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GLAHOLT BOWLES
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# BUILDING INSIGHT

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NEWSLETTER

## IN THIS ISSUE



# "Rough Justice" in Construction Adjudication: It's Not Natural

The introduction of adjudication into Ontario's *Construction Act* caused many to coin this new process as "rough justice" as it allows parties to get swift, interim relief, without bringing the project to a halt.

The Divisional Court in *Ledore Investments v. Dixin Construction, 2024 ONSC 598* has confirmed how inappropriate the "rough justice" misnomer really is. Adjudication is not a form of "rough justice" that makes the process immune to fundamental rights embodied in the concept of natural justice.

**Facts**

The applicant, Ledore Investments Limited ("**Ledore**"), applied for judicial review pursuant to the provisions governing judicial review in Ontario's *Construction Act*. In its application, Ledore sought to set aside the determination of the adjudicator dismissing its claim for payment against the general contractor, Dixin Construction ("**Dixin**").

The adjudication touched on the prompt payment provisions of the *Act*, in that Ledore had delivered three invoices to Dixin, which Dixin had included in its payment application to the owner, for which it was paid. Dixin did not deliver to Ledore a "notice of non-payment" within the time-period required by the *Act*, but nevertheless refused to pay Ledore's invoices after it had terminated Ledore's subcontract and claimed set-off.

Ledore sought interim relief by way of adjudication, however the adjudicator declined to order Dixin to pay Ledore, because the form and content of Dixin's invoicing to the owner did not "engage" the prompt payment provisions as it was not a "proper invoice," a form of invoice defined in the *Act* with statutorily mandated contents.

Importantly, neither Ledore nor Dixin had raised this as an issue in the adjudication, however the adjudicator took it upon himself to render his determination without input from the parties.

**The Adjudication**

The agreed upon adjudication process permitted both parties to provide written submissions of various lengths. No oral submissions were permitted, but both parties had submitted witness statements.

On July 20, 2022, the adjudicator delivered his determination, together with written reasons, concluding that Dixin was not required to pay Ledore for the invoices, but his reasoning turned on a point neither party had raised in their written submissions. He determined that, because Dixin had not delivered to the owner a "proper invoice" as defined in the *Act*, the *Act's* prompt payment provisions did not apply.

Strikingly, he acknowledged that neither party had raised this argument, stating that:

> Although not raised by either party, my review of the material submitted by the parties also raises an issue with respect to the form and content of [Dixin]'s invoicing (that is, the invoice from [Dixin] to the [owner], which purports to have started the Prompt Payment process).

The adjudicator was troubled with the result of his analysis, remarking that:

> I feel it necessary to note that I am concerned with the outcome in this matter, as it appears [Dixin] is able to (unintentionally, it would seem) take advantage of its own failure to comply with the Act. Although not fully canvassed/analysed herein, had the fact of the improper form of [Dixin]'s invoice to the [owner] been known/realized by [Ledore] prior to issuing the Notice of Adjudication, perhaps the adjudication could have been structured in a way to deal with [Dixin]'s failure in this regard.

**Judicial Review**

Ledore's application for judicial review of the adjudicator's determination raised three issues:

1. Is judicial review available in this court?

2. If judicial review is available, was there a breach of procedural fairness?

3. If there was a breach of procedural fairness, what is the appropriate remedy?

One the first issue, the court considered Section 13.18(5) of the *Act*, which requires an applicant to establish one or more of these grounds for review to have a determination set aside. Ledore relied on two of these grounds:

> 13.18(5) The determination of an adjudicator may only be set aside on an application for judicial review

> if the applicant establishes one or more of the following grounds:
>
> 3. The determination was of a … matter entirely unrelated to the subject of the adjudication.
>
> 5. The procedures followed in the adjudication did not accord with the procedures to which the adjudication was subject under this Part, and the failure to accord prejudiced the applicant's right to a fair adjudication.

The court found that the *Act* specifically provides that procedural fairness is a ground for a party to seek judicial review, and Dixin conceded this point. Consequently, judicial review was available under Section 13.18(5)5 and the court did not need to consider Ledore's argument that the determination related to matter that was unrelated to the adjudication.

**Was there a breach procedural fairness?**

The court devoted most of its time on the second issue, determining whether there was a breach of procedural fairness. At the forefront of the court's analysis was the level of procedural protection that should be afforded to parties in an adjudication.

On the one hand, as Dixin argued, adjudication is "a fast and informal process intended to secure an interim result pending the parties pursuing their dispute more comprehensively in court or before an arbitrator." The interim nature of a determination limited the procedural protections. The court agreed, in part, with Dixin, that in considering the statutory framework, the legislature intended to "establish a prompt and abbreviated adjudicative process," that should not be overwhelmed by strict procedural conformity.

But it's not "rough justice" that is devoid of all procedural protection, simply because the process results in an interim determination that can be corrected by the courts or an arbitrator, where the procedural rights are more comprehensive. The court found that while procedural protection was limited, some procedural protections remained, as:

> the right to be heard on the determinative issue is a central component of even more limited procedural protections. It is a legal truism in our system of justice that it is fundamentally unfair, and quite possibly unreliable, for a judicial officer or adjudicator to reach a conclusion in his or her reasons for judgment in a proceeding based on an issue that has not been pleaded or relied upon by a party to the proceeding.

While the courts tend to pay a significant amount of deference to the determinations of specialized decision-making bodies, this is subject to basic safeguards being met. The procedural entitlements in adjudication were not so low as to eliminate the fundamental right to be heard on the dispositive issue, and accordingly there existed procedural unfairness.

**What is the appropriate remedy?**

Ledore submitted that the court should set aside the adjudicator's determination as unreasonable and substitute it with its own analysis. The court disagreed, and determined that the adjudicator, who had experience in the construction industry, had not yet had the benefit of the parties' submissions on the dispositive issue.

Thus, the matter was remitted back to the adjudicator for determination in accordance with the court's reasons.

**Conclusion**

The court has provided valuable guidance: Adjudication is not "rough justice" and remains subject to the most basic of procedural protections as embodied in the a*udi alteram partem* principle, one of the two pillars supporting natural justice. Even though adjudication is interim, parties can at very least expect these basic protections, particularly the right to a fair hearing, and to be informed of and respond to the dispositive issue on which their dispute turns.

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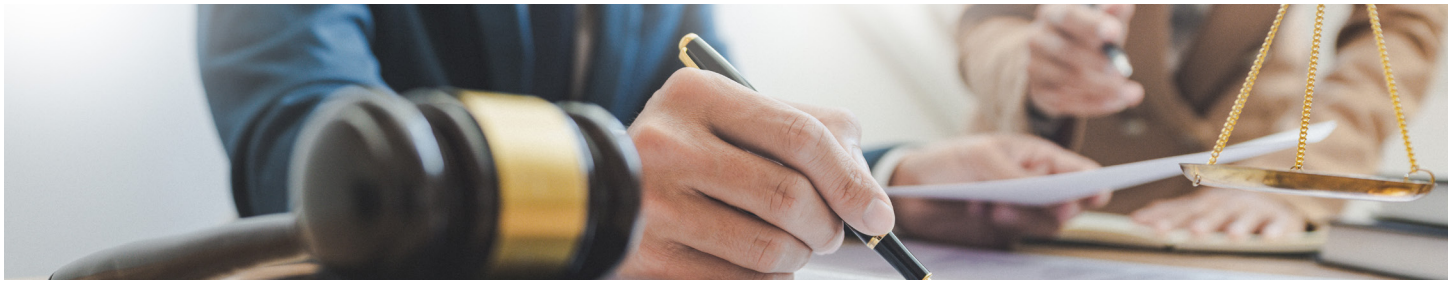

# Navigating Liability in Construction Contracts: A Case Analysis of *Centurion Apartment Properties Limited Partnership v. Sorenson Trilogy Engineering Ltd.*

The project at issue concerned the construction of an 11 storey, 90-unit apartment building (the "**Building**") in Langford, BC (the "**Lands**") between 2017 and 2019, which subsequently faced evacuation post-occupancy due to severe structural deficiencies jeopardizing resident safety. At the time of construction, the legal owner of the Lands was 113407 B.C. Ltd. (the "**Owner**"), a wholly owned subsidiary of Loco Investments Inc. ("**Loco**"). The Owner held the Lands as a bare trustee for Loco.

The Owner engaged DB Services of Victoria Inc. ("**DB Services**") to perform certain design-build works for the Building (the "**DB Services Contract**"). DB Services, in turn, entered into a contract with Sorensen Trilogy Engineering Ltd. ("**Sorensen**") for structural engineering services required for the Building's design and construction (the "**Sorensen Contract**"). Both the Sorensen Contract and the DB Services Contract contained clauses that allocated risk and specifically limited liability, and limited damages to the amount paid for the services.

Following construction, the Building was sold, with the Owner maintaining legal title to the Lands in trust for Centurion LP as the beneficial owner. Significant deficiencies were later discovered in the Building's design and structural integrity, leading to the revocation of the occupancy permit and the evacuation of the residents. Consequently, the legal and beneficial owners, the Owner and Centurion LP, initiated an action for the losses incurred due to repairs found to have been necessary to avoid risk, against several parties, including Loco, DB Services, and the structural consultants, alleging, among other things, negligence and breach of contract, and significantly as featured in the decision, claims for misrepresentation and failure to warn.

Sorensen and its principals made applications to have the negligence claims against them summarily dismissed, on the basis that the risk allocations in the contracts negated the proximate relationship required to establish a duty of care, and as third parties, to limit the damages for contribution and indemnity to the fees paid under the Trilogy Contract, in accordance with the contractual limitations.

**Summary Trial Results**

The Summary Judgment/Trial Court granted both applications, resulting in:

1. **Negligence:** Only the trustee, legal Owner, had standing to pursue negligence claims for losses to the trust. Centurion LP, as a beneficial owner, did not. The beneficiary claims for misrepresentation and failure to warn, however, could proceed as they were not dependent upon the trust property;

2. **No Duty:** As the contracts explicitly allocated risk, altering the duty of care, no proximate relationship or duty of care was established between the structural consultants and the Owner;

3. **Limitation of Liability:** The limitation of liability clause in the Trilogy Contract, restricting the liability of the structural consultants to the fees paid to Trilogy was reasonable and appropriate, given the context and sophistication of the parties involved, and accordingly enforceable as to all claims.

These findings were subsequently appealed.

**The Appeals and Cross-Appeal**

The British Columbia Court of Appeal permitted the appeals, in part, concluding that:

1. The lower court correctly determined the lack of standing;

2. The lower court was incorrect in concluding that the relationship between the structural consultants and the Owner was not sufficient, on the modified *Anns* analysis, to establish a duty of care owed by the consultants to the Owner;

3. The enforceability of the limitation of liability clause in the Trilogy Contract applied to the parties, however as to the claims for misrepresentation and failure to warn, was not appropriate for summary trial because an assessment of the full factual matrix was required to determine the proper interpretation and scope of the limitation, and public policy considerations.

Of these findings, both the determination that the lower court erred in concluding that the structural consultants did not owe the Owner a duty of care, and that the contractual limitation required a contextual analysis are particularly significant

for the construction industry. This decision hinges on the application of the well-established test enunciated by the House of Lords in *Anns v. London Borough Council*, the "*Anns* test", revisited, in Canada, by the 2001 decision of the Supreme Court of Canada in *Cooper v. Hobart*.

The "*Anns* test" is a well-established legal framework that outlines the criteria for determining whether a duty of care exists between two parties, such that one party should be compensated for a wrongful act by the other party. The first step is to consider whether a prima facie duty of care exists between the parties (often referred to as "proximity"). The second part of the test examines whether any policy considerations limit the duty of care.

Applying the first part of this test, the lower court concluded that the contracts between the parties negated any proximity between the Owner and the structural engineers, thus precluding a duty of care. The Court of Appeal disagreed.

Rather than considering just the contractual framework, the Court of Appeal examined the relationships among the parties in a construction contract. It specifically assessed whether there was a "proximate relationship" between the Owner (the legal owner of the building) and the structural engineers (who performed the negligent work).

The Court of Appeal identified a proximate relationship between the Owner and the structural engineers, referencing the Supreme Court of Canada decision in *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 SCR 85 in which the Supreme Court found that contractors responsible for constructing a building owed a duty of care to the building's owner, even a subsequent owner, to ensure that

the work did not contain defects that posed foreseeable dangers to the health and safety of the occupants. The Court of Appeal concluded that, as in *Winnipeg Condominium*, the defects in question posed a foreseeable danger to the Building's occupants. The "proximate relationship" between the building owners and the impact of negligent contractors or consultants on the building's construction established sufficient proximity to ground a duty of care owed by the contractor or consultant to the owner. Contractual clauses allocating risk did not negate this duty of care.

As to the contractual exclusion, the Court of Appeal affirmed that the exclusion operated as between the direct parties to it, however it required interpretation on a contextual basis to assess whether it was intended to be limited to negligence or extended to the additional claims for misrepresentation and failure to warn, and possible public policy unenforceability that were in issue. These issues and the interpretation and application of the contract exclusions were found to be inappropriate for summary trial in that the context could only be properly developed on a full evidentiary record, at trial.

Significantly, there was no discussion of the principles or limits to public policy unenforceability.

**Takeaways**

This decision underscores that corporate structures and contractual arrangements between parties in the construction chain do not operate to completely regulate and limit liability under the law of negligence when the nature of the risk rises to the level of real and substantial danger.

The contractual limitation in this case provided that liability was limited to the amount of the fees paid, a common provision. The Court of Appeal approached this narrowly, indicating that this limitation might "itself be interpreted as not extending beyond claims of professional negligence to the claims framed by DB Services in misrepresentation and failure to warn." (par 145)

The one potential silver lining in this extended liability cloud is that the Court of Appeal found that the issue as to the scope and enforceability of the contractual limitations was not appropriate for summary trial. However, the cloud remains, in that the Court of Appeal found that a consideration of all circumstances,

and public policy, was required before giving effect to the contractual limitations.

While this approach allows potentially liable parties seeking to rely upon a contractual exclusion or limitation to establish that the contractual provisions were meant to limit all liability, it equally imports uncertainty. Industry, particularly the construction industry, values certainty, and depends upon contract terms. Any element of uncertainty tends to be disruptive and increase cost.

This case serves as yet another caution, reminding construction participants to draft limitation clauses inclusively enough, and ensure coverage at some level to indemnify against the consequences of any acts or omissions beyond the immediate contractual matrix.

The Court of Appeal's reluctance to allow the contract terms to be used as a shield against justified public safety claims reinforces the policy rationale for holding parties accountable for foreseeable consequences of breaches of duties that carry potential for significant risk of harm, as in *Cooper*:

> "*whether a duty of care should be imposed, taking into account all relevant factors disclosed by the circumstances*"

The appeal decision again affirms that the door remains open for owners, and their successors, to advance claims for pure economic loss incurred to avert a real and substantial danger, from a presently existing risk, against construction parties in construction projects with whom no direct contractual relationship existed, even despite contractual limitations or allocations of risk, when the risks establish sufficient proximity to support a duty of care, and either contextual interpretation or unspecified public policy negates contractual, bargained for, limitation of liability.

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# Caution: Letters of Credit Challenged as Lien Security in Ontario - Stay Tuned

Letters of credit have been acknowledged as viable forms of lien security by courts for many years, but there is very little case law on this practice and none on the sufficiency of the commonly used standard form that is found, for example, as an appendix in the precedents section of *Conduct of Lien, Trust and Adjudication Proceedings*. That is about to change, since this was precisely the matter under consideration in *TruGrp Inc. v. Karmina Holdings Inc.* 2024 ONSC 2165.

Associate Justice Robinson heard a motion to set aside an order vacating a lien upon posting of security in the form of a letter of credit. His Honour's reasons for decision released on April 15, 2024, put a spotlight on the current commonly used form of letter of credit and whether it is sufficient security for a lien.

Associate Justice Robinson outlined but did not finally resolve the issue of the sufficiency of the letter of credit. The Court will only issue its final decision upon notice and an opportunity for the Accountant of the Superior Court of Justice and the bank who provided the letter of credit to be heard.

It is worth keeping an eye on this matter. The final decision could potentially influence future legal interpretations and practices regarding the use of letters of credit in securing liens.

**Vacating a lien**

Section 44 of the *Construction Act* contemplates an *ex parte* motion to vacate the registration of a claim for lien and certificate of action upon posting "security" in the required amount.

"Security" is not defined in the *Construction Act*. However, for decades both lien bonds and letters of credit have been accepted as security by the court.

The form of lien bonds is prescribed by s. 2(20) of O Reg 303/18 under the *Construction Act*, i.e., Form 21. The actual form for letters of credit is not prescribed in the Act however, s. 44(5.1) was added in 2018 to clarify that letters of credit that contain references to an international commercial convention are acceptable for the purposes of s. 44.

As noted, the form of letter of credit at issue is not a mandated form under the *Construction Act*. It never has been.

A precedent form of letter of credit appears in the appendices to the current edition of *Conduct of Lien, Trust and Adjudication Proceedings*. The form is substantially unaltered from the precedent that appeared in the first edition of *Conduct of a Lien Action* in 2004, then authored by Duncan Glaholt. As Mr. Glaholt noted in the preface to the first edition, the Toronto masters presiding over construction lien court at the time provided invaluable assistance and input to that first edition, including in respect of this precedent form of letter of credit.

Associate Justice Robinson correctly notes that there is no case law addressing the sufficiency of the expiry and renewal provisions in the current standard letter of credit; in fact, courts have not addressed why they have accepted the commonly used form of letter of credit as sufficient security.

**Background**

Karmina Holdings Inc. ("**Karmina**") moved *ex parte* for an order vacating TruGrp Inc.'s ("**TruGrp**") two claims for lien and certificate of action supported by security in the form of a letter of credit issued by the Bank of Montreal ("**BMO**"). The court reviewed and rejected the initial wording of the letter of credit, for reasons which are immaterial to the issue still to be resolved. Karmina amended and resubmitted the letter of credit. The court approved the amended letter of credit and granted the Order.

Associate Justice Robinson correctly noted that the form of letter of credit at issue had been specifically reviewed, revised, and re-submitted before it was approved by the Court. This was more than just a "pro forma" approval. However, as is permitted by the *Construction Act,* the order vacating the lien was obtained *ex parte* and without notice to the lien claimant, TruGrp.

Subsequently, Karmina posted the letter of credit with the office of the Accountant of the Superior Court of Justice (the "**Accountant**") and registered an application to delete construction lien to vacate TruGrp's registrations from title to the premises.

After its claims for lien and certificate of action were already vacated from title, TruGrp moved to set aside Associate Justice Robinson's order vacating TruGrp's two claims for lien and certificate of action. Alternatively, TruGrp sought directions from the court to address its concerns.

TruGrp's letter of credit contains the same language found in the typical form of letter of credit. The current common form letter of credit provides for the automatic renewal for the letter of credit for the successive one-year periods unless the issuing bank elects not to extend the letter of credit. The bank may only exercise its option not to extend the letter of credit by providing at least thirty days' written notice to the Accountant and providing the Accountant with a bank draft for the balance of the security.

TruGrp initially brought the motion in Hamilton, where the lien actions were brought, however Justice Nightingale directed the motions to proceed before Associate Justice Robinson since the vacating order had been issued by the Associate Justice on an *ex parte* motion in Toronto. It is relatively commonplace for the Associate Justices in Toronto to hear vacating motions for liens outside of Toronto because they specialize in such motions and have *ex parte* court time set aside that may not be available outside of Toronto. It is therefore not unusual to seek to bring an *ex parte* motion in Toronto for a non-Toronto lien, particularly where there is some urgency to obtaining the order vacating the lien. The circumstances here were not unusual and the letter of credit was in standard form.

However, sometime after receiving Associate Justice Robinson's *ex parte* Order, TruGrp became concerned with the expiry and renewal language in the letter of credit issued by BMO. TruGrp submitted that the language was such that it could result in there being no security for its lien. As proof of this, TruGrp stated that it had received communications from the Accountant which confirmed that the Accountant would not accept a replacement bank draft sent by BMO without both a court order and compliance with subrule 72.03(2) of the *Rules of Civil Procedure*. Rule 72.03 (2) essentially states that in order

to receive payment out of court in accordance with a court order, a person must file with the Accountant a written request for payment, as well as the court order or report ordering the payment, and an affidavit saying that, in the case of a report, the report has been confirmed and the manner of confirmation, or in the case of an order, the time prescribed for an appeal has expired and no appeal is pending or that the appeal period for the order has expired with no pending appeal.

**The Legal Arguments**

TruGrp put forward numerous arguments why the letter of credit was insufficient in the circumstances:

1. The terms of the letter of credit providing for potential replacement with a bank draft at the bank's option gives rise to a contingency in the security that is at odds with the *Construction Act*.

2. The letter of credit placed duties and obligations on the Accountant that are at odds with the *Public Guardian and Trustee Act*.

3. There was a potential gap whereby the letter of credit is not renewed by BMO, but the Accountant will not accept the bank draft as contemplated by the letter of credit without a court order, resulting in there being no enforceable security held in court for TruGrp's lien between that time. Since Karmina is allegedly seeking to sell the liened premises, TruGrp is concerned that it could be left without any security for its lien, contrary to the intent of the *Construction Act*.

4. Since nothing in the letter of credit requires notice to any party other than the Accountant, a lien claimant could also be entirely unaware of a potential deficiency with the security for its lien.

5. The requirement in the letter of credit for the Accountant to accept a bank draft creates positive duties and obligations on the Accountant that are contrary to the scope of the Accountant's statutory role, which is limited to being a "custodian" of lien security. The role and duties of the Accountant are now governed by the *Public Guardian and Trustee Act*. TruGrp relied on the stated role of the Accountant as a "custodian", in s. 3(7) of the Regulation under that Act, which states that "[t]he Accountant is the custodian of mortgages, securities, other instruments and other personal property deposited with him or her, **but has no other duties or obligations with respect to them.**"

6. If the letter of credit is not renewed and the bank provides a bank draft instead, it would require the Accountant to interpret the letter of credit to determine if BMO's notice was compliant, then review the bank draft to confirm that it is also compliant, and then decide whether to accept or reject the bank draft, which may require the Accountant to actually investigate the matter. TruGrp argued that these duties are not properly part of the Accountant's role.

Karmina attempted to have the motion dismissed on procedural grounds, relying on five separate arguments for why the court should not entertain the motion. Ultimately, each of these arguments were rejected; Associate Justice Robinson held that now that the sufficiency of the letter of credit had been challenged, the challenge should be resolved on the merits.

With respect to the merits, Karmina maintained that the court's approval of BMO's letter of credit was not contrary to either the *Construction Act* or the *Public Guardian and Trustee Act*. It argued that courts have accepted this form of letter of credit for decades without any issues like the one advanced by TruGrp arising. Further, it argued that the approved letter of credit included a specific direction that BMO may provide replacement security to the Accountant by way of bank draft. That being the case, the Accountant, as the custodian of the letter of credit on the terms that have been approved by the court, has no basis for refusing to accept a bank draft from BMO, provided that the required notice of at least thirty days has been given.

The court reviewed but did not resolve the controversy on the merits without first affording the Accountant and BMO an opportunity to make submissions. The matter has been adjourned to allow those parties to be put on notice and to potentially respond.

**Commentary**

As one if its five procedural challenges, Karmina contended that the issue was moot because there was no evidence suggesting that BMO might not renew the letter of credit or opt for a bank draft instead. There is apparent merit in Karmina's argument regarding the mootness of the issue presented before the court. It is indeed notable that there was no evidence indicating BMO's intention to not renew the letter of credit or the likelihood of it opting for a bank draft instead. It is interesting that the court chose not to wait for a live controversy to address this matter.

In any event, the core matter for Associate Justice Robinson's consideration is whether the initial court order suffices in its entirety, or if a subsequent court order is necessary.

Should the court decide two orders are necessary under the current standard letter of credit form, it

could pose complications for lien claimants whose liens are presently secured with the existing form for letters of credit. However, such an outcome appears unnecessary. The court's original Order sanctioned the letter of credit in its presented form, thereby endorsing the possibility of BMO substituting the letter of credit with a bank draft. This approval encompassed an express provision regarding the replacement condition in question. Thus, the court effectively sanctioned BMO's potential substitution of the letter of credit with a bank draft.

In other words, the original order inherently permits the substitution of the letter of credit with a bank draft, even if not explicitly stated. The Order provides that the letter of credit is only cancelled if the bank actually provides a replacement bank draft for the Accountant to accept. The Order, by its terms, at least implicitly requires the Accountant to not only accept the letter of credit but accept it subject to its terms, including tendering of the replacement draft.

Further, a bank draft, a familiar instrument to both banks and accountants, is essentially equivalent to cash. Unlike a normal "cheque" which merely directs one's banker to remit the face value of the instrument, provided that there is adequate credit held to the customer's account with the financial institution, a bank draft asserts to the holder that the issuing or certifying institution financially backs the instrument.

Therefore, in the authors' view the Accountant should not require further explicit court authorization to accept the bank draft as replacement security for the court-approved letter of credit.

The *Construction Act* specifies the required forms or contents for letters of credit and bonds but is silent on the language for a bank draft. We believe this omission was intentional by the legislature, recognizing that while letters of credit and bonds may require legislative guidance, no such issues exist for bank drafts.

The historical context of the 1932 *Mechanics Lien Act* also supports this view. It allowed for the vacating of a lien using a bond or "other security" satisfactory to a judge or officer, without defining "other security." This flexibility has permitted the use of various forms of security, including bank drafts and letters of credit, for over 90 years without significant issues. This long-standing acceptance demonstrates that bank drafts are an effective and appropriate form of security.

Given their equivalence to cash and their established use in legal and financial contexts, bank drafts should be accepted without requiring additional court authorization. This interpretation aligns with legislative intent and practical considerations of efficiency and reliability in financial transactions. If the Accountant maintains that acceptance of the bank draft is contingent upon obtaining a further court order, then it seems logical that the letter of credit persists until such authorization is acquired. The bank cannot unilaterally revoke the letter of credit; it remains valid until all terms are met. This scenario does not appear to endanger or prejudice the lien claimant. Hence, the crux of Associate Justice Robinson's decision lies in determining the sufficiency of the original court order, rather than mandating a second one. Insisting on two orders might introduce uncertainty.

It will be interesting to see if and how the Accountant and/or BMO participate in the relevant motion, as well as the court's ruling on the suitable language for letters of credit utilized in lien security.

It is also worth keeping an eye on this from the perspective of the review of the *Construction Act* which the Ontario government has appointed Duncan Glaholt to conduct. The form of lien bond, for example, has been mandated by the Regulations to the *Construction Act* for many years. The form of letter of credit has not. It may be time to resolve any controversy and affirm this long-standing practice by stipulating the acceptable form of letter of credit to post as security through regulation.

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# Canada's *Federal Prompt Payment for Construction Work Act*: Ensuring Fairness and Timeliness in the Construction Industry

In the realm of construction projects, delays in payment can cause significant disruptions, strain relationships, and impede progress. Projects involving federal property are no exception. Accordingly, the *Federal Prompt Payment for Construction Work Act*, S.C. 2019, c. 29, s. 387 (the "*Act*") was implemented to ensure prompt payment on federal projects. This article discusses key provisions and implications of the *Act*.

**Implementation and Application**

The *Act* came into force on December 9, 2023 and all existing construction contracts have 1 year to comply (i.e. by December 9, 2024). As stated in s 4 of the *Act*, its purpose is

> *to promote the orderly and timely carrying out of construction projects in respect of any federal real property or federal immovable by addressing the non-payment of contractors and subcontractors who perform construction work for the purposes of those projects.*

Ultimately, the *Act* aims to streamline payment processes within the construction industry by establishing clear timelines for payment and dispute resolution (i.e. adjudication). The legislation applies to federal construction projects, ensuring that contractors, subcontractors, and suppliers receive timely compensation for their work.

Pursuant to s 2(1) of the *Act*, "construction project" is broadly defined to include any addition, alteration or capital repair, restoration, construction, erection, or installation, and includes "complete or partial demolition" and "installation of equipment that is essential to the normal or intended use of the federal real property or federal immovable".

"Real property" includes land, mines and minerals, buildings, structures, improvements, and other fixtures, whether above or below ground.

"Immovables" include land and or anything permanently attached to land (such as buildings and structures) including the rights of a lessee.

Notably, the Governor in Council has authority to designate that provincial legislation will apply in lieu of the *Act* where a province has legislation similar to the *Act* (e.g. the Ontario *Construction Act*, R.S.O. 1990, c. C.30).

Where the *Act* applies, the Federal Government (or its service provider) has a duty to inform the contractor that the *Act* applies to the contract, and the contractors and subcontractors have a duty to inform their subcontractors.

**Prompt Payment Timelines**

Central to the *Act* are its provisions outlining payment timelines, which are triggered by issuing a "proper invoice" to the federal entity that owns the project. Invoices may be issued monthly or as specified by the subject contract, and must include:

a. The date of the invoice and the name, street and mailing address, telephone number and email address of the contractor that performed the construction work;

b. The period during which the materials or services were supplied;

c. The contract number or other authorization under which the materials or services were supplied;

d. A description, including the quantity, if applicable, of the materials or services supplied;

e. The amount payable for the services or materials supplied and the payment terms; and

f. The name, title, street and mailing address, telephone number and email address of the person to which payment must be made.

As summarized below, the payment timelines under the *Act* mimic those of the Ontario *Construction Act*.

| Event | Federal *Prompt Payment for Construction Work Act* | Ontario *Construction Act* |
|---|---|---|
| Payment: Owner to Contractor | 28 days from invoice (s 9(2)) | 28 days from invoice (s 6.4(1)) |
| Payment: Contractor to Sub | 7 days after payment from owner (s 10(1)) | 7 days after payment from owner (s 6.5(1)) |
| Payment: Sub to Sub-Sub | 7 days after payment from contractor (s 11(1)) | 7 days after payment from contractor (s 6.6(1)) |

**Disputes and Nonpayment**

The only mechanism to avoid payment obligation is a notice of non-payment. The time to issue a notice of non-payment under the *Act* is based on when a proper invoice was issued to the owner. To facilitate this, s 9(5) of the *Act* provides that on request, a contractor must inform any subcontractor in the subcontracting chain of the date on which a proper invoice was issued.

As summarized below, dispute timelines under the Act differ slightly from those under the Ontario *Construction Act*.

| Event | Federal *Prompt Payment for Construction Work Act* | Ontario *Construction Act* |
|---|---|---|
| Payment: Owner to Contractor | 21 days from invoice (s 9(3)) | 14 days from invoice (s 6.4(2)) |
| Payment: Contractor to Sub | 28 days after invoice to owner (s 10(3)) | 7 days after notice from owner or, if no notice, within 35 days of invoice to owner (s 6.5(6) & (7)) |
| Payment: Sub to Sub-Sub | 35 days after invoice to owner (and so on down the chain of subs in increments of 7 days) (s 11(3)) | 7 days after notice from contractor or, if no notice, within 42 days of invoice to owner (s 6.6(6) & (7)) |

**Enforcement**

The *Act* is self-enforced by referral to adjudication (see s 15–21 of the *Act*, "Dispute Resolution"). Pursuant to s 16(2) of the *Act*, adjudication must be commenced within 21 days of a certificate of completion being issued or expiry of time limit for payment under the last proper invoice.

Notices of adjudication are governed by s 16(3) of the *Act* and must include:

a. the names of the parties to the dispute;

b. a brief description of the dispute, including details of how and when it arose;

c. the amount requested to be paid;

d. the name of a proposed adjudicator; and

e. any other information prescribed by regulation.

Adjudication is administered by Canada Dispute Adjudication for Construction Contracts ("CanDACC"), which is run by Ontario Dispute Adjudication for Construction Contracts (ODACC).

Adjudicators must have at least 10 years of relevant working experience in construction and attend a CanDACC orientation program, as well as having not been convicted of an indictable offence or be an undischarged bankrupt.

**Impact on Stakeholders**

By ensuring timely payments, the *Act* fosters stability and enables contractors to confidently purchase equipment and materials, pay employees, and meet other financial obligations.

For contractors and subcontractors, the *Act* provides assurance that they will be promptly compensated, thereby reducing financial strain and uncertainty. With improved cash flow, these entities can operate more efficiently and pursue growth opportunities with greater confidence.

Project owners also benefit from the *Act*. Ensuring timely payments to contractors and subcontractors minimizes the risk of delays and cost overruns, such that project timelines are more likely to be met.

Suppliers and service providers within the construction supply chain also stand to gain from the *Act*. Timely payments enable these entities to maintain stable operations, fulfill orders, and deliver materials and services without disruptions, ultimately contributing to the smooth progression of construction projects.

**Challenges and Future Outlook**

While the *Act* represents a significant step forward for the construction industry, challenges remain in its implementation and enforcement. As mentioned, the Governor in Council has the authority to decide that provincial legislation will apply in lieu of the *Act*, and it is unclear how this discretion will be utilized.

Moreover, the interplay and potential conflict between the *Act* and provincial legislation creates the possibility of jurisdictional challenges, which may undermine the provincial objective of having construction disputes summarily resolved.

It is also notable that the *Act* largely relies on contractors and subcontractors being duly informed of its application and their understanding of how to enforce the *Act*. As industry stakeholders are still learning how to utilize the adjudication process most effectively, this adds another factor to be mindful of.

**Conclusion**

The *Act* strives to promote fairness, transparency, and timeliness within the construction sector. By establishing clear payment timelines and dispute resolution mechanisms, the *Act* fosters a more conducive environment for project delivery, thereby enabling stakeholders to navigate payment issues effectively and focus on advancing critical infrastructure initiatives. As the industry continues to evolve, the Act will hopefully play a beneficial role nationwide.

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# Understanding Notice Holdback

Ontario's *Construction Act* (the "***Act***") underwent significant amendments in 2018 and 2019, most of which were aimed at modernizing the construction payment regime and enhancing protections for contractors, subcontractors, and suppliers. Among the notable changes (but perhaps less talked about than others over the last half decade) are those related to "Notice Holdback".

**What is Notice Holdback?**

Sending a "written notice of lien" is a first step that a party may want to consider prior to registering or giving a claim for lien. Upon receipt of a written notice of lien, a payer (i.e., the party or parties above the lien claimant in the construction pyramid) must retain an amount sufficient to satisfy the lien. This is often referred to as "Notice Holdback".

The practical effect of a party giving a written notice of lien is such that the normal contractual flow of funds is disrupted (at least to the extent of the Notice Holdback) until the written notice of lien is discharged, vacated, or withdrawn.

In a situation where an owner fails to retain Notice Holdback and continues to pay its general contractor in the face of a written notice of lien, the owner may be liable for the full amount of the written notice of lien if the general contractor does not pay the subcontractor and goes bankrupt. As such, the owner's maximum liability is increased from the basic holdback set out in section 22 of the *Act* to the applicable Notice Holdback.

Importantly, from a lien claimant's perspective, a written notice of lien does not "stop the clock from running" in respect of the time to preserve a claim for lien. It is a temporary measure and if the claimant remains unpaid after the written notice of lien is given, the claimant must still preserve its claim for lien, or it will lose its lien rights.

**Rules under the *Construction Act***

1. **Form of notice:** The "written notice of lien" must be in Form 1 and given by a person having a lien. Under the old Act, "written notice of a lien" was defined as follows: "written notice of a lien" includes a claim for lien and any written notice given by a person having a lien that,

   (a) identifies the payer and identifies the premises, and

   (b) states the amount that the person has not been paid and is owed by the payer.

   With the changes to the *Act*, the circumstances where Notice Holdback obligations are triggered are narrower and require the use of a particular form.

2. **Service of the notice:** A written notice of lien must now be served by personal service as provided for in Rule 16.02, or by an alternative to personal service as provided for in Rule 16.03 (section 87 of the *Act*).

3. **Content:** Form 1 requires information related to the parties, the time period of supply, description of the supply (i.e., the services or materials), description of the premises, contract price and amount of claim. It also requires the signature of the lien claimant.

4. **Resolving a written notice of lien:** A written notice of lien can be:

   a. withdrawn (in accordance with section 41(2) of the *Act*);

   b. vacated (in accordance with section 44 of the *Act*); or

   c. declared expired (in accordance with section 47(1) of the *Act*).

**Practice Implications**

Notice Holdback has several practical implications for stakeholders within the construction industry:

1. **Compliance requirements:** parties must familiarize themselves with the specific Notice Holdback provisions outlined in the *Act* to ensure compliance. Failure to adhere to these requirements could result in increased liability, for example, if an owner makes payments after a written notice of lien has been received.

2. **Increased leverage for subcontractors and suppliers:** subcontractors and suppliers can use a written notice of lien to protect against solvency issues with contractors and subcontractors above them in the construction pyramid and facilitate payment without formally registering a lien on title.

3. **Contractual considerations:** owners, contractors, subcontractors and suppliers should review their contracts and update them to reflect the provisions in the *Act*, and make sure they account for written notices of liens.

In summary, Notice Holdback represents opportunity and risk for construction players, and it is important to understand the obligations bestowed upon each party in a situation where there has been a written notice of lien given on a construction project.

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# *MGW-Homes Design Inc v. Pasqualino*, 2024 ONCA 422; *MGW Homes Design Inc v. Pasqualino*, 2024 ONSC 2852

**Overview & Facts**

The Ontario Court of Appeal and the Ontario Superior Court of Justice, Divisional Court each recently released a decision on *MGW-Homes Design Inc v. Pasqualino*. The decisions stemmed from the same appeal from an order vacating a writ of enforcement pursuant to an adjudication decision.

In brief, Pasqualino and MGW-Homes Design Inc. sought to resolve a construction contract dispute through the adjudication process. The adjudicator's decision resulted in an award of $119,314 to be paid to MGW Homes. MGW Homes filed the adjudicator's decision with the court, but failed to give notice to Pasqualino that they did so as required by s 13.20(3) of the *Construction Act*. MGW Homes subsequently obtained a writ of enforcement, which Pasqualino disputed. The motion judge found that MGW Homes' violation of s 13.20(3) was fatal not only to MGW Homes' writ of enforcement, but also to any future attempts to enforce the adjudicator's order.

MGW Homes appealed the order vacating the writ of enforcement to both the Ontario Court of Appeal and the Divisional Court.

**(i) Jurisdiction of the Court**

The Ontario Court of Appeal considered whether it had jurisdiction to hear the appeal. The issue was resolved through the interpretation of the term "judgment" in s 71(1) of the *Construction Act*.

Relying on the precedents from *Villa Verde LM Masonry Ltd v. Pier One Masonry Inc.*, [2001] OJ No 1605 and *TRS Components Ltd v. Devlan Construction Ltd.*, 2015 ONCA 294, the Court of Appeal held that the term "judgment" should be construed broadly. Accordingly, an order to vacate a writ of enforcement is a "judgment" under the *Construction*

*Act*, and any right of appeal would fall within the jurisdiction of the Divisional Court.

**(ii) Judicial Discretion to Grant Remedies Where the *Construction Act* is Silent**

The Divisional Court went on to decide whether MGW Homes' failure to give notice pursuant to s 13.20(3) of the *Construction Act* was fatal to any future enforcement of the adjudicator's decision. The parties did not dispute that the order vacating the writ itself was an appropriate remedy for MGW Homes' failure to give notice.

The Divisional Court made three key findings in holding that the court may exercise judicial discretion in granting remedies for non-compliance with the adjudication provisions. First, the *Construction Act* is silent on the consequence for non-compliance with s 13.20(3). In light of this, as well as the *Construction Act's* central goal of expediency, judicial discretion in granting a remedy where the adjudication provisions do not provide for one is appropriate.

Second, adjudication determinations are not analogous to lien claims. Whereas lien claims affect rights and obligations under the *Construction Act* and require strict compliance, adjudications are part of the prompt payment regime. Rather, to achieve expediency, "[t]he notice requirement is more properly seen as a statutorily required courtesy...", allowing for some forgiveness for non-compliance.

Finally, the writ is not completely void for non-compliance with the notice provision. Accordingly, the remedy is subject to judicial discretion. While some consequence is clearly required, its extent is highly circumstantial.

Given that MGW Homes agreed that the order vacating the writ was appropriate for their failure to give notice, the court declined to exercise its discretion to grant a different remedy. The Divisional Court, however, provided a list of factors to be considered in similar cases going forward: 1) the severity of the non-compliance; 2) an explanation for the non-compliance; and 3) prejudice to the payor. Ultimately, the Court's exercise of discretion requires consideration of all the circumstances.

The related decisions from the Ontario Court of Appeal and the Divisional Court shed insight on the court's jurisdiction with respect to adjudication determinations. First, appeals from "judgments" flowing from adjudication decisions lie with the Divisional Court, not with the Court of Appeal. Second, non-compliance with s 13.20(3) is not necessarily fatal to a writ of enforcement. Underlying both decisions is the overarching goal of expediency within the prompt payment regime of the *Construction Act*. These cases represent a push for actual cash flow within construction hierarchies and eliminating legal barriers to the completion of construction projects.

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# Notable Case Law

***Arcamm Electrical Services Ltd. v. Avison Young Real Estate Management Services LP*, 2024 ONCA 251**

An appeal from a summary judgment under r. 20 lies to the Court of Appeal, even if the appeal concerned findings by the motion judge that Arcamm's invoices were not "proper invoices" for the purposes of s. 6.1 of the *Construction Act* and that Queen was an "owner" under the *Construction Act* and was contractually liable to Arcamm.

In this case, the judgment was not made under the *Construction Act*. Instead, the source of the motion judge's jurisdiction was r. 20, a rule promulgated pursuant to the *Courts of Justice Act*.

In addition, the relief granted was based on a claim for damages in contract for unpaid invoices, a non-statutory cause of action. The grounds of appeal highlighted the significance of this point. Queen's primary ground of appeal was its contention that the motion judge erred in failing to find a genuine issue requiring a trial, specifically by failing to consider the defence of contributory fault and whether Arcamm's conduct caused or contributed to the same damages claimed in contract. These issues were not matters governed by the *Construction Act*; they were specific to the application of the test under r. 20.

***1593095 Ontario Ltd. (Northwood Window and Door Centre) v. McCann*, 2024 ONSC 163 (S.C.J.)**

A breach of contract by a contractor is not *carte blanche* for the homeowners to make extravagant claims amounting to a complete refund of what was paid for the work. The homeowners must act reasonably and prudently and must mitigate their losses if possible.

***Demikon Construction Ltd. v. Oakley Holdings Inc. et al*, 2024 ONSC 2151 (S.C.J.)**

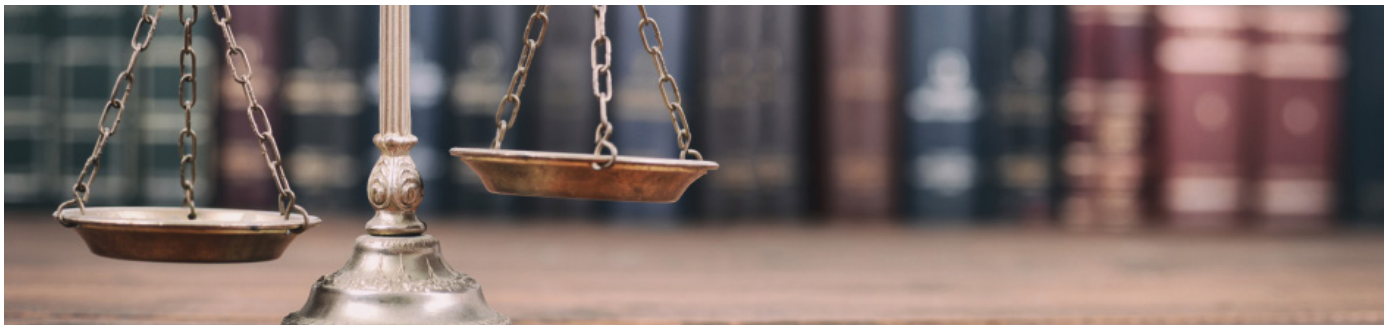
Direct payments under s. 28 of the *Construction Act* can be made to any persons having a lien, not just to persons who have a claim for lien. Valid s. 28 payments can be made to any person, "…on account of any amount owing to that person for services or materials", which would encompass persons who have an amount owing to them for services and materials. It would not require them to be lien claimants.

There is no reason why payments made under s. 28 payments would not factor into the court's summary exercise in s. 44(5). As stated by McCarty J.:

> Indeed, how could they not? Common sense, fairness, simple accounting, commercial reality, the mechanics of security and the entire scheme and purpose of the *Act* would all be perverted if direct subcontractor payments were not central to the court's analysis of a security reduction motion. Moreover, s. 29 clearly stipulates that payments made in accordance with that part of the Act operate as a discharge of the lien to the extent of the amount paid. Section 17(1) of the Act stipulates that the lien of a person is "limited to the amount owing to the person", while s. 17(3) clarifies that the amount as between payer and the person the payer is liable to pay is "equal to the balance in the payer's favour of all outstanding debts, claims or damages". Undoubtedly, the terminology "amount owing" and "balance" contemplates a lien value subject to updating, credits, reductions, and adjustments.

***2708320 Ontario Ltd. cob Viceroy Homes v. Jia Development Inc.*, 2024 ONSC 1608 (A.J.)**

The court discussed whether liability for costs under section 86(1)(b)(i) includes conduct that is "reckless" and "willfully blind." Recklessness and willful blindness have been defined as having a level of knowledge that is the moral equivalent of actual knowledge. Such conduct is well beyond mere negligence or a laziness underlying a failure to inquire. It involves knowledge of an actual risk that is at the level of a "clear probability" and then a failure to act to avoid the risk or make inquiries.



The court concluded that liability for costs under section 86(1)(b)(i) includes recklessness and willful blindness. Statutory interpretation was one reason for this conclusion. Section 86(1)(b)(i) includes the phrase "where it is clear that the lien is without foundation, or is for a grossly excessive amount, or that the lien has expired." That phrase is not necessary to the rest of the sentence. It was added to capture the situations where the representative does not have actual knowledge of the baselessness of the claim but knowledge of a "clear probability" that it is baseless and fails to act or inquire.

The second reason for this interpretation is the lawyer's gatekeeper function. Where the lawyer's knowledge has reached that of a "clear probability" of the claim's baselessness, the lawyer's duty to the court, the property owner and others who may be adversely affected should supersede the lawyer's duty to the client, and the lawyer should investigate or refuse to participate.

***Atlas Dewatering Corporation v. Harvie Construction Inc.*, 2024 ONSC 1775 (S.C.J.)**

In a case involving two experienced contractors, where a contract was silent on payment terms, the court implied a term that interim payments would be made. The level of sophistication of both parties, along with the billing of monthly progress draws, allowed the court to infer that interim billing and payment was an expected part of the contract for the parties. The court discussed *Marden Mechanical Ltd. v. West–Con Developments Inc.*, 2007 CarswellOnt 1629, where Corbett J. found that there was an implied term that interim payments would be made. The court found that although the contract was silent as to payment terms, it contemplated progress draws because it would have been unreasonable to expect the contractor to perform three quarters of the contract work by building a warehouse and then wait months for payment while another building was being constructed before it could complete the contract work and get paid. Also referenced was a decision of Master Sandler, *RSG Heating & Air Conditioning Ltd. v. Maxximum Design & Construction Inc.*, [2002] O.J. No. 3844, in which he held that even though there are no payment terms in a quotation, and no formal contract superseding the quotation and acceptance, the usual practice is for interim billing when a job is to take more than one month.

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# Building Insight Podcasts

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**March 2022**

Associates, Patricia Joseph, Jackie van Leeuwen and Myles Rosenthal, reflect on construction contracts, including a discussion of some pragmatic considerations that are relevant before and during contract performance.

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## Episode 35: Construction Prompt Payment and Adjudication in Canada

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John Paul Ventrella, Partner, and Matthew DiBerardino, Articling Student, discuss some key considerations regarding the conduct of a construction adjudication in Ontario and the status of prompt payment and adjudication legislation in other Canadian jurisdictions.

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## Episode 36: 2022 Annotated Construction Act and Conduct of Lien, Trust and Adjudication Proceedings

**June 2022**

Partners, Brendan Bowles and Lena Wang, and Director of Research, Markus Rotterdam, discuss the 2022 Annotated Construction Act and Conduct of Lien, Trust and Adjudication Proceedings texts available from Thomson Reuters Canada Limited. Key updates to the books are discussed and commentary on their development is given.

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## Episode 37: Bankruptcy and Insolvency in Construction

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Brendan Bowles, Partner, Markus Rotterdam, Director of Research, and Megan Zanette, Articling Student, discuss recent developments in Ontario case law surrounding bankruptcy and insolvency in the construction industry.

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## Episode 38: Adjudicating the Future: Trends and Insights in Construction Dispute Resolutions in 2023 (Where we are and where we are going)

**January 2024**

Lena Wang, Partner, and Amir Ghoreshi, Associate, review and discuss the statistics, trends, and key takeaways from the recent ODACC annual reports against the backdrop of an increase in popularity of Construction Act adjudications and recent noteworthy court decisions that are shaping the adjudication landscape.

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## Episode 39: Careers in Construction Law: From Private Practice to In-House Counsel

**March 2024**

Katie McGurk, Associate, joins Barbara Capes, General Counsel at Kiewit Canada Inc., and Caitlin Steven, Legal Counsel & Contracts Manager at Chandos Construction, for a discussion on working as in-house counsel in the construction industry. In this International Women's Day episode, Katie, Barbara and Caitlin discuss the transition from private practice to working in-house, and how we can entice more female lawyers to pursue careers in construction law.

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