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BILL 69, THE PROMPT PAYMENT ACT - THE GOOD, THE BAD AND THE UGLY

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It is hard to object to the notion of “a fair day’s pay for a hard day’s work”, which is perhaps why Bill 69, the *Prompt Payment Act, 2013* received all party support when it passed second reading in the Ontario Legislature in May 2013.

For a Bill that proposes significant changes to some common industry practices, it is a little surprising how little attention Bill 69 has received in the construction industry as a whole.

Most private member’s bills do not become law and that may be the fate of this Act, but many in the industry think that this little Act has a more than passing chance. It is now with the Standing Committee on Regulations and Private Acts and several construction industry associations which are backing the Act have started to ramp up their efforts to push it forward. And, in a minority government under pressure to make peace with opposing parties to avoid an election, who knows? An Act which purports to assist the smallest player on construction projects could easily, and quickly, become law.

Nevertheless, there has not been any public consultations and awareness of the substance to date and impact of the Act is not widely spread, especially among developer, owner and project finance

groups.

If Bill 69 is ever to become law, it will need public consultation to iron out some uncertainties, and to address some obvious concerns with the Act as it is currently drafted.

Objectives

The Act focuses on three primary objectives: (1) prohibit all holdbacks on a construction project other than those required under the *Construction Lien Act*, (2) impose mandatory payment terms on construction parties, both in terms of timing and consequences of non-payment, (3) establish new financial disclosure obligations on construction parties.

The Act attempts to address a number of problems faced by contractors, all related to cash flow on the project, as the full name of the Bill suggests (*An Act respecting payments made under contracts and subcontracts in the construction industry*). None of the issues addressed in the Act are new issues. In fact, in some ways, the Act merely attempts to codify into law certain provisions that are often (but not always) found in construction contracts, including the CCDC standard form contracts.

However, in doing so, it will remove the freedom and flexibility of construction parties to negotiate specific terms for particular projects and impact the allocation of project risks. In setting out to protect contractors and subcontractors, it is not clear that the full impact of the proposed law has been fully considered: some of the unintended consequences of the cure may be worse for them than the disease.

Applies to All Contracts

The Act will apply to every construction contract or subcontract related to an improvement. Existing contracts are grandfathered, but all other contracts are deemed to be amended to comply with the Act.

It should be noted that the Act contemplates regulations that have not been drafted yet. These will no doubt provide for certain exceptions or clarifications relating to the application of the Act, such as perhaps smaller home renovations, but the clear intention of the Act is that it will apply to nearly all construction projects.

Prohibition on non-CLA Holdbacks

The Act changes industry practice on holdbacks. It will require the statutory holdback of the *Construction Lien Act* to be paid within one day after the applicable lien period ends. The Act also prohibits any holdbacks other than the holdbacks permitted or required to be withheld under the *Construction Lien Act*.

The only holdback that will be permitted under the Act is a holdback for amounts claimed in an invoice for which the payer objects within 10 days. It seems that this would prevent an owner from avoiding payment of an invoice even if a deficiency is discovered relating to prior, already paid invoices.

Final milestone payments, deficiency or completion reserves, set-offs will not be permitted under the Act. This appears to conflict with section 17(3) of the CLA, which allow set-off of claims and payments, as well as common law rights of set-off. The Act and the CLA will need to be reconciled before Bill 69 is to become law.

The Act will also prevent a payer from holding back any funds for deficiencies at the end of the

project when all progress payments have already been made since the Act requires payment of the statutory holdback the day after the end of the lien period and prohibits all other holdbacks. This is a significant change to customary industry practice in the interest of protecting contractors and suppliers.

If the *Prompt Payment Act* became law, owners, developers and project lenders, and even general contractors, will need to consider means of security and protection for deficiencies on projects other than retention of payment. This could include additional bonding, letters of credit or other financial security requirements. It could also result in an advantage for larger contractors with more financial backing and stronger balance sheets.

Mandatory Progress Payments

The Act will codify into law several payment obligations, effectively giving statutory force to some payment regimes that are common in some, but not all, contracts and giving them some teeth.

It establishes a progress payment regime for all projects. If your contract or subcontract provides for progress payments, then those progress payments will now become payable no later than 31 days after the first day that services or materials are supplied to the construction project.

If your contract does not provide for progress payments, then the Act requires an owner to pay its contractors within 20 days after submitting their monthly invoice and requires contractors to pay their subcontractors within 10 days after a payment certificate is issued or 30 days after the subcontractor submits its invoice.

Payment structures are designed to reflect a balance between cash flow and allocation of risk on the project. It is not clear how the Act will impact those many types of projects that do not fit neatly into a monthly progress payment structure. Many larger or multi-faceted projects are, for example, often paid on a milestone basis which would not be permitted under the Act. It is equally unclear how the Act will be applied to contractual relationships that involve a fee for ongoing operation and maintenance that includes some repair and occasional construction work. How are deposits treated under the Act?

There is also no protection in the Act for an owner that is relying upon project financing or landlord payments (for leasehold improvements), and has not received its advance on time.

So what happens under the Act if a payer doesn't pay on time? The Act, not surprisingly, provides payees with a few remedies that are not uncommon in construction contracts, and would now be statutorily enforceable in all cases.

Deemed Acceptance of Invoices

First, all invoices submitted by payees are deemed to be approved by the payer 10 days after the day the payee submits its invoice, unless the payer provides written notice of disapproval or amendment, with full particulars of the disapproval or amendment. This is a very short period of time, especially if third party engineers or municipal inspectors are required to certify payments or assess deficiencies.

Interest Charged

Second, all late payments will accrue interest from the date a payment was payable at the greater of (a) the prejudgment interest rate determined under the *Courts of Justice Act* and (b) the rate specified in the contract or subcontract.

"Pay when paid?"

Third, and perhaps most significant, the law permits a payee to suspend work or terminate a contract or subcontract if the payee is not paid a progress payment that the payee is entitled.

This new rule will apply to all payers, including general contractors which fail to pay subcontractors. This, of course, puts general contractors in a bind. What if they haven't been paid yet by the owner? They could be really squeezed. The Act gives them an out, or at least a bit of an out. There is a sort of "pay when paid" clause. If a contractor or subcontractor has not been paid a progress payment, then it does not have to pay further down to its subcontractors.

However, it is only a sort of "pay when paid" clause because there are two significant caveats. First, if a payee who is also a payer wants the protection of the "pay when paid" clause, it will have to either suspend its own work or terminate its own contract or start to enforce its lien rights for *every delayed payment*. This obviously will have an adverse impact on owner-contractor relations, financing for the project and scheduling.

Second, the protection only lasts until the *earliest* to occur of (1) the date that the contractor receives payment from the owner, (2) the date that the payment dispute is resolved or finally determined or settled, or (3) the date that its lien rights expire. Ultimately, a general contractor will have to either pay out of its own pocket to keep the peace on the project, or it will have to pay or start fighting the owner for payment.

Right to Information

The third objective of the Act is to impose more financial transparency on projects to the benefit of contractors and subcontractors. It attempts to accomplish this by establishing two disclosure obligations: one on the owner and one on all other payers including general contractors.

Ability to Pay

Before entering into a construction contract, the Act will require that an owner demonstrate to its contractor that it has the financial ability to pay for the project. It is not clear how this would get satisfied since regulations have not been drafted yet.

The CLA imposes certain financial obligations on construction parties, but these principally relate to limited financial status items relating to the project and not the owner's financial strength or solvency or liquidity. The Act will go much further and require disclosure of confidential, personal or commercial information such as a business' operational revenues, a homeowner's salary, details about lending terms, etc.

The Act does impose some confidentiality obligations, but in practice it is difficult, if not impossible, to prove that a particular contractor breached the confident obligations. It is not clear whether owners, developers and municipalities will take any comfort from the Act's confidentiality protections.

There are some further disclosure items like updates. The failure of an owner to disclose what it is required to under the Act, or to provide incorrect information negligently, will make the owner liable to contractors and subcontractors for any damages sustained by reason of the failure to make the disclosures properly.

Receipt of Payments

Once the project gets underway, there is a disclosure obligation on payees. Whenever a contractor

or subcontractor receives a payment on the project, it must promptly notify all of its subcontractors of the payment and must post the information on a website that can be accessed by those subcontractors. Some general contractors have expressed concern regarding the heavy administrative burden this imposes on contractors, especial on large projects with hundreds or thousands of subcontractors and suppliers. The computer systems and project management requirements resulting from the Act may provide larger general contractors with an advantage over newcomers or small players.

Next Steps

As noted at the outset, the *Prompt Payment Act, 2013* is now before committee and has not yet been brought forward to the committee's agenda for discussion. Some MPPs, in speaking on the Act in the Legislature, noted that several concerns would need to be addressed in committee. To date, the bill has not had any public hearings or even any invitation for public comment, and hopefully it will.

Gowlings' Construction Law Group is following the course of the Act closely as it will have a direct and significant impact upon many of our clients and the industry as a whole.