



#41: May 2018

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## Law Reform Notes

Legislative Services Branch, Office of the Attorney General  
Chancery Place, P.O. Box 6000, Fredericton, N.B., Canada E3B 5H1  
Tel.: (506) 453-2855 E-mail: [lawreform-reformedudroit@gnb.ca](mailto:lawreform-reformedudroit@gnb.ca)

*Law Reform Notes is produced in the Legislative Services Branch of the Office of the Attorney General. It is distributed to the legal profession in New Brunswick and the law reform community elsewhere, and is available on the Office of the Attorney General's website. The Notes provide brief information on some of the law reform projects currently under way within the Branch, and ask for responses to, or information about, items that are still in their formative stages.*

*We welcome comments from any source. If any of our readers are involved either professionally or otherwise with groups or individuals who may be interested in items discussed in these Notes, we encourage them to let them know what the Branch is considering and to suggest that they offer their comments.*

*Opinions expressed in the Law Reform Notes merely represent current thinking within the Legislative Services Branch on the various items mentioned. They should not be taken as representing positions that have been taken by either the Office of the Attorney General or the provincial government. Where the Office or the government has taken a position on a particular item, this will be apparent from the text.*

*Responses to the items below should be sent to the address above or to [lawreform-reformedudroit@gnb.ca](mailto:lawreform-reformedudroit@gnb.ca). We would like to receive replies no later than **July 15, 2018**, if possible. We welcome suggestions for additional items which should be studied with a view to legislative reform.*

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### **1. Powers of attorney legislation**

In the previous issue of the *Law Reform Notes*, we outlined our plan to propose a new Act on powers of attorney and discussed a few specific issues – an optional standard form power of attorney, measures to protect donors from financial abuse, concerns relating to financial institutions, and the relationship between powers of attorney for personal care and health care directives.

The responses we have received indicate that there is support for a new Act, for an optional standard form and for measures aimed at reducing financial abuse, including notice requirements and the ability to appoint a “monitor”.

There is also support for the creation of a system through which suspected abuse of a power of attorney could be reported to a public body and investigated. Over the past few months we have explored this idea

and attempted, without success, to identify a body that currently has the expertise and resources to administer such a system. We have also come to appreciate that abuse of a power of attorney is only one method by which financial abuse can be perpetrated. We have therefore come to the conclusion that a system for reporting and investigating is beyond the scope of this project.

This raises the question of what, if anything, the new Act should say about suspected abuse of a power of attorney. Our inclination at present is to propose that the Act allow a person to report suspected abuse to the monitor designated in the power of attorney or to any alternate attorney. The monitor or alternate attorney would then be in a position to address the matter informally or, if necessary, to take formal measures such as a report to the police or an application to the court for the removal of the attorney.

We are also considering whether the Act should provide that a financial institution may refuse to disburse funds, or disburse only a limited amount, to an attorney if financial abuse is suspected. Some provinces provide for this, and it is our understanding that some financial institutions already do this in certain circumstances. We think it might be helpful for financial institutions to have clear authority to withhold funds, as this could encourage them to intervene and preempt financial abuse.

In the previous issue we discussed a few options for dealing with the overlap between powers of attorney for personal care and health care directives under the *Advance Health Care Directives Act*. The comments we have received indicate that the preferred option would be to incorporate the provisions of the AHODA into the new powers of attorney Act – in other words, to repeal the AHODA and replace it with a comprehensive Act that deals with powers of attorney (for personal care and property) and health care directives and proxies. We are currently working with the Department of Health, which is responsible for the AHODA, to see whether this is a viable solution.

We thank everyone who has provided comments on this project, and invite further comments in relation to the above discussion or any other aspect of powers of attorney.

## **2. Mechanics' Lien Act**

In *Law Reform Notes #40*, we outlined our plans to modernize the *Mechanics' Lien Act* ("the Act"), setting out several potential reforms. In that issue, we focused mainly on the modernization of the existing Act, inviting comment on several potential changes. In this issue, we focus on prompt payment, expedited interim dispute resolution and three further issues relating to modernization: Crown immunity, the *Crown Construction Contracts Act* claims process and bonding on public projects.

We welcome feedback on the issues raised in issue #40 or below, as well as issues that have not been raised but are important to readers. We also reiterate our interest in hearing how these issues might be addressed on a practical basis.

### **Feedback on issue #40**

We begin by summarizing the feedback on issue #40. We were pleased to receive a number of detailed responses, including from the CBA-NB Construction Law Section ("CBA-NB") and various industry stakeholders, most of which were supportive. Only a selection of the feedback is addressed below, but all will be taken into consideration as we develop our proposals. We thank all who shared their insights.

#### **Definitions**

There is support for amending the definitions of "owner" and "improvement". Other suggestions included:

- including "fixtures" in the definition of improvement;
- clarifying that "services" (in the definition of "work") includes the services of engineers and architects; and

- clarifying some definitions (e.g. “completion”) and adding others (e.g. contract, materials, price, subcontract).

## Liens

### *Procedure*

In issue #40, we asked about the procedural difficulties associated with vacating liens by posting security. It is clear from the submissions that this is not the only element of lien procedure that is problematic. For example, the CBA-NB suggested that the Act likely does not reflect current practice with respect to filing or registering claims for lien and that this should be remedied. The CBA-NB and others suggested that the procedure for filing liens against condominiums, subdivisions and leases could also be simplified and/or codified. It was also suggested that the Act should be flexible enough to accommodate changes in procedure and technology (e.g. allowing for the possibility of filing and vacating liens electronically).

The CBA-NB also suggested that the process of vacating liens, which it described as time-consuming and cumbersome, should be simplified. It suggested adopting a procedure that allows liens to be vacated without notice, provided the party bringing the motion pays into court or posts security in an amount equal to the face value of the lien, plus an amount for security for costs (see, for example, s. 44 of the Ontario *Construction Lien Act*).

The CBA-NB further suggested that, where the amount of a lien is disputed, or liens are “stacked”, there should be a summary way for the parties to go before the court to determine the proper amount of security to be posted. This would include the right to file affidavits and to cross-examine the affidavits on a claim for lien.

It was also suggested that it should be possible to post security to vacate a written notice of lien made pursuant to subsection 16(1) of the Act.

### *Abuse of lien rights*

Response to the suggestion of creating a specific right of action for damages caused by abusive lien claims was somewhat mixed. The CBA-NB took no position, except to note the issue could be dealt with through the Rules of Court and costs consequences. The contractors who responded were in favour of making it easier to challenge abusive claims. It was also suggested that the consequences (i.e. costs) for parties who filed such claims should be meaningful.

### *Preliminary notice to owners (uninformed householder)*

Response to the suggestion of preliminary notices to owner was also mixed. While there was some support for giving owners advance notice that a contractor/supplier is contributing to an improvement, there was little enthusiasm for requiring advance notice of actually filing a lien. Readers expressed concern that this might simply trigger owners to stop payment, rather than encourage dispute resolution.

We were also asked to clarify whether these notices would apply only to residential construction or to all construction projects. We have not reached a firm conclusion on this point. Though the rationale for the notices originates in the residential context, we can see how they might also be of benefit on non-residential projects. It may also be difficult to draw a clear line between what is a “residential” project and what is not.

## Holdbacks and substantial performance

### *Substantial performance – definition and notice*

There is strong support for defining “substantial performance” and for making the definition formula-based (in addition to requiring that the improvement be in use, or ready for use). The formulae in other provinces are similar to one another in form, but use a range of threshold values. For example, the Ontario definition provides, in part, that a contract is substantially performed when the improvement can be completed (or a known defect corrected) for not more than:

- (i) 3 per cent of the first \$500,000 of the contract price,
- (ii) 2 per cent of the next \$500,000 of the contract price, and
- (iii) 1 per cent of the balance of the contract price.

As of July 1, 2018, the \$500,000 figure will be increased to \$1,000,000. Alberta, British Columbia, and Saskatchewan use \$500,000; Newfoundland and Labrador and Manitoba use \$250,000. In Nova Scotia, substantial performance is reached when the cost of the work to be done can be completed or corrected for not more than two and one-half percent of the contract price.

There is also support for improving communication of the fact that substantial performance/completion has been achieved. This would likely include requiring the use of certificates of substantial performance/completion (for contracts and sub-contracts, respectively) in a prescribed form (similar to Forms 6 and 7 in Ontario) and posting notice of substantial performance/completion at the job site and on an online registry similar to that created/managed by the Construction Association of Nova Scotia. We are open to expressions of interest from organizations willing to do the same in New Brunswick.

### *Release of holdback – early and mandatory*

Support for facilitating early release of holdback was somewhat mixed. Recall that three specific changes were suggested:

- allowing the owner and the general contractor to certify that a sub-contract is substantially performed/complete (where there is no architect, engineer, or other payment certifier);
- where certification is refused, allowing a subcontractor or contractor to apply for a declaration of substantial performance/completion; and
- clarifying that owners are protected from later lien claims and that early release applies to the main contract and subcontracts.

The CBA-NB agreed there are impediments to partial release of holdback, particularly for early contributors, but did not comment on the specific suggestions. One industry group supported certifying subcontracts as complete, provided the Act is permissive; an individual contractor expressed concern about the possible impact of the changes.

Two submissions addressed mandatory release of holdback. Both were supportive, with the caveat by one that it be on a “pay when paid” basis.

Based on the feedback, we favour the following certification and holdback release scheme:

- Substantial performance – At the request of the contractor, the payment certifier (i.e. architect, engineer or any other person upon whose certificate payments are made) *must* determine whether the contract has been substantially performed. If it has, the payment certifier *must*

provide a certificate of substantial performance (in the prescribed form). If there is *no* payment certifier, the owner and contractor must make the determination together and provide the certificate.

- Release of “basic” holdback (s. 17) – As in Ontario, release of the main or “basic” holdback will be mandatory (provided 60 days have passed and all liens, if any, have been dealt with).
- Early release (s. 15) – At the request of a contractor or subcontractor, the payment certifier *may* determine whether a subcontract has been completed. Where there is no payment certifier, the owner and contractor together *may* do so. If the subcontract is complete, a certificate of completion (in the prescribed form) *must* be provided.
- Court order – Where there is a request for certification of a subcontract, but a failure or refusal to determine whether it is complete within a *reasonable* time, any person may apply for an order certifying the subcontract is complete, which the court *may* grant if it is satisfied the subcontract is complete.
- Interest – Although early release will not be mandatory, once a subcontract is certified complete, timely release of the associated holdback (provided 60 days have passed and any liens have been dealt with) is to be encouraged. To that end, anyone retaining a holdback in respect of a completed subcontract who does *not* make payment within sixty-five days of certification of the subcontract as complete will be liable for interest on the amount that should have been paid.

We are also considering, based on changes made in Ontario, allowing an owner to refuse to pay some or all of the basic holdback, provided he or she publishes a notice of non-payment (described further below) and notifies the affected contractor. Where this occurs, contractors and subcontractors would then be permitted to refuse to pay related holdback amounts to their own subcontractors, provided they also gave notice and, for contractors, took steps to address the dispute with the owner.

We acknowledge this scheme may raise concerns. One submission already pointed out the complications and expense associated with court applications. Another expressed concern (if we understand correctly) that allowing any release of holdback without the involvement of an architect or engineer may put trust funds (and therefore subcontractors) at risk.

We understand these concerns, but also note the concern raised by practitioner Howard Krupat, who describes the permissive nature of early release of holdback in Ontario as a “significant stumbling block” to its use. We presume a similar problem exists in New Brunswick and hope that the above scheme will make early release of holdback more accessible. In our view, this is a reasonable middle ground between the present scheme and that in, for example, Saskatchewan. There, certification of subcontracts *and* early release of holdback are mandatory, and a person who receives a request to certify but fails or refuses without reasonable excuse to do so is liable to anyone who suffers loss or damage as a result.

In regard to architects and engineers, we understand the important role they play in certifying substantial performance/completion on the projects in which they are involved. We agree that on projects where there is a payment certifier, such as an architect or engineer, it is that person who should make these decisions. However, as noted above, it is also our view that early release of holdback should be more accessible, which includes making it available on projects without a professional payment certifier. We note that this is permitted in several other provinces.

### *Release of holdback – annual, phased, and segmented*

There is support for annual, phased, and segmented release of holdback. One submission suggested (and we agree) that such mechanisms should be permissive and that segmented or phased release should apply only to prescribed projects, for example those valued at over \$20 million and/or longer than two years in original duration. This is similar to the limits in other provinces. In Ontario, for example, annual and phased release are permitted if the contract is longer than one year and allows for such releases, the contract price exceeds the “prescribed amount” (presently \$20,000,000) and there are no liens (or they have been discharged). Saskatchewan and Newfoundland and Labrador allow for annual release on contracts with a completion schedule longer than one year for contract prices in excess of \$25,000,000 and \$20,000,000, respectively.

### Construction trusts

We received few comments on the topic of construction trusts. The CBA-NB agreed that steps should be taken to mark or otherwise keep track of trust funds in the context of insolvency, but otherwise took no position on the proposals. Others agreed there is a need to protect trust funds in the event of insolvency, preferring holdback trust accounts to the “New York Model” recently adopted in Ontario. There is also support for introducing owner’s and vendor’s trusts.

### Simplified dispute resolution

#### *Small claims*

We note first two developments since the last issue of the *Law Reform Notes*. First, the jurisdiction of the New Brunswick Small Claims Court has increased to \$20,000. Second, following the recommendation of the Expert Review, the Ontario Act has been amended to allow claims under \$25,000 to be referred to Small Claims Court (as of July 1, 2018; see s. 58 of the Act). (Recall that a referral procedure is necessary because final jurisdiction over lien claims rests with the superior court.) It appears that claims between \$25,000 and \$100,000 will continue to follow ordinary procedure (the Expert Review had recommended a simplified procedure for these claims).

Response to the suggestion that New Brunswick adopt a tiered dispute resolution scheme was positive. At present, we are considering recommending an approach similar to that adopted in Ontario and recommended in Nova Scotia.

The Ontario scheme may be summarized as follows. Either party may seek referral, on motion, after the delivery of all statements of defence, or after the time for their delivery has expired. If the matter is ultimately referred, the Small Claims Court judge has the power and authority of the Superior Court of Justice to try and completely dispose of the action and all related matters. The findings of the Small Claims Court judge are set out in a report, which is then reviewed by a judge of the Superior Court of Justice, who can confirm, reject, or vary it. Confirmation can be opposed on motion; unopposed reports are deemed confirmed after 15 days from the date the report is served. (See Rules 54 and 55 of the Ontario Rules of Civil Procedure, analogous to Rule 56 in New Brunswick).

The Law Reform Commission of Nova Scotia took a slightly different approach to initiating references (one that we prefer). In its view, references should not “require the trappings of a formal motion”, which would require the assistance of counsel. Instead, it recommended that a party be permitted to simply elect referral to Small Claims Court at the time it filed its claim or defence. The election would, however, be subject to objection by the other party, on motion, to the Supreme Court, or on the Supreme Court’s own initiative. To ensure wealthier parties did not take advantage of this mechanism to force a matter to the Supreme Court, the Commission recommended that the Court adopt a restrictive approach to

objections: where referral is sought, it is the presumptive option and should not be rejected unless it can be shown that the matter is *clearly* not suitable for Small Claims Court adjudication. It also suggested that the Supreme Court have the option of crafting an order tailored to the circumstances, for example, referring some matters to the Small Claims Court while reserving others for its own determination.

We encourage readers to share their suggestions for how referral to Small Claims Court could be made both simple and effective (keeping in mind that the referral itself cannot be avoided).

As a final note on procedure, as of July 1, 2018, most of Ontario's provisions dealing with procedure on lien claims will be moved from the Act to the [regulations](#). We favor a similar approach.

### Right to information

We previously suggested that the disclosure obligations set out in section 32 be expanded. The CBA-NB was supportive, noting the need for a way of requesting a copy of any labour and material payment bond. It further suggested that the requirements for the state of accounts be clarified. An industry group offered qualified support, noting the need to balance the right to information with the right to privacy. It supported requiring disclosure of the parties to a contract, the contract price, copies of labour and material payment bonds and the state of accounts (noting that an explicit list of what constitutes a "state of accounts" would also be useful).

It was also suggested that the requirement to provide the "the terms of the agreement" is vague and should be removed and that copies of contracts should not be necessary given the other information that is/will be available. One contractor suggested that increased disclosure obligations would be difficult and time-consuming for most contractors.

There was some support for placing a time limit on responses to information requests and for allowing for disclosure orders, provided it was clear the court has the discretion to *not* make the order.

### Bonds

Response to the bond issue was mixed. Some were of the view that New Brunswick should not adopt an "opt out" regime, while others thought it was worth considering, as long as the alternative security adequately protected stakeholders. It was also suggested that an explicit acknowledgement in the Act that holdback bonds could be used to enable owners to release holdback would be beneficial to industry. We continue to consider this issue and are open to further suggestions.

## **Further issues related to modernization**

### Crown immunity

New Brunswick is one of only three provinces (with Newfoundland and Labrador and Alberta) in which the provincial Crown enjoys blanket immunity to construction lien legislation. In the remaining provinces, the Crown generally has the same rights and responsibilities as any other "owner".

We plan to recommend that New Brunswick narrow the extent of Crown immunity. Nova Scotia provides a useful model for reform. As of January 1, 2005, the Nova Scotia Act became binding on the provincial Crown. Instead of a lien attaching to the Crown's estate or interest in land, however, it forms a charge on the holdback. The notice of lien is served on the Department of Justice and 30 days prior notice in writing is required before an action to perfect a lien is commenced. Improvements to public streets or highways, however, continue to be exempt.

The CBA-NB has expressed its support for this change.

### Streamlining the security of payment regime

#### *Eliminating the claim process in the Crown Construction Contracts Act*

Security of payment in the New Brunswick construction industry is governed by two schemes: “public” projects (those where the Crown is an owner) by the *Crown Construction Contracts Act* (“CCCA”), and “private” projects by the *Mechanics’ Lien Act* (“MLA”). At present, only Alberta takes a similar approach.

The CCCA was enacted in 1972 in response to complaints that, because of Crown immunity to the MLA, unpaid suppliers of services/materials on public projects had no remedy if a general contractor failed to pay. The CCCA was intended to fill this gap. Modeled on Ontario’s *Public Works Creditors’ Act*, it provided a parallel security of payment scheme for public sector projects. Included in this scheme was a process that allowed (but did not require) the government to pay unpaid subcontractors and suppliers directly (see s. 7).

Shortly after the CCCA was proclaimed in New Brunswick, Ontario abandoned this dual approach to payment security in the construction industry, repealing the *Public Works Creditors’ Act* and simply making its lien legislation binding on the Crown.

In our view, if the new Construction Act (replacing the MLA) is made binding on the Crown, the separate claims process in the CCCA would no longer be necessary. Instead, unpaid suppliers of services/materials on public projects would – like suppliers on private projects – rely on the remedies in the new Act (or, where available, a labour and material payment bond).

This would increase consistency within the New Brunswick construction industry, align New Brunswick’s practices with those in other provinces and simplify a complex area of law. It would also eliminate one source of confusion on public-private partnerships (P3s), which do not fit neatly into either the CCCA or the MLA.

#### *Bonding on public projects*

We are also considering recommending changes to bonding on public projects. At present, tenderers awarded a contract for which the estimated value of work is \$500,000 or more must supply a performance bond and a labour and material payment bond, both equal to 50% of the value of the tender (*General Regulation – Crown Construction Contracts Act*, s. 15). In our view, the use of bonding on public projects should be increased. We base this opinion on recent changes to the Ontario Act (see Part XI.1) and the practice in the United States.

As of July 1, 2018, Ontario will require that a contractor entering a public contract priced at over \$250,000 provide the owner with a labour and material payment bond and a performance bond. The coverage limit is at least 50% of the contract price for contracts under \$100,000,000, and \$50,000,000 for those over \$100,000,000. Labour and material payment bonds must also extend protection to subcontractors and persons supplying labour and materials to the improvement. The same rules apply, with some modification, to Alternative Financing and Procurement (“AFP”) projects.

In the United States, payment bonds are required on nearly all public construction projects valued at over \$100,000. At the state level, the thresholds vary – some states require bonds on all contracts; others have thresholds ranging from \$20,000 to \$200,000 – but all are significantly lower than New Brunswick’s.



Finally, we are also considering whether, if a payment bond *is* in place on a project where the Crown is an “owner”, unpaid suppliers of services/materials should be *required* to claim against the bond, rather than exercising lien rights.

### **Prompt payment and adjudication**

We begin with a brief update.

In January 2018, the federal government announced it has engaged Bruce Reynolds and Sharon Vogel, the authors of the Ontario Expert Review, to undertake a similar consultation process. Their recommendations are intended to “inform the development of an effective legislative solution” relating to prompt payment and adjudication for federal construction contracts. It appears that Bill S-224, *An Act respecting payments made under construction contracts*, which awaits first reading in the House of Commons, will not proceed.

In Ontario, the housekeeping and non-substantive amendments to the *Construction Lien Act* have come into force, and four [draft regulations](#) have been released. The substantive changes *other than* those relating to prompt payment and adjudication will come into force on July 1, 2018; those relating to prompt payment and adjudication will come into force on October 1, 2019.

#### Prompt payment

##### *The Ontario Scheme*

In our view, a prompt payment scheme similar to that in Ontario should be adopted in New Brunswick. As in Ontario, it should apply to both the public and private sector, to all construction projects (from small home renovations to P3s), at all levels of the construction pyramid (with the exception of wages). The key elements of the Ontario scheme (set out in [Part I.1](#) of the Act) may be summarized as follows.

The trigger for payment is the contractor’s delivery of a “proper invoice” to the owner. Unless the contract provides otherwise, proper invoices must be given on a monthly basis (s. 6.3(1)). The Act sets out in detail the information that must be included in the invoice, but also allows other requirements to be added by contract (s. 6.1). Generally speaking, the parties are free to contract in respect of payment terms (e.g. allowing for milestone payments). The giving of a “proper invoice” cannot, however, be made conditional on the prior approval/certification by the owner or payment certifier (some exceptions apply) (s. 6.3(2), (4)). Certification or owner approval can, however, be required *after* a proper invoice is given (s. 6.3(3)).

Once the owner receives the “proper invoice”, it must pay the contractor within 28 days unless, within 14 days of receiving the invoice, the owner gives the contractor a notice of non-payment (s. 6.4(1)). The notice (Form 1.1) must set out the amount not being paid and the reasons for non-payment (s. 6.4(2)). Any amounts payable that are *not* the subject of a dispute must still be paid within 28 days (s. 6.4(3)).

Once a contractor receives payment from the owner, it has seven days to pay those of its subcontractors who supplied services or materials included in that proper invoice (s. 6.5(1), (2)). If the owner does *not* pay, the contractor is still required to pay its subcontractors within 35 days of the date it delivered the proper invoice to the owner (s. 6.5(4)). Both deadlines are subject, however, to the contractor providing to its subcontractor(s) one of two notices of non-payment (s. 6.5(5), (6)):

- Where the owner has not paid (Form 1.2) – The notice must state the amount that will not be paid within the required time and that it will not be paid because of non-payment by the owner. The form must be accompanied by a copy of the owner’s notice of non-payment and indicate the date

the proper invoice was submitted (s. 6.5(5)). The contractor must also undertake to refer the matter to adjudication within 21 days of giving the notice.

- Where the contractor disputes entitlement to payment (Form 1.3) – The notice must indicate that the contractor disputes the subcontractor’s entitlement to an amount included in the proper invoice, specify the amount not being paid and detail all the reasons for non-payment (s. 6.5(6)).

If the owner has given a notice of non-payment, the contractor must give its notice of non-payment within seven days of receiving the owner’s notice. If the owner has *not* given a notice of non-payment, the contractor has 35 days from the date it submitted its “proper invoice” to give notice to the subcontractor (s. 6.5(7)). The Act also sets out rules for when there has been only partial payment by the owner and multiple subcontractors, not all of whom may be implicated in the dispute (s. 6.5(2), (3)).

The payment obligations of subcontractors are very similar to those of contractors. Once a subcontractor has been paid, it has seven days to pay its sub-subcontractors (s. 6.6(1), (2)). If the subcontractor is not paid, or is only partially paid, it still must pay its sub-subcontractors within 42 days (s. 6.6(4), (5)). As above, however, both deadlines are subject to the giving of a notice of non-payment (s. 6.6(6), (7), Forms 1.4 and 1.5). The only significant difference between the rules for contractors’ and subcontractors’ notices is that subcontractors are not required to refer matters to adjudication. The deadlines for subcontractors’ notices of non-payment are also similar, except that, where the owner has not given a notice of non-payment, the subcontractor has 42 days from the date the proper invoice was submitted to give its notice of non-payment to the sub-subcontractor (s. 6.6(5)).

Any amounts due under the prompt payment rules (Part I.1) that are not paid when due and for which a notice of non-payment has not been given are subject to interest (s. 6.9).

#### *Contingent payment clauses*

One issue not addressed in the new Ontario scheme, but that we may address here, is pay-if-paid clauses.

The Expert Review noted that contingent payment clauses (pay-when-paid and pay-if-paid) have been a source of debate in the industry and have been prohibited or limited in several jurisdictions, including the U.K., Ireland, Australia, New Zealand and some U.S. states. In Ontario, Prompt Payment Ontario (“PPO”, a coalition of contractor associations, unions, suppliers, general contractors, pension trust funds, and others) argued in its submission to the Expert Review that pay-if-paid clauses should be statutorily void. In its view, transferring the entire risk of non-payment to a party not in privity with the owner could not be justified on a commercial or ethical basis. (In the United States, the American Subcontractors Association has taken a similar position.) PPO was willing to accept *pay-when-paid* clauses, provided payers took reasonable steps to pursue collection.

The Expert Review concluded that *pay-when-paid* clauses should be allowed, provided reliance on such clauses was circumscribed by requiring timely, detailed notices of non-payment and that contractors undertake to begin proceedings to enforce payment. It made no recommendation, however, in respect of *pay-if-pay* clauses, and they are not addressed in the revised Act.

Approaches to this issue in other jurisdictions vary. In the U.K., all conditional payment provisions are rendered void by statute *except* where non-payment is due to third party insolvency. In the United States, most states allow conditional payment clauses, but enforce pay-if-paid clauses only if they are explicit. Some states, however, have statutorily voided such clauses (e.g. Delaware, Wisconsin). In others, their use has been limited by statute or on public policy grounds by courts. In Illinois, Indiana, and Kansas, for

example, pay-if-pay clauses are allowed, but cannot be used to defeat mechanics' lien and/or bond claims. Texas also allows pay-if-paid clauses, but prevents their enforcement where: non-payment is not the claimant's fault, the claimant objects, the relationship between the owner and contractor is a sham, or enforcement would be unconscionable.

We tend to agree with PPO and question whether pay-if-paid clauses are consistent with one of the key purposes of the Act, i.e. ensuring suppliers of services and materials get paid. We are therefore considering allowing pay-when-paid clauses, but prohibiting or limiting pay-if-paid clauses.

#### *Objections to prompt payment*

In Ontario, support for prompt payment was strong, but not unanimous. Various stakeholders expressed concern that prompt payment would:

- unduly interfere with freedom of contract;
- be administratively burdensome, particularly on large and/or complex projects;
- not allow sufficient time to review invoices or inspect and certify the work, particularly on large and/or complex projects;
- not allow set offs for deficiencies, or would force payors to pay for work that was unsatisfactory;
- be an unworkable, "one size fits all" approach; and
- for public owners, be incompatible with existing approval processes and procedures.

The Expert Review noted these concerns, but concluded that a prompt payment regime customized to Ontario, in conjunction with an effective dispute resolution system, would nevertheless be an improvement over the present circumstances. It further noted that it had attempted to create a scheme that impaired the parties' freedom to contract only to the extent necessary, while being flexible enough to accommodate the varied needs of many different stakeholders.

We acknowledge the above concerns, but agree with the Expert Review. Experience in other jurisdictions has shown that prompt payment schemes, though initially a significant change, work well. If prompt payment were adopted here, we expect that the local construction industry would adapt well, given sufficient lead time. To that end, we expect there would be a significant delay (in Ontario, it was nearly two years) between proclamation and the coming into force of such a scheme. There would also (as in Ontario) be transitional provisions that would "grandfather" existing contracts and improvements (see s. 87.3).

#### Adjudication

Nearly every jurisdiction that has adopted prompt payment has also enacted a scheme of expedited, interim dispute resolution. Such schemes generally require the parties to submit disputes to an expert (non-judge) adjudicator who renders a prompt decision that is binding until the completion of the project. The scope of disputes that may be adjudicated varies widely, from payment-related only to any dispute arising out of the contract. The intent is to prevent disputes from causing work stoppages and delays that cascade down the construction pyramid, leading to gridlock and (often) litigation.

Of the jurisdictions that have enacted prompt payment legislation, only the United States has chosen *not* to also enact an accompanying interim dispute resolution scheme. There, the parties are left to resolve payment-related disputes through ordinary litigation, with its attendant delays and expense. This has caused some commentators to question the efficacy of the entire American prompt payment scheme.

At the recommendation of the Expert Review, Ontario has adopted an expedited dispute resolution regime modeled on that in the U.K., which has a long history of success. The key details of the Ontario scheme are set out below.

### *The Ontario scheme*

Set out in [Part II.1](#) of the Act, the Ontario scheme gives the parties to a contract or subcontract the right to require the adjudication of a limited subset of construction disputes:

- the valuation of services or materials;
- payment, including in respect of a change order;
- disputes that are the subject of a notice of non-payment under the prompt payment rules;
- certain amounts retained as set-off;
- payment and non-payment of holdback; and
- any other matter that the parties agree to, or that may be prescribed.

The Act allows the parties to agree to their own adjudication procedure, provided it meets the minimum requirements set out in the Act. If there is a conflict between the procedures, or if the contract does not address adjudication, the default scheme in the Act applies. It is, briefly, as follows:

- An adjudication is started by one party giving notice to the other, in writing, that it wishes to refer a dispute to adjudication. The notice must state the names and addresses of the parties, the nature of the dispute, the redress sought and the name of the proposed adjudicator (adjudicators are addressed further below).
- The parties can mutually agree to an adjudicator or ask that one be appointed by the Authorized Naming Authority (“the Authority”, also discussed further below). The adjudicator must be selected from a list maintained by the Authority and can only be agreed to after the dispute arises (i.e. the adjudicator cannot be pre-selected in the contract).
- Unless the parties and the adjudicator agree otherwise, an adjudication may only address a single matter, though separate adjudications involving the same or related matters may be consolidated. A matter may be referred to adjudication even if it is the subject of a court action or an arbitration.
- Adjudicators have broad powers and wide procedural latitude and may conduct an adjudication in the manner they determine “appropriate in the circumstances”.

As with prompt payment, the Act imposes short timelines at each step in the process:

- An adjudicator must consent to conduct the adjudication within four days of the notice of adjudication being given. Otherwise, the party who gave notice must request that an adjudicator be appointed (that appointment must be made within seven days).
- Within five days of the adjudicator being selected, the party who gave notice must provide him or her with a copy of the contract/subcontract and any documents on which it intends to rely.
- The adjudicator must make a determination of the dispute (in writing, with reasons) within 30 days of receiving the required documentation. The deadline may be extended at the request of the adjudicator or on consent. A determination made after the deadline is of no force or effect.

- A party who is required by a determination to pay another party must do so within ten days of the determination being communicated to the parties. Late payments are subject to interest, and if the amount is not paid, the contractor or subcontractor has the right to suspend work until it has been paid.
- A determination is binding on the parties until the matter is finally determined by a court or by arbitration, unless the parties have agreed between themselves that it is finally binding. A determination is admissible in court and can be enforced as if it were an order of the court.

Where a party disagrees with a determination, its options are limited. Judicial review is available, with leave, but the determination can only be set aside on the limited grounds set out in the Act, and no appeal lies from an order dismissing a motion for leave. We have yet to see what attitude Canadian courts will take to determinations, but in the U.K., adjudication decisions are enforced “robustly”, and courts will only rarely interfere. Provided the adjudicator answers the right *question*, the decision is binding and enforceable until the parties’ rights are finally determined, *even if the answer is wrong*.

With regard to cost, the default position is that the parties bear their own costs unless there has been bad faith or frivolous or vexatious conduct. Adjudicator fees are either agreed between the parties or set by the Authority in accordance with the regulations. As a general rule, these fees are apportioned equally. It is not clear how much adjudication will cost in Canada. The Expert Review reports that, in the U.K., the two most common cost ranges are £2,500 to £5,000 and £15,001 to £20,000.

#### *Authorized Naming Authority*

A key element of the Ontario scheme is the “Authorized Naming Authority”. Designated by the Ministry of the Attorney General (this has yet to be done), this entity is responsible for carrying out a number of duties relating to adjudicators. These include: developing and overseeing adjudicator training programs, establishing and maintaining a publicly available registry of adjudicators, establishing a schedule of fees, maintaining an adjudicators’ code of conduct, appointing adjudicators (as necessary), and issuing “certificates of qualification to adjudicate” to qualified individuals. The qualifications are set out by regulation and include:

- having at least seven years relevant (in the Authority’s view) working experience in the construction industry, which *may* include experience as an accountant, architect, engineer, quantity surveyor, project manager, arbitrator or lawyer;
- successfully completing a training program provided by the Authority; and
- not being an undischarged bankrupt and not having been convicted of an indictable offence in Canada or a comparable offence outside Canada.

We note that the Ontario Expert Review had recommended that adjudicators be *required* to be members in good standing of a self-governing professional body (e.g. engineers, architects, accountants, lawyers, or quantity surveyors).

#### *Is adjudication the appropriate solution for New Brunswick?*

In our view, if prompt payment is adopted in New Brunswick, it should be accompanied by some sort of expedited dispute resolution mechanism. We are unsure, however, whether the Ontario scheme is the best option.

Our main concern is that a scheme like Ontario’s, particularly the Authorized Naming Authority, is simply not feasible in a small jurisdiction. The Manitoba Law Reform Commission raised this concern in its

February 2018 consultation paper, [The Builders' Liens Act: A Modernized Approach](#). Among the issues considered was whether Manitoba should adopt prompt payment and, if so, how payment-related disputes should be resolved. The Commission noted the Ontario Expert Review's conclusion that, to be effective, a prompt payment regime requires a "nimble" adjudication process. However, it also noted that the volume and costs of construction litigation in Ontario and Manitoba are not similar. For reference, the GDP of the construction industry in Ontario in 2016 was approximately \$38 billion dollars – in Manitoba it was \$4.3 billion; in New Brunswick, \$1.4 billion.

Given the much lower volume of disputes in Manitoba, the Commission questioned whether it might be more appropriate to concentrate on maximizing access to existing court resources, rather than introducing adjudication in the style of Ontario. It also expressed concern about making changes to the judicial system (and securing funds to do so) without a real idea of how much the volume of payment disputes might actually expand. The Commission suggested three possible alternatives. First, send claims of up to \$10,000 to Small Claims Court. Second, appoint "dedicated well-qualified Masters" to absorb any new prompt-payment-related litigation. The third option was to do nothing, on the grounds that planned enhancements to the construction trust provisions, including imposing a duty on trustees to pay promptly, "might be sufficient". The Commission noted that, although the writers of the Ontario Report were "particularly taken" with the adjudication processes in the U.K., builders' lien and trust regimes had "never been part of [that] legal landscape".

We appreciate the concerns raised in Manitoba but are not certain that the proposed alternatives are necessarily better: we doubt the Small Claims process would be fast enough; New Brunswick makes only limited use of masters; and it is unclear what difference changes to the trust provisions will actually make.

We note that the Ontario scheme has also been criticized by at least one experienced Ontario arbitrator, [Stephen Morrison](#), whose concerns include:

- the "one-size-fits-all" nature of the scheme, i.e. the same process and deadlines apply to a relatively minor dispute over a home renovation as to a multi-year, multi-million dollar project;
- the difficulty in finding qualified adjudicators with a sufficient window of availability;
- whether the fees set by regulation will be sufficient to attract the most qualified adjudicators;
- a lack of procedural safeguards;
- the limited bases for setting aside a determination;
- the potentially severe consequences for owners who are unable to pay within the required ten days, given the contractor's right to stop work; and
- the risk that responding parties will be "ambushed".

In the U.K., the problem of "ambush" was one of the few major problems with the adjudication process. There, respondents have complained of having inadequate notice of all or part of a claim, of having insufficient time to consider it and respond, and that claimants deliberately hold back new submissions and evidence, deploying it for the first time in adjudication in the hope of gaining a tactical advantage.

To some extent, it may be possible to address the issue of ambush legislatively. We note, for example, New Zealand's legislation, which gives respondents the right to serve a written response within five days of receipt of a claim (claimants then have five days to reply). The Hong Kong Development Bureau has made two further proposals intended to discourage claimants from deliberately holding back new submissions and/or evidence. The first is to allow adjudicators to disregard such material to the extent the

respondent was unaware of it (but should reasonably have been given notice of it) when the notice of adjudication was served. The second is to give adjudicators the option of resigning if they consider it impossible to determine the dispute fairly in the time available.

We welcome comments on whether a scheme similar to that in Ontario, or a simplified version of it, is likely to be feasible here. If not, are there other mechanisms (perhaps based on the arbitration model) that might work? Are the alternatives proposed in Manitoba viable?