include specific measures affecting condominiums and other real estate-relevant provisions[1].

At the time of writing, the regulations accompanying the Bill (the Regulations) have been released for public consultation by the Ministry of the Attorney General, and this paper includes discussion of the Regulations where they assist in operationalizing the substantive amendments of the Bill. The reader should exercise caution with respect to the Regulations as described herein, as they may be modified through the public consultation process. In recognition of this risk, this paper expressly refers to the Regulations when their contents are referenced.

We begin with a discussion of the sections most relevant to real estate practitioners, discuss when the amendments come into force, and then provide an overview of the most important amendments to the Act.

Real estate

a. Condominiums

The *Construction Act* will require that notice of a lien related to the common elements of a condominium must be given to the condominium corporation and each unit owner, and in the case of a common elements condominium corporation, to an owner of a parcel of land

mentioned in subsection 139(1) of the *Condominium Act, 1998*, to which a common interest is attached and which is described in the declaration of the corporation[2].

In addition, it will provide that an individual unit owner may bring an *ex parte* motion to have the registration of the common elements lien vacated from title to their individual condominium unit, by posting security equal to the individual unit's *pro rata* share of the lien's value, plus the lesser of \$250,000 and 25% of the unit's *pro rata* share of the lien's value, for costs.[3] This provision greatly simplifies the process of vacating a common elements lien from title to an individual condominium, when (for example) the owner of the unit wishes to either sell or refinance their unit.

b. Landlords' limited liability for liens and responsibility to respond to information requests from lien claimants

One of the "thorny" issues involving the interaction between construction lien law and real estate law has always been the question of who (the tenant or the landlord, or both) is subject to a construction lien for work done on leasehold premises. Often, the lien claimant will register its lien against the freehold owned by the landlord – sometimes in addition to, and sometimes instead of, the leasehold premises. Sometimes, there will be no registered lease, which will lead some construction lawyers to register the construction lien only against the freehold.

Up to now, this issue has been dealt with in two ways by the *Construction Lien Act*:

1. Under section 19 of the *Construction Lien Act*, if the contractor gave the freehold owner written notice, in advance of construction, that the freehold would be subject to the lien, then the interest of the landlord would also be subject to the lien to the same extent as the interest of the leasehold owner, unless the landlord responded within 15 days of the notice, indicating in writing that it assumed no responsibility for the improvement;
2. If the owner of the freehold comes within the definition of "Owner" in section 1 of the *Construction Lien Act*, then its freehold interest is also subject to the construction lien (Note that the caselaw has greatly narrowed the circumstances in which a landlord will be found to be an "Owner" within the meaning of the *Construction Lien Act*).

The amendments to the *Construction Lien Act* will eliminate #1 above (the ability of lien claimants to provide written notice to the landlord). In section 19(5), the amended Act will maintain #2 (though as noted above, this will be of limited utility to lien claimants, given the narrow interpretation of it in the caselaw).

However, most significantly, amendments to section 19 will provide that if a landlord is paying for all or part of an improvement on tenants' leased premises (e.g., through a tenant inducement), and if the payment is included in a lease, renewal, or any connected agreement to which the landlord is a party, then the landlord's freehold interest will be subject to the lien, to the extent of 10% of the amount of such payment.[4]

This liability on the part of a landlord paying for a tenant's improvement, which is limited to 10% of the landlord's payment, conceptually parallels the potential liability of a mortgagee for any shortfall in the 10% holdback to be retained by the owner, under section 78 of the *Construction Lien Act*, where the mortgagee is funding the construction of the improvement.

The landlord will also be required to respond to information requests under Section 39 of the *Construction Act*, and must provide the following information to parties with lien or trust

rights under the Act:

- the names of the parties to the lease,
- the amount of any payment referred to in section 19.1 of the *Construction Act*, being any payment for all or part of the improvement, which is “accounted for under the terms of the lease or any renewal of it, or under any agreement to which the landlord is a party that is connected to the lease,” and
- the state of accounts between the landlord and tenant, containing the following information:
 1. The price of the services or materials that have been supplied under the contract or subcontract.
 2. The amounts paid under the contract or subcontract.
 3. In the case of a state of accounts under paragraph 4 of subsection (1), which of the amounts paid under the contract or subcontract constitute any part of the payment referred to in subsection 19 (1).
 4. The amount of the applicable holdbacks.
 5. The balance owed under the contract or subcontract.
 6. Any amount retained under section 12 (set-off by trustee) or under subsection 17 (3) (lien set-off).
 7. Any other information that may be prescribed.^[5]

c. Capital repairs

The definition of an “improvement” will be amended to clarify that an improvement includes a “capital repair,” whereas the Act previously only referred to a repair. This change provides clarity regarding whether repair work is subject to a lien, and a new subsection provides that a capital repair is one that is intended to extend the normal economic life or improve the value or productivity of the land or any structure on the land, but does not include maintenance work to prevent normal deterioration.^[6]

When are these changes coming?

Certain amendments to the Act are already here, having taken effect on the day that Bill 142 received Royal Assent. However, these immediate amendments were minor in nature, and the vast majority of changes – including all of those discussed in this paper – will only take effect on a future date to be proclaimed.

An important consideration in the passage of the Bill, reaffirmed during the legislative debates, was to provide an adequate period of time for education and preparation within the construction industry. In keeping with this intention, the Ministry of the Attorney General has announced that prompt payment and adjudication will come into force on October 1, 2019, while all other amendments will come into force more than a year earlier, on July 1, 2018.

Prompt payment

The significant length of time that contractors, subcontractors, and suppliers typically have to wait to receive payment following the submission of an invoice has been a long-standing issue in the construction industry. To address these concerns, the Ontario Legislature has

previously considered the implementation of prompt payment legislation, specifically in 2011 through Bill 211, and again in 2013 through Bill 69, but both of these Bills failed to materialize as legislation and the current amendments to the Act represent the first prompt payment legislation in Ontario.

a. Time periods for payment

The effective starting point for the prompt payment regime is the submission of a “proper invoice” from the contractor to the owner, following which the owner must pay the contractor within 28 days. The time requirements follow the flow of funds, and the contractor must pay its subcontractors within seven days of having received related amounts from the owner, and each subcontractor must then pay its own subcontractors within seven days of receiving funds.

The function of a “proper invoice” as a trigger for the payment obligation translates into the opportunity or risk, depending on one’s perspective, that parties will manipulate what constitutes a proper invoice for the purpose of controlling the process. The amendments to the Act respect freedom of contract, but also impose limits to curb potential abuse. Specifically, a proper invoice must meet the requirements specified in the contract, but the Act prohibits a proper invoice from being conditional on certification by a payment certifier or the owner’s approval (although this restriction is not applicable to Alternative Financing and Procurement (AFP) Projects, as discussed further below). During the passage of the Bill through the legislature, a provision was added to clarify that the prohibition against certification or owner approval does not prevent a proper invoice from being made conditional on testing and commissioning.

b. Bases for refusing payment

The prompt payment regime recognizes that there may exist legitimate reasons for a payer to refuse payment, such as deficiencies in the work performed, notwithstanding that the requirements of a proper invoice may have been satisfied. The regime articulates a process for non-payment and it imposes stringent timelines that must be adhered to, which is in keeping with the spirit of prompt payment.

If an owner intends to refuse to make payment, then within 14 days of receipt of the proper invoice the owner must give the contractor a notice of non-payment that sets out the amount not being paid and the reasons for non-payment.

The situation for a contractor or subcontractor that intends to refuse to make a payment is slightly different than that of the owner, due to their position within the payment chain. Specifically, if a contractor or subcontractor intends to refuse to make payment, then they must elect to base their refusal on: (i) not having received funds themselves due a non-payment, or (ii) disputing the entitlement of their payee. This election has important implications. If a contractor or subcontractor refuses to pay on the basis that they were not paid themselves, then they must pay through any amounts they receive and provide an undertaking to refer the matter to adjudication within 21 days of providing notice to their payee (unless such an undertaking was already given by a party higher in the payment chain). In contrast, if they choose to dispute the entitlement of their payee (essentially taking the fight on themselves), then they do not need to pay through amounts received or refer the matter to adjudication, but they must provide a notice of non-payment specifying the amount not being paid and detailing the reasons for non-payment.

Undisputed amounts must still be paid in accordance with the time periods set out in the Act, which may require that these amounts be apportioned among several payees. In such

circumstances, the prompt payment regime provides that payees not implicated in the dispute are to be paid in full, with the other payees implicated in the dispute to be paid on a rateable basis. In all other cases, all payees are to be paid on a rateable basis.

Adjudication

The amendments to the Act include the introduction of an interim adjudication regime, which is intended to promote the prompt resolution of disputes. Adjudication is viewed as a necessary adjunct to prompt payment for the purpose of ensuring that there is a rapid enforcement mechanism to support the objectives of timely payment. However, while the types of disputes referred to in the Act as the proper subject of an adjudication relate to payment, the scope of adjudication is broader and can include other matters to which the parties and the adjudicator agree.

a. The adjudication process

A party to a contract or subcontract can refer a matter to adjudication at any time prior to the contract or subcontract being completed, even if the matter in question is already the subject of a court action or arbitration. This right to refer a matter to adjudication is protected by the Act and the parties cannot contract out of interim adjudication.

The adjudication process is initiated when one party serves the other with a notice of adjudication, which must set out, among other things, a description of the dispute and remedy sought, as well as the proposed adjudicator – the adjudicator cannot be determined in advance by way of contract. If the parties cannot agree on an adjudicator, or the adjudicator does not agree to conduct the adjudication, within four days of the notice of adjudication, then the referring party must request the appointment of an adjudicator by the Authorized Nominating Authority (the Authority), and the Authority must make the appointment within seven days of receiving the request.

Once an adjudicator is selected, the party that initiated the adjudication must provide the adjudicator with the notice to adjudicate, the contract or subcontract, and any documents on which the initiating party wants to rely. The adjudicator will then conduct the adjudication in an inquisitorial manner and must make a determination within 30 days of receiving the documents from the referring party, subject to extensions that are agreed to by the parties. Any amounts payable in accordance with the adjudicator's determination must be paid within 10 days, and if such amounts are not paid then the unpaid contractor or subcontractor may suspend further work.

It is important to note that although adjudication will provide quick decisions to ensure that funds flow between the parties during the performance of the contract or subcontract, the determinations of adjudicators are interim and the parties may proceed to have the matter determined in accordance with their contractually agreed upon dispute resolution procedures or by the courts. However, the experience in the United Kingdom, which introduced adjudication almost 20 years ago, has been that parties tend to accept the decisions of adjudicators as final.

b. The Authority and adjudicators

The adjudication regime will be overseen by an organization called the "Authority", which will be designated by the Minister. The Regulations provide that the Authority will be responsible for adjudicator training programs, issuing certificates of qualification to adjudicators, maintaining a public registry of adjudicators, establishing a code of conduct, establishing a

fee schedule, and developing educational materials for the public. The Authority will be required to issue an annual report, to be publicly available, providing information on the number of adjudications, amounts both claimed and paid, fees owing and paid, as well as segregating the foregoing information on an industry sector basis.

The Regulations also address the requirements for an individual to become an adjudicator. Specifically, an adjudicator will be required to have at least seven years of working experience in the construction industry, and some or all of this experience may be from outside of Ontario. Adjudicators will also be required to have completed a training program for which the Authority is responsible, but this educational requirement may be waived by the Authority within the first year of the regulations coming into force. Adjudicators will be required to comply with the code of conduct, and the Authority may suspend an adjudicator's certificate of qualification if they cease to meet the requirements for the certificate, or are found to be incompetent or unsuitable to conduct adjudications.

Construction liens & holdback

The amendments to the Act do not alter the core principle that each payer upon a contract or subcontract under which a lien may arise must retain a holdback of 10%. However, there are important changes to the time periods relating to liens and the release of holdback.

a. Lien preservation and perfection

Holdback cannot be released until all liens that may be claimed against the holdback have expired, or have been satisfied, discharged, or otherwise provided for under the Act. With respect to the expiration of lien rights, the amendments to the Act will result in this occurring at a later point in time, as a result of the time period for the preservation (registration or delivery) of liens being increased from 45 to 60 days. Accordingly, the title search prior to making an advance under construction financing will now be conducted 61 days after publication of the certificate of substantial performance, rather than 46 days thereafter. On this point, however, note that the transitional provisions must be reviewed, which state that contracts signed or for which the procurement commenced prior to July 1, 2018 are grandfathered and dealt with under the old time limits. The transitional provisions are complex, and legal advice should be sought in that regard.

The time period for the perfection of a lien (commencing the action and registration of the Certificate of Action) will also be increasing, from 45 to 90 days, resulting in the combined preservation and perfection period lengthening from 90 days to 150 days. The purpose of these longer time periods is to allow more time for parties to resolve their disputes.

b. Early release of holdback

One of the issues on a large or lengthy project is that contractors or subcontractors that perform work early in the process may have to wait a long period of time, sometimes several years, after the completion of their own work before receiving their holdback. To address such issues, the Bill has introduced several mechanisms that will facilitate the early release of holdback on an annual, phased, or segmented basis.

The annual and phased release of holdback sections operate in a similar manner. In both cases, if the contract exceeds a prescribed amount (set by the Regulations at \$20 million) and the contract so provides, then holdback may be paid out annually or as phases of the work are completed, provided that as of the payment date there are no preserved or perfected liens, or all liens have been satisfied, discharged, or otherwise provided for.

Another amendment to the Act is a deeming provision pursuant to which multiple improvements under a single contract will be deemed to be separate contracts for the purposes of determining substantial performance and completion if: (i) each of the improvements is to lands that are not contiguous, and (ii) the contract so provides. An example would be a contract to construct multiple buildings in different locations throughout Ontario, and this deeming provision would allow the parties to agree to the release of holdback on a building-by-building basis, as opposed to having to wait until the completion of the last building to pay out holdback on the first.

P3/AFP Projects

The amendments to the Act take into account P3/AFP Projects, which were not contemplated when the last major amendments were implemented in 1983. These project structures involve a government entity entering into an agreement (the Project Agreement) with a special purpose entity (Project Co) to complete a project. It is Project Co that then enters into an agreement with the contractor.

Project Co will be deemed to be the owner for certain purposes, including the certification of substantial performance, expiration of liens, and requests for information. The agreement between Project Co and the contractor is deemed to be the contract for all of the foregoing, and holdbacks and substantial performance are to be determined based on this agreement.

After the introduction of the Bill, there was industry concern about risk being stranded at the Project Co level, and this section of the Bill underwent significant evolution before receiving Royal Assent. One of the amendments was to include a deeming provision that the Act will apply to the Project Agreement as if it were a contract, which extends the reach of prompt payment and adjudication to the upper tier of the project structure between the government entity and Project Co.

It is important to note that there are exceptions to the application of prompt payment and adjudication. In the case of the former, prompt payment does not apply to operations and maintenance, and the submission of a proper invoice may be subject to prior payment certification. In the case of the latter, certain determinations cannot be referred to adjudication, such as substantial completion of the Project Agreement, substantial performance of an agreement between Project Co and a contractor, and achievement of a payment milestone. Parties to the Project Agreement may also be constrained in their choice of adjudicator, as they must request the independent certifier (if one is specified in the Project Agreement) to serve in this capacity, provided that the independent certifier is an adjudicator listed in the registry.

The agreement between Project Co and the contractor will also be deemed to be a public contract *between the contractor and the government entity* for the purposes of mandatory surety bonding, which is discussed in the next section.

Mandatory surety bonding

The Act will require that certain surety bonds be provided in relation to a public contract, which is defined as a contract respecting an improvement if the owner is the Crown, a municipality, or a broader public sector entity.

A contractor to a public contract must provide both a labour and material payment bond and a performance bond. The Regulations provide that these bonds will only be required if the public contract price is \$250,000 or greater. If required, the Regulations require that the

minimum coverage for each bond will be 50% of the contract price up to a maximum of \$50 million in coverage (reached at a contract price of \$100 million).

[1] This paper is for general information only, and does not constitute legal advice. Advice from a qualified construction lawyer should be sought.

[2] *Construction Act*, R.S.O. 1990, c. C-30, section 34(9). (Not yet in force).

[3] *Construction Act*, R.S.O. 1990, c. C-30, subsections 44(1), (2.1) and (2.2). (Not yet in force).

[4] *Construction Act*, R.S.O. 1990, c. C-30, section 19(1). (Not yet in force).

[5] *Construction Act*, R.S.O. 1990, c. C-30, section 39(4) and 39(4.1). (Not yet in force).

[6] *Construction Act*, R.S.O. 1990, c. C-30, sections 1(1) ("improvement"), 1.1 and 1.2. (Not yet in force).