THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

Expert Review of a Legislative Scheme for Federal Construction Contracts

CANADIAN BAR ASSOCIATION
CONSTRUCTION AND INFRASTRUCTURE LAW SECTION

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500–865 Carling Avenue, Ottawa, ON, Canada K1S 5S8
tel/tél. 613 237-2925 • **tf/sans frais** 1-800 267-8860 • **fax/téléc**. 613 237-0185 • cba.org • info@cba.org

PREFACE

The Canadian Bar Association is a national association representing 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the CBA Construction and Infrastructure Law Section, with assistance from the Legislation and Law Reform Directorate at the CBA office. The submission has been reviewed by the Law Reform Subcommittee and approved as a public statement of the CBA Construction and Infrastructure Law Section.

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I. INTRODUCTION

The Construction and Infrastructure Law Section of the Canadian Bar Association (the CBA Section) is pleased to comment on the expert review of prompt payment and adjudication of federal construction contracts led by Bruce Reynolds and Sharon Vogel of Singleton Urquhart Reynolds Vogel LLP (the Expert Review). We are responding to the request for comments outlined in the February 2018 Information Package.

The CBA Section comprises lawyers across Canada with expertise in construction and infrastructure law, who act for a broad cross-section of stakeholders in the construction industry, including public and private owners, building code authorities, contractors and subcontractors, construction lenders and insurers, construction professionals and construction industry associations. In our CBA Section role, we do not speak for, nor represent their individual interests.

The CBA Section has closely followed developments in prompt payment legislation across Canada. In November 2017, we wrote[1] to the Minister of Public Services and Procurement urging the federal government to undertake broad stakeholder consultation before introducing any prompt payment legislation in the construction industry. Prompt payment legislation will have significant and direct impacts on commercial arrangements throughout the country and the CBA Section applauds this Expert Review and its consultation process. Further, we recommend that the mandate and timelines of the Expert Review be extended through the legislative drafting stage, and that stakeholders be afforded an opportunity to comment on the Expert Review report.

Below, we offer our comments on a proposed federal legislative scheme.

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1 See CBA Section letter to Minister of Public Services and Procurement, November 9, 2017, available online (https://bit.ly/2HHbV4l).

II. A WORKABLE SYSTEM – HARMONIZATION, CLARITY AND FLEXIBILITY

The CBA Section brings a unique perspective to this Expert Review, as our members practice in all jurisdictions of Canada. We share developments in construction law, and often discuss the marked differences across the country, both in practice and in principle. While we applaud efforts by the federal government to ensure prompt payment in the construction industry, we foresee challenges in a national system, particularly given the myriad rules that exist across the country. We recommend a modest workable system, and our comments are largely informed by this perspective.

We note the differences across Canada to illustrate the complexity in introducing prompt payment legislation at the federal level. Ontario recently implemented a novel prompt payment and adjudication scheme. It is comprehensive and extends far beyond that of most jurisdictions. However, it will require significant financial investment from the provincial government. Other jurisdictions are considering more modest ways to modernize their legislation. For example, in British Columbia, the Law Institute has undertaken a review of its legislation and will prepare a report and recommendations to the government; in Manitoba, the Law Reform Commission has released a consultation paper on its legislation and is seeking feedback, and in New Brunswick, the Attorney General's Legislative Services Branch has published Law Reform Notes to gather feedback on aspects of its legislation in relation to the three pillars of the Ontario reform – modernization, prompt payment and adjudication.

Quebec is also carefully studying prompt payment options. The province implemented a pilot project in December 2017[2] testing various measures aimed at facilitating the payment of enterprises that are a party to public contracts or subcontracts. These measures may include the use of payment calendars, a dispute settlement mechanism and accountability reporting mechanisms, based on terms and conditions determined by the Chair of the Québec Treasury Board. The pilot project will run for three years, after which a report will be published.

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[2] On December 1, 2017, Québec adopted Bill 108, *An Act to facilitate oversight of public bodies' contracts and to establish the Autorité des marchés publics*, which amended the *Act respecting contracting by public bodies* to, amongst other things, allow the Chair of the Conseil du trésor to authorize implementation of this pilot project.

Some jurisdictions in Canada continue to rely on statutes that have been amended piecemeal over many years and appear long overdue for reform.[3] The CBA Section is concerned with the challenges stemming from a lack of uniformity in legislation across Canada and that this may be exacerbated if another unique legislative scheme is implemented at the federal level. Given that Ontario has done a complete overhaul of its regime, and jurisdictions undertaking reform efforts are looking to Ontario's approach, the Expert Review should consider if the federal legislation could run lock-step with any elements of the Ontario model to address some of these existing jurisdictional challenges. When weighing options for reform, the Expert Review, and other provinces and territories across the country, would be well served by promoting values of harmonization and clarity as much as possible in the circumstances. Flexibility should also be encouraged as much as possible to avoid stifling innovation in complex federal projects.

The CBA Section is also of the view that Bill S-224*, Canada Prompt Payment Act*, contains significant flaws and that the federal government, should it introduce prompt payment legislation, would be well served by drafting legislation separate and apart from Bill S-224.

III. PROMPT PAYMENT

The CBA Section supports efforts to effect prompt payment in the construction industry. Similar to the Construction and Infrastructure Law Section of the Ontario Bar Association (a Branch of the CBA), we encourage the Expert Review to consider the broad impact of prompt payment legislation on the many stakeholders in the construction industry, including owners, contractors, sureties and lenders.

A. Application

Federal Projects

The CBA Section questions the scope and kinds of contracts to which a federal scheme should apply. Our concerns stem from overlapping jurisdictions, unnecessary complexity and potential conflicts.

We recommend that any federal legislation apply to projects where the federal government is both the owner of the project and the lands on which construction is taking place (we see this

[3] See, for example, the New Brunswick *Mechanics' Lien Act*, RSNB 1973, c M-6, enacted in 1973; the Saskatchewan *Builders' Lien Act*, SS 1984-85-86, c B-7.1, enacted in 1984; and the Northwest Territories *Mechanics' Lien Act*, RSNWT 1988, c M-7, and Prince Edward Island *Mechanics' Lien Act*, RSPEI 1988, c M-4,both enacted in 1988.

as clearly federal jurisdiction). We also recommend that federal legislation apply to any contract with a Government of Canada department, agency or crown corporation, for improvements or supply of services, and in relation to any land owned or directly controlled by the Government of Canada, and any improvements to the interest of the Government of Canada in any land (tenant improvements or repairs). Bill S-224, as currently drafted, creates confusion as to how it would apply to different project delivery models. Clear statutory language is necessary in any federal scheme to give certainty to stakeholders.

The CBA Section recommends that federal legislation not apply where the federal government has a limited role or interest in a project, such as where the project is not entirely federally funded, on lands not owned by the federal government. We also recommend that projects should not be under the application of federal legislation solely by virtue of being a federal undertaking (e.g. a pipeline or airport). Issues of jurisdictional overlap already arise in these types of projects, with associated confusion and burden on stakeholders. A federal scheme should not add additional complexity, cost and confusion. As well, these types of projects may already be subject to prompt payment legislation under provincial jurisdiction.

Public-Private Partnerships

The CBA Section sees no reason to exclude public-private partnership (P3) projects from the proposed federal legislation. P3 contracts at the local trade levels are not dissimilar to the typical general contractor (GC)/subcontractor contracts – they are still relatively conventional projects at this stage – which should warrant inclusion in prompt payment legislation. Should the government decide that P3 projects are appropriately included in the scope of the legislation the CBA Section recommends that the Ontario approach be adopted at the federal level.

International Projects

International projects, such as an international bridge commission/authority, may also require special consideration. For simplicity, we recommend that these projects be excluded from the scope of federal legislation.

Prescribed by Legislation/Regulation

Notwithstanding the above, the CBA Section appreciates that limiting prompt payment legislation to federal projects on federal lands may pose challenges. An alternative may be to expressly list the types of projects to which prompt payment legislation would apply, either by

legislation or regulation. This approach is used in other contexts where there is a potential for overlapping jurisdiction, as a means of providing clarity and certainty. For example, the *Canadian Environmental Assessment Act, 2012*[4] contains a project list approach (rather than a trigger approach), whereby projects are designated by regulation or by Ministerial order.

Parties

Some members of the CBA Section recommend that prompt payment run all the way down the contractual construction pyramid. Issues with timeliness of payment often occur further down the contractual chain, beyond the GC/owner, as those parties lower in the pyramid often lack leverage, power and protection in contractual relationships. They would benefit significantly from prompt payment. Any federal legislation should also be consistent with the *Financial Administration Act*. Other members of the CBA Section question the practicality of applying prompt payment down the contractual chain, since a GC may subcontract portions of their work under different payment structure such as unit rates or milestones. To address this issue, the CBA Section recommends that a federal legislative scheme balance freedom of contract (for example, by allowing the GC/owner to adopt varied payment structures) with statutory intervention to ensure that payment flows (for example, by adopting shorter time periods for payment to lower tiers on the pyramid).

Another challenge when applying a prompt payment regime down the construction pyramid is ensuring that funds actually flow down with properly spaced intervals between tiers. The CBA Section encourages the Expert Review to consider a relative pay period between each tier in the pyramid. The Ontario model would be a suitable example for tiered payment, with its 28-7-7-7 timing. Prescribing a fixed date by legislation for only two tiers, as contemplated by Bill S-224, will create problems for subsequent tiers.

B. Project Value Threshold

There may be some discussions as to whether a minimum project value threshold should apply for prompt payment. Although we understand the appeal of a minimum threshold (e.g. $100,000 threshold) to avoid a legislative burden on small contractors, there are persuasive countervailing arguments First, a dollar threshold may lead to confusion where, for example, a contract starts at $90,000, and through change orders becomes $110,000. Second, smaller

4 S.C. 2012, c. 19, s. 52.

subcontractors are likely the most vulnerable and would benefit from the protection of the proposed legislation.

C. Invoicing and Payment Schedule

Submitting a proper invoice should be the trigger to start the clock running on the prompt payment periods, however defined. The CBA Section believes, however, that parties ought to be left to negotiate invoicing terms best suited to their specific project and business needs, as in Ontario. We also recommend that milestone payments be permitted, and do not support the prohibition on milestone payments in Bill S-224 (section 11(1)). If a payer and payee agree that milestone payments are appropriate for the subcontract work, it is unclear what interest the federal government has in forcing them to use invoicing terms incompatible with their business interests.

The CBA Section recognizes that a clear regime for timely invoices is necessary for prompt payment to work. There is some disagreement, however, amongst our members as to whether there should be complete freedom of contract or a minimum interval such that payment cannot take place on an interval slower than the payment schedule between the government institution and general contractor. The payment periods established in Ontario appear to be reasonable, and we would support a consistent approach across jurisdictions. Most members also support the Ontario approach of an implied minimum term, such as a monthly payment of 28 days.

In the context of milestone payments, some members encourage requirements for written/email/posted notice of milestone payments by a GC before entering into a construction contract (similar to section 11(2) of Bill S-224). This type of requirement gives clarity to payers and payees and is in the best interests of all parties.

D. Payment Triggers and Certification

The CBA Section supports the Ontario approach of prohibiting certification as a precondition to a proper invoice because it would remove an impediment to payment flowing down the chain. Issues of payment certifiers delaying payment by refusing to certify work are all too common in the construction industry. The one exception would be for P3s projects, similar to the Ontario model, where certification is a necessary step on account of the financing machinery in place. Section 7(3) of Bill S-224 does not address these delays in approval of certification of

payment applications, and again we recommend a payment period triggered by submitting a proper invoice.

Any legislation will require clear drafting of terms such as proper invoice, certification and approval when outlining payment triggers. Outlining a minimum standard for a proper invoice, and allowing parties the freedom to negotiate additional inclusions appears to be a rational approach to ensuring flexibility in the prompt payment system for varying project sizes.

With respect to payment applications, Bill S-224 contains a deemed approval of payment applications (see section 16). While deemed approval can create clarity and is fundamental to the objectives of prompt payment, we caution against tying payment in this manner without adequately addressing the timing of payment throughout the entire payment stream. Timing requirements help ensure that payments are not out of sync down the chain and that parties are not forced to make downstream payments when there is no assurance of upstream payments. This would be onerous on subcontractors and suppliers further down the chain and could impact solvency. As well, we recommend allowing sufficient time between receipt of the application and the deeming, to ensure payers have time to adequately verify the work after an application has been received.

E. Disclosure Obligations

The CBA Section believes it would be beneficial for basic payment information[5] to be easily accessible, and recommends either requiring it to be publicly posted (where possible), or mandating that it be made available upon request, with five to seven days' notice. We suggest looking to existing lien legislation in Ontario and BC.[6] Most members of the CBA Section are of the view that payment information should be limited in scope. It would be challenging, for example, to ask a GC to submit detailed payment information that may include sensitive pricing information, or to break down progress draws by line item or subcontractor work components, each and every month; the burden would be unnecessarily severe.

F. Remedies and Consequences of Non-Payment

Notice Requirement

To manage issues with non-payment and its impact on the construction pyramid, some CBA Section members suggest a formal notice requirement if an owner or GC does not intend to pay.

5 For example, information such as date, amount, and proper invoice reference number.

6 See Ontario's *Construction Lien Act,* RSO 1990, c 30, s. 39 and BC's *Builders Lien Act*, SBC 1997, c 45, s. 41.

Notice of non-payment could be required at several levels to increase communication about payment on projects, and failure to provide notice could result in mandatory payment. Payment disputes, as indicated in a standard notice, could proceed by way of an efficient dispute resolution system, for example, a separate adjudication scheme or contractual dispute resolution. After a decision or determination is made, a process would need to be established to enforce payment, where applicable.

Trust Schemes

Some CBA Section members also propose adopting consequences for failure to pay. If trust rules were adopted, holding officers and directors[7] personally liable for any failure to pay project beneficiaries (i.e. diversion of payments outside of a project stream, as in several provincial builders' lien acts) would be a new remedy available to payees. Those members note that many contractors in Canada are working in provinces that have already adopted trust/trustee schemes to protect funds in the construction space, so this would not be a major change from existing practice. Currently, the Northwest Territories, Yukon, Nunavut, Prince Edward Island, Newfoundland and Quebec, do not have trust provisions. We recognize that implementing a trust scheme would be a significant departure for these jurisdictions and would require careful consideration. There are many complications associated with establishing a trust scheme where there are none (notwithstanding the challenges posed by the existing jurisdictional schemes).

Bonding

The CBA Section also recognizes that most federal projects request bonding, and we recommend that federal projects continue to request or require bonding. Performance and payment bonds offer assurances that projects will be completed in the event of a general contractor default, and also ensure all sub-trades and suppliers have recourse in the event of non-payment. Sureties also continuously monitor bonded projects and contractors, and have the ability to track any failures to pay or aged payments accruing.

Suspension and Termination Rights

Some of our members recommend that suspension and termination rights be available for non-payment, similar to the Ontario approach. These members note that a suspension right is

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7 Along with any other person that knew or ought to have known, or acquiesced to the breach, for example, following common wording of trust remedies in lien legislation across Canada.

clearly contemplated by the standard form contracts endorsed by the Canadian Construction Documents Committee. However, Bill S-224, as drafted, raises serious concerns, as an immediate right to suspend discourages negotiation and other informal means of dispute resolution and instead allows payees to exercise the "nuclear option" very early in the process (with negative consequences for all parties and the project). We recommend the Ontario model be followed, and not the model contained in Bill S-224.

Alternatively, the federal government could look to standard form contracts prepared by the Canadian Construction Association, as well as US legislation that requires GC payment to sub-trades in a stipulated time from receiving payment.

G. Set-Off Rights

The CBA Section urges caution in interfering with set-off rights. The federal government should be reluctant to restrict set-off rights (as set out in section 22 of Bill S-224) as the implications could be severe, particularly in the case of bankruptcy. If a GC becomes bankrupt, without the right of set-off, the government may be forced to make payment to a receiver instead of using contract funds to complete defective work. Conversely, an owner's set-off rights are often abused toward the end of the project. For example, on substantial completion, a deficiency holdback may be established, the GC then dutifully completes the deficiencies only to find an increasing number of excuses as to why it will not be paid. Cross-contractual set-off rights between GCs and federal owners typically exist already, with significant potential consequences, especially in some of the larger federal infrastructure projects – if a major GC went under, protection of the lower tiers on many projects could be in jeopardy. Similarly, a lack of set-off rights could prejudice a surety's subrogration rights.

IV. ADJUDICATION

A. Appropriateness in the Federal Context

Payment delays are tied to the timely resolution of disputes and therefore an effective dispute resolution system is an important part of improving the promptness of payment. However, some members question whether adjudication is appropriate in the federal context, notwithstanding political will to adopt an adjudication system. The scope of federal projects, combined with the vastness of Canada, raises question about the efficiency of a federal adjudication process in the traditional sense; in-person adjudications appear impractical.

These same challenges are less likely in smaller geographical areas, such as a single province or territory, as opposed to all of Canada.

The CBA Section suggests letting the Ontario adjudication process unfold and seeing what lessons can be learned before implementing something similar at the federal level. [8] Adopting a sophisticated adjudication process such as in the United Kingdom, or more recently, Ontario, would be a significant change requiring considerable resources. For example, the UK model requires a GC to expend considerable time and money to document projects in case a dispute arises. This may not be feasible or cost effective for certain types of projects, unless alternative solutions are explored. The UK also has a different constitutional structure than Canada.

Other CBA Section members suggest, given that there is only one owner in the federal context, that greater attention be placed on standard form procurement documents, to strengthen existing dispute resolution processes. Having the dispute resolution process in procurement documents, as opposed to legislation, would offer parties greater flexibility to make changes in the future. What's more, the existing dispute resolution system in most federal procurement documents, although not without challenges or concerns, appears to be working relatively well.

Alternatively, a legislative scheme could include adjudication as a default, unless the federal entity has a fast track dispute resolution mechanism to ensure that disputes are resolved in a set number of days. We encourage the Expert Review to look at existing federal dispute resolution models.

A further option is a model adjudication 'light' process included in federal contracts, whereby payment disputes are subject to a 30-day decision-making process, or any dispute resolution process is conducted by arbitrators or mediators on shortened timelines.

B. Appointment and Qualifications

If an adjudication process is implemented through federal legislation, the CBA Section supports the establishment of an Authorized Nominating Authority (ANA), similar to the UK approach for nominating adjudicators. The CBA Section views an ANA as an essential element of a successful prompt payment adjudication system. Given the need to resolve disputes in a timely manner, it would be too time consuming to have court appointed adjudicators.

8 This could be achieved through staged implementation, as discussed below.

However, we foresee a number of challenges with establishing an ANA at the federal level, including determining who will run the authority and who will fund it. We anticipate a limited desire on the part of the federal government to organize, fund, staff and administer an entirely new federal authority. But, as we have previously stated, [9] setting up an effective adjudication system requires active engagement, commitment and funding from the department charged with its administration.

What's more, establishing a sufficient body of qualified adjudicators may prove difficult. A federal adjudication process will require more adjudicators than the Ontario model, for example, to cover the volume of federal contracts and their associated disputes. Particular qualifications, namely knowledge and expertise in the unique federal construction industry, may also be in short supply. The CBA Section suggests that the federal government consider recognizing adjudicators already certified under a provincial or territorial regime to manage some of these resource challenges, as authorities are established across the country.

The CBA Section also urges the federal government to be sensitive to regional and local differences in the construction industry and the challenges it poses. For example, many disputes are sensitive to local building codes and practices, which would make it difficult for an Ontario-based adjudicator to effectively adjudicate a Nova Scotia matter, notwithstanding that the federal law governing the projects and the contracts is the same. As well, given that adjudicators ought to, and are expected to have, significant construction expertise (and not all lawyers), the inherently local nature of construction will require an extensive breadth and density of adjudicators (more than may currently be under consideration). Adjudicators will need to be extensively trained and developed for a federal adjudication scheme to be practical and effective.

We also wish to raise the issue of procedural fairness. In particular, an actual or perceived conflict of interest may arise in a federal prompt payment adjudication scheme given that the federal government would likely be a party to disputes and may also fund the project.

C. Types of Disputes

The primary purpose of a federal adjudication process should be to resolve payment disputes. In Ontario, disputes other than payment disputes are also eligible for adjudication, on agreement of the parties. Allowing greater scope in what is subject to adjudication may give

9 *Supra* note 1.

parties much sought after flexibility, but care should also be taken to specify what is and is not subject to adjudication. For example, some jurisdictions outline particular circumstances in which a bona fide dispute has arisen justifying a right to withhold payment. The CBA Section supports this approach as it would gives greater clarity to stakeholders and may reduce certain types of disputes.

All parties should be subject to, and be able to, initiate adjudication when there is agreement. Parties should also be able to consolidate, on agreement, akin to the Ontario model. Further, at the GC level, parties should be able to consolidate by right to avoid being trapped in a subcontractor/ owner fight. We also recommend following the Ontario model for who can adjudicate a dispute, but recommend a time limitation on initiating adjudication to avoid the risk of "adjudication by ambush" where one party amasses an enormous claim and drops it on the other side with little or no time to respond.

D. Implementation

The federal government should give time for the novel Ontario adjudication scheme to be established before any rules for a federal scheme are finalized or come into force. Ontario will have the first statutory adjudication model in the Canadian construction industry and it will not come into force until October 2019.

The CBA Section also suggests that the timeline for implementing a federal adjudication model and its mechanical details be set in regulation. This will allow flexibility to amend the adjudication scheme if necessary. We also recommend waiting until well after Ontario's rules come into force before any federal regulations are finalized or in force. This will give ample time to respond to lessons learned from the Ontario model and for industry to adapt and comply before regulations come into force. As a consequence, we see a continuing need for the Expert Review, and for further consultation.

V. JURISDICTIONAL OPERATION

The CBA Section recommends that the scope of jurisdictional operation be modest. Any federal prompt payment legislation must carefully consider the constitutionality of including projects that are not wholly federally funded or financed and constructed on federal lands. Section 91(1)(a) of the *Constitution Act, 1867* grants federal jurisdiction over federal property and public debt, but our understanding is that, generally, the regulation of construction contracts falls under provincial power pursuant to the property and civil rights powers in section 92(13).

Federal legislation should also consider existing jurisprudence, particularly to avoid conflict between provincial lien legislation and obligations on federal lands. There are no lien rights to federal lands. However provinces differ in whether holdback or trust obligations arise on projects involving federal lands (even if lien rights do not). Certainly, holdbacks can be allowed or imposed by contract in federal projects as a matter of contract law. Typically though, holdbacks are thought of as a companion concept to a lien right, where the lien represents a charge against the holdback maintained to protect, in part, downstream suppliers and subcontractors. One exception might be the imposition of a trust regime for holdbacks or on amounts owing to or received by a contractor or subcontractor (but not an owner's trust). The CBA Section encourages careful consideration of these issues to avoid further exacerbating the patchwork of rules across the country. Stakeholders will benefit from an effective and efficient scheme for federal projects.

The CBA Section has not commented on how federal legislation would interact with Indigenous property and treaty rights, when First Nations reserve lands are incorporated into, or involved in federal projects as it is beyond our purview.

VI. CONCLUSION

The CBA Section is pleased to offer our perspective on the Expert Review and we support efforts to effect prompt payment in the construction industry. We trust that our comments are helpful and we would be pleased to discuss any of the above in more detail.