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Construction Law Newsletter

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Supreme Court: Trustees May Have a Duty to Proactively Disclose Construction Bonds to Beneficiaries

The Supreme Court of Canada ("SCC") recently ruled that parties named as trustees of a labour and material payment bonds ("LMP"), usually the Owner and/or General Contractor of a construction project, may have an obligation to disclose the existence of the bond to its beneficiaries, typically the subcontractors. Prior to this decision, it was commonly understood that construction lien legislation only required the disclosure of a bond's existence where specific inquiries were made about it.

Background

In *Valard Construction Ltd v Bird Construction Co*, 2018 SCC 8, the LMP bond was posted by the subcontractor, Langford Electric Ltd ("Langford"), at the request of the General Contractor, Bird Construction Co ("Bird"), for the benefit of any sub-subcontractors. The LMP bond named Bird as the trustee.

Langford contracted with Valard Construction Ltd ("Valard") to provide directional drilling work on a project. Langford eventually became insolvent and stopped paying Valard's invoices.

The debt owing to Valard eventually grew to approximately $660,000. Valard obtained default judgment against Langford, but was not able to collect on its judgment. Valard subsequently learned of the LMP bond, and that it named Bird as trustee and Langford as principal. Valard then sought to make a claim under that bond.

The bond provided that a beneficiary may sue the surety for unpaid sums where it has not received payment within 90 days of the last day on which it provided work and/or materials. However, in order to claim under the bond, the beneficiary must provide

notice to the surety, principal and trustee of its claim within 120 days of the last date work and/or materials were provided.

Unfortunately, Valard only learned of the LMP bond's existence only after the expiry of the 120 day notice period. The surety thus denied Valard's claim. Valard then brought an action against Bird for its failure to advise it of the bond's existence. Both the trial court and the Alberta Court of Appeal found that Bird had no obligation to notify Valard or any other subcontractor of the existence of the LMP bond. Valard then appealed the case to the SCC.

Supreme Court Ruling

The majority of the SCC approached the case primarily through the lens of a trustee's fiduciary duty to hold property solely for the beneficiary's enjoyment. The Court noted that a trustee generally has an obligation to inform a beneficiary of the existence of a trust wherever it would be to the unreasonable disadvantage of the beneficiary not to be informed of its existence.

The Court found that Bird, as trustee of the LMP bond, had an obligation to take steps to inform Valard of the existence of the trust, including the right to claim under the LMP bond. The Court held that the standard to be met by a trustee in respect of the duty to disclose the existence of a trust is that of honesty, and reasonable skill and prudence, and that not every case will require a trustee to disclose the existence of a trust.

The Court held that Bird committed a breach of trust, and should have taken reasonable steps to notify potential beneficiaries of the trust's existence. The Court also noted that reasonable steps could have been satisfied by posting the bond in the on-site trailer where notices were normally posted and where Valard was required to attend daily meetings.

The Court further held that Valard was entitled to be compensated for the sum that it could have obtained under the bond had it been aware of its right to claim thereunder. As the record did not disclose the sum available on the bond at the relevant times, the Court remitted the issue of damages to the trial judge for adjudication.

Takeaways

Section 39 of Ontario's *Construction Lien Act* requires Owners or Contractors, upon request, to disclose the existence of a construction bond. Given the Court's ruling in *Valard*, they may now also have a duty to proactively take reasonable steps to notify the beneficiaries of the bond's existence regardless of whether a s. 39 request for information is made. What is considered reasonable in any given situation will depend on the particular context. However, a good starting point would be posting such bonds in a conspicuous place on the project site, such as the site trailer, where it can be seen by the potential beneficiaries. Owners should also consider whether to make it a term of their contracts that a contractor must advise its subcontractors of the existence of the bond.

— KC —

Construction Act: Big Changes Ahead for Construction Industry

On December 12, 2017, Bill 142, which significantly amends the *Construction Lien Act*, R.S.O. 1990, c. C.30 (the "*Act*"), gained royal assent in the Ontario legislature. While some amendments come into force beginning July 1, 2018, the more significant

amendments with respect to prompt payment and adjudication are projected to come into force in October, 2019. The amended legislation is expected to modify and revolutionize Ontario's construction industry, as captured by its new and simple name, *Construction Act*. This article is intended to provide a cursory overview of only the most significant of changes.

Substantial Performance

To reflect the modern cost of construction projects, calculations with respect to substantial performance have been revised. A contract is now considered substantially performed when the project is ready for its intended use or is being used, and where the cost of completion, or of the correction of a known defect, is not more than:

i. 3% of the first $1 million of the contract price (formerly $500,000);

ii. 2% of the next $1 million of the contract price (formerly $500,000); and

iii. 1% of the balance of the contract price.

A contract is also deemed complete when the price of completion, correction of known defect, or last supply is the lesser of 1% of the Contract Price or $5,000 (formerly $1,000).

Lien Periods

Lien periods have also been significantly revised. The period within which a party must "preserve" their lien by registering a claim for lien against title has been extended to 60 days (formerly 45). Further, the period within which a party must "perfect" their lien claim by commencing a court action has also been extended to 90 days (formerly 45) from last day the claim for lien could have been preserved.

The termination of a contract and/or subcontract is now considered an event that triggers the clock with respect to preserving or perfecting lien claims. Further, where a Contract is terminated, a notice must be published in a construction trade newspaper.

Finally, where a party wishes to vacate a claim for lien by paying monies into Court or posting security, not only must they post the full amount of the lien claim, they must also post the lesser of $250,000 (formerly $50,000) or 25% of the lien claim as security for costs.

Holdbacks

The requirement for a payor in the construction pyramid to retain 10% of payment on account of the basic and/or finishing holdback has not changed. However, it is now permissible for the holdback to take the form of security, such as a letter of credit, rather than cash, which is the current industry standard.

Also, while it was previously merely permissible for a payor to release the holdback following the expiry of the lien period, such release will now be mandatory, subject to specific amounts that may be retained pursuant to a payor's right of set-off. Note that, as outlined further below, a party that holds amounts back on the basis of set-off are now required to provide formal notice that they are doing so.

There are also provisions that allow for the annual or phased release of the holdback, as long as a contract explicitly states so. Further, in the case of annual holdbacks, the project must have a completion schedule longer than one year, and provide for payment of the accrued holdback on an annual basis. For phased holdbacks, the contract must provide for the payment of the accrued holdback on a phased basis and identify each phase. The contract must also exceed a prescribed amount, which the draft regulations set at $20 million.

In the event that a payor does not want to pay the holdback, it must follow specific steps. For example, an Owner that does not wish to pay some or all of a holdback is required to publish a Notice in a construction trade newspaper, within 40 days of the applicable Certificate or Declaration of Substantial Performance, specifying the amount not being paid, and notifying the Contractor of the publication.

A Contractor that refuses to pay one of its subcontractors, can refuse to pay some or all of the holdback if the Owner refuses to pay the holdback to the Contractor, the Contractor refers the matter to Adjudication (described below), and the Contractor notifies every Subcontractor of the amount not being paid and of the Adjudication referral. Provisions also exist for Subcontractors that refuse to pay holdback monies to their Suppliers.

Prompt Payment

Late payment is well known and industry-wide problem. The new regime addresses this issue by providing sub/contractors the right to claim for progress payments that are either to be paid or otherwise disputed within a reasonable amount of time.

A Contractor's request for payment must take the form of a "Proper Invoice", which is a formal document that must include certain information, such as the amount payable, the period of supply, a description of the services supplied, and how the work was authorized.

Owners should take note that the submission of a Proper Invoice cannot be conditional on prior approval from the Owner or the Owner's payment certifier, such as its architectural consultant.

An Owner must pay the Contractor within 28 days of receiving the Proper Invoice. However, an Owner can refuse to pay all or a portion of the Proper Invoice if it gives notice of non-payment to the Contractor within 14 days and details the reasons for non-payment, including amounts retained as set-off.

A Contractor that receives payment from an Owner is required to pay its Subcontractors within 7 days.

A Contractor can refuse to do so if it gives the Subcontractor notice of non-payment within 7 days after receiving a non-payment notice from the Owner. If no notice was given by the Owner, the Contractor must give Notice to Subcontractor no later than 35 days after Proper Invoice was submitted to the Owner. Provisions also exist for payments and disputes between Subcontractors and their suppliers.

Adjudication

Perhaps the most important change to the *Act* and industry is the addition of "Adjudication" as a dispute resolution forum.

In short, Adjudication is a process designed to produce an interim binding decision to a construction dispute, rendered by an impartial Adjudicator, within a matter of weeks.

Parties are free to develop their own dispute resolution procedures in their contracts as long as they comply with the minimum requirements of the Adjudication default scheme.

The province of Ontario must now develop a body, currently defined as the Authorized Nominating Authority (the "Authority"), which will be responsible for training, licensing, and supervising a roster of qualified Adjudicators. Adjudicators are expect to have at least 7 years of relevant experience in the construction industry, and are expected to include professionals such as architects, engineers, project managers, accountants, and lawyers.

Where a dispute arises, for example, with respect to the valuation and/or payment of services and/or materials supplied, one party can serve the other with a Notice of Dispute (the "Notice"). The Notice sets out the nature of the dispute and proposes an Adjudicator. The Adjudicator must agree or decline to conduct the Adjudication within 4 days of the Notice. Where the proposed Adjudicator declines, one will be appointed by the Authority.

Where the Adjudicator agrees to conduct the Adjudication, he or she is provided with a copy of the Notice, the underlying sub/contract, and key relevant documents. The Adjudicator has broad powers to conduct the Adjudication as he or she sees fit, including conducting on-site inspections, and obtaining the assistance of third parties. Within 30 days of receiving the documents the Adjudicator will issue a "Determination" of the dispute, supported by written reasons.

The Adjudicator and/or the parties can request an extension of this deadline.

Unless they agree otherwise, parties cannot commence Adjudication if the Notice is given after the date the sub/contract is complete. Parties can terminate the Adjudication any time before a Determination is made. Parties can also refer a matter to Adjudication even if it is the subject of a Court action or Arbitration, unless it has been finally determined in that forum. Further, parties are not allowed to name an Adjudicator in their contract in advance.

Only a single dispute can be referred to Adjudication at a time. However, if the same matter or related matters are the subject of separate Adjudication proceeding, the parties to each Adjudication can agree to have the issues resolved together by a single Adjudicator. Even where the parties do not agree, the Contractor has the power to require the consolidation of separate Adjudications.

Generally, each party bears their own costs of Adjudication, and the Adjudicator's fee is split evenly between them, unless a party has acted in a manner that is frivolous, vexatious, an abuse of process or in bad faith.

A party required to pay as a result of Adjudication must do so within 10 days of the Determination, subject to any applicable holdback requirements. If an amount payable under a Determination is not paid when due, the sub/contractor may suspend further work until paid, including interest, and reasonable costs incurred, including the costs of resuming the work.

Note that a Determination of amounts payable or overpaid should be included in the Contract Price for the purposes of calculating substantial performance.

Resort to the Courts

Within 30 days of the Determination a party can apply to the Divisional Court for leave to appeal the Determination. The Court can set the Determination aside only in certain limited circumstances, including Adjudicator bias, fraud, or improper procedure.

A party has 2 years to file a certified copy of the Determination with the Court to make it an enforceable Court Order.

It is important to note that the Determination is binding until a further decision is rendered by a Court or an Arbitrator, which means that a party can re-litigate the subject matter of the Adjudication if they are not satisfied with the result. However, in the UK, where statutory adjudication has been in use since the 1990s, parties have tended to treat the Determination as a final result without the need for further litigation. There is hope that parties in Ontario may treat Adjudication here in a similar fashion.

Where a party that intends to re-litigate the subject matter of Adjudication, it should be mindful of the potential limitations periods that might apply. Based on UK precedent, where the parties do not agree that a Determination is final, the winning party should commence legal action to confirm the Determination within 2 years of the cause of action underlying the dispute. By contrast, the losing party should bring a legal action for repayment of amounts awarded pursuant to the Determination within 2 years of the date of Determination. Where an Adjudicator rejects a party's claim outright or even partially, that party should bring legal action within 2 years of the underlying cause of action.

Also note that, with Court permission, parties can now proceed in the Small Claims Court for claims worth less than $25,000. Claims worth $25,000 to $100,000 can proceed via Simplified Procedure in Superior Court. Finally, parties are no longer required to commence action where the project lands are located.

Bonds

Note that contracts involving public bodies now require the Contractor to provide the Owner with a Labour and Material Bond, as well as a Performance Bond, if the Contract Price exceeds a prescribed amount, which the draft regulations set at $250,000. Owners

are free to require other types of bonds as well.

Trust Funds

There are new record keeping and other requirements for sub/contractors with respect to trust funds. In short, trust funds must be deposited into a bank account in trustee's name, and the trustee must maintain records detailing amounts received and paid out, transfers made, and any other prescribed information.

Transition Period

The Attorney General, Yasir Naqvi, has announced that all changes, except those related to prompt payment and Adjudication are expected to come into force on July 1, 2018. Amendments related to prompt payment and Adjudication are expected to come into force on October 1, 2019, presumably to allow the province time to establish the Authority and develop a roster of qualified Adjudicators.

In general, the pre-amendment version of the *Act* will continue to apply to construction contracts entered into before the amendments come into force, regardless of when any subcontract is entered into.

That is also the case where a procurement process with respect to such a contract was commenced before the new provisions come into force.

General Comments

It will be interesting to watch how the construction industry and the Courts react and adapt to these amendments, and in particular, what influence the role of prompt payment and Adjudication will have on the industry. In the interim, parties should begin reviewing their contracts to ensure compliance with the forthcoming amendments. Further, given the relatively tight timelines for prompt payment and dispute notices, parties should begin considering ways to streamline their internal processes for payment approvals, dispute notices and related matters.

Further, given the quick turnaround expected in the Adjudication process, parties should review their document organization practices to ensure that participation in the Adjudication process involves well-organized files that can be easily transferred to counsel as necessary, as opposed to suddenly trying to compile relevant invoices, purchase orders, change orders, emails and other relevant documents. Finally, once the roster of Adjudicators is developed and posted, parties should review same and develop a list of Adjudicators they consider acceptable.

— KC —

Subcontractors' 'Date of Last Supply' Not Limited to Last Day Physically On Site

In *Toronto Zenith Contracting Limited v. Fermar Paving Limited*, 2016 ONSC 4696 ("*Toronto Zenith*"), the Ontario Superior Court of Justice (the "Court") confirmed that the last day a subcontractor supplies services to a Project, which triggers the 45 day period within which they have to preserve a claim for lien, is not necessarily the last day they are physically on-site, but can extend to off-site work done in respect of a project as well.

Liens Generally

In general, a subcontractor's lien rights expire 45 days from the date it last supplies services to a project, unless it preserves its lien rights by registering a claim for lien within that time. Often, in order to calculate whether a subcontractor is still within the time required to preserve its lien rights, owners or contractors begin counting from the day the subcontractor was last physically on site. However, as *Toronto Zenith* highlights, in certain circumstances, work performed by a subcontractor off-site, even after the last date the subcontractor was physically on-site, may in fact be the proper date of last supply.

Facts

In *Toronto Zenith*, the defendant, Fermar Paving Limited ("Fermar"), was the general contractor with respect to a road improvement project. Fermar retained Toronto Zenith Contracting Limited ("Zenith") as its structural subcontractor. Zenith's work started in 2013 and continued throughout 2014.

The subcontract had a scheduled project shutdown for the winter of 2014-15. The shutdown started in mid-December, 2014, such that the last day Zenith's workers were physically on site was December 19, 2014. During the shutdown, a dispute arose between Zenith and Fermar with respect to Zenith's work, delays, and payment. On February 6, 2015, Zenith gave notice to Fermar that it was terminating the subcontract.

Zenith thereafter preserved its lien by registering a claim for lien on March 18, 2015, which was beyond 45 days from the last date it was physically on site, but within 45 days from the date it gave notice it was terminating the subcontract.

The Motion

Fermar brought a motion seeking a declaration that Zenith's lien had expired on the basis that it was preserved after the 45 day period had already expired. Zenith countered that its subcontract required more than just the physical supply of services and/or material to the site, but also included design and preparatory work that was being performed on an ongoing basis during the winter shutdown and in anticipation of work resuming in the spring. Zenith took the position that it last supplied services and/or materials to the improvement on February 6, 2015, the day it served notice that it was terminating the subcontract.

The Court noted that the *Construction Lien Act* does not limit "supply" to only physical supply, but also includes "any work done or service performed upon or in receipt of an improvement". Previous court decisions have held that lien rights include work done both directly to the improvement, but also indirectly, which can include off-site work.

The Court accepted that Zenith had performed off-site work under it subcontract during the winter shutdown, including: communicating with a subcontractor in respect of its preparation of shop drawings, submitting documents and shop drawings, picking up other materials prepared by a subcontractor, and engaging in ongoing communications with Fermar regarding Zenith 's ongoing responsibilities at the Project. Zenith's position was further assisted by the admission of Fermar's witness during cross-examination that there was an ongoing need for Zenith to perform work during the shutdown period.

The Court declined Fermar's motion, declined to declare that the lien had expired, and awarded Zenith approximately $15,000 in costs.

Takeaways

This case should remind all parties that the last date a subcontractor or supplier supplies services to a project includes not only the last day they were physically on site, but also includes off-site services as well, provided such services fall within the scope of the contract.

If there is uncertainty about the date on which a subcontractor last supplied services, parties could seek a declaration under s. 31 of the *Construction Lien Act* setting out a date of last supply date that is "deemed to be true against the person making the declaration".

— KC —

Alberta Court Offers Guidance on Proving Extras and Back Charges

During the course of a construction project, disputes often arise between subcontractors that claim they are owed certain amounts as "extras", and contractors that apply "back charges" against their subcontractors. *Impact Painting Ltd. v. Man-Shield (Alta) Construction Inc.*, 2017 ABQB 743 from the Alberta Court of Queen's Bench (the "Court") provides a useful guide on how courts tend to approach issues surrounding the legitimacy of claims for extras and back charges.

Facts

Man-Shield (Alta) Construction Inc. ("Man-Shield") was the general contractor for a project that required the construction of a retirement community in Edmonton (the "Project"). Impact Painting Ltd. ("Impact") was Man-Shield's painting subcontractor on the Project. Upon completing their work, Impact issued invoices to Man-Shield for extras totalling $133,964.39.

Man-Shield disputed most invoices, following which Impact registered a builder's lien. Man-Shield then issued back charges to Impact that totalled $208,579.73.

Man-Shield also deposited a bond in court to discharge the builder's lien.

Impact then brought a lawsuit against Man-Shield for payment of its invoices. Man-Shield counterclaimed for the back charges.

Claim for Extras

The Court stated that, in order to maintain a successful claim for extras, the claimant must prove the following elements with respect to each extra claimed:

1. Was the work performed, in fact, extra work?
2. If so, did the owner give instructions, either express or implied, that the work be done, or was the work otherwise authorized by the owner?
3. Was the owner informed or necessarily aware that the extra work would increase the cost?; and
4. Did the owner waive the provision requiring changes to be made in writing or acquiesce in ignoring those provisions?

The Court analyzed each of the extras claimed by Impact, but declined to award Impact the entire amount claimed. In many cases, Impact lacked sufficient evidence to prove they either had approval to do the work as claimed in the invoice, or had completed all of the work as described therein. In other cases, the work performed by Impact was found to be within its scope of work pursuant to its contract with Man-Shield. For example, Impact was not entitled to claim extras for painting heaters as

heaters fell within the contract's definition of "other mechanical equipment".

Conversely, Impact was allowed to recover for priming and painting of all drywall patches. The poor workmanship of the drywall contractor necessitated repairs to the drywall. After such repairs, Impact was asked to repaint, which is work it claimed as an extra.

The Court allowed this claim because the contractual scope of work did not include any repainting necessitated by the poor workmanship of another party.

Back Charges

The Court went on to consider Man-Shield's counterclaim for back charges. In order to establish the legitimacy of back charges, a claimant has the onus of proving the following:

1. The back charge is for an expense actually, necessarily and reasonably incurred by the party claiming the back charge;
2. By the terms of the subcontract, or by some other agreement between the parties, the charge is one, or is in relation to some task, for which the subcontractor undertook responsibility;
3. The general contractor incurred the expense because the subcontractor defaulted on the responsibility to which the charge relates; and
4. Prior to incurring the charge, the general contractor gave notice to the subcontractor of its default and a reasonable opportunity to cure it.

In most cases, the Court found that Man-Shield did not satisfy its onus. For example, Man-Shield claimed back charges for a second final clean up pursuant to the sub-contract. The Court disallowed this charge on the basis that Man-Shield did not prove that the expense was incurred because Impact defaulted on its obligation to clean the site after completing its work.

Of particular importance was Man-Shield's back charge relating to supply painters. As Impact was unable to meet certain deadlines, Man-Shield hired other painters to do so. Impact objected to these back charges, arguing that, contrary to its request, it did not have supervision authority over the supply painters, and that the need for supply painters arose from Man-Shield's wish to meet unreasonable deadlines.

The Court disagreed with Impact and allowed the claim for these back charges. Further, the fact that the parties did not reach an agreement regarding supervision did not change the fact that they had agreed that the supply painters would be hired and charged to Impact.

Conclusion

This case serves as a reminder that parties should review their contractual rights and obligations, prior to performing work, and should seek clarification where any rights and/or obligations are unclear. Furthermore, parties should document all work performed during the course of a project as their success in making a claim for "extras" or "back charges" will require them to provide clear and sufficient evidence that meets the tests outlined above.

— KC —

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