

## A CONSTRUCTION LIEN PRIMER – PART II

This is Part II of our three-part series dealing with the changes to Ontario’s Construction Lien Act (the “Old Act”) (renamed the Construction Act (the “New Act”). In this News ReLease we address the holdback requirements, changes to the definition of “substantial performance” and “completion”, and we also discuss how a lien may be “bonded off”. In Part III we will outline the new prompt payment and adjudication regimes applicable to contracts entered into from and after October 1, 2019.

### THE HOLDBACK SYSTEM

Both the Old Act and the New Act require that any party who hires a contractor to do work or supply materials for an improvement on land or for a building, must hold back certain amounts from the contractor’s invoices as the work proceeds and the materials are supplied. These holdback amounts serve as a pool of funds for the benefit of subcontractors and suppliers. The funds may not be paid to the contractor until certain conditions are met. Failure to maintain the required holdback may jeopardize the owner’s interest in the land and building.

There are three types of holdback: “basic holdback”, “finishing holdback”, and “notice holdback”.

### BASIC HOLDBACK

The party who hires a contractor must holdback 10% of the price of services and materials supplied, until 60 days after a certificate of substantial performance is published (or if there is no certificate, until 60 days after the contract is completed, terminated or abandoned).

### FINISHING HOLDBACK

When a contract has been certified or declared substantially performed, but some services or materials remain to be supplied to finish the work, a similar 10% holdback of the price of the remaining services and materials applies, until 60 days after the contract is fully completed, terminated or abandoned.

### NOTICE HOLDBACK

If an owner receives a written notice of lien from a subcontractor, the owner is required to hold back the entire amount claimed in the notice, in addition to the 10% holdback, until the notice of lien is either withdrawn or vacated by a court. Under the New Act, the written notice of lien must be served (versus simply being mailed by registered or certified mail under the Old Act).

### EXPIRY OF THE LIEN PERIODS

Under the Old Act, a party was no longer required to retain a holdback once the liens that could be claimed against those amounts had expired, been satisfied or discharged. Under the New Act, there is now a **positive obligation** to release the holdback **on expiry** of the applicable lien periods (except for a holdback in response to a written notice of lien). In light of the statutory obligation to make payment on the expiry of the applicable lien periods, the determination of the expiry dates is now of critical importance. The changes affecting these dates and the applicable definitions are described below.

### SUBSTANTIAL PERFORMANCE AND COMPLETION

The New Act modernizes the definitions of “substantial performance” and “completion”, by increasing applicable monetary thresholds.

Under the New Act, “substantial performance” occurs when:

- (a) the improvement to be made under the contract or a substantial part of it is ready for use or is being used for the purposes intended; and
- (b) the improvement to be made under the contract is capable of completion or, where there is a known defect, correction, at a cost of not more than:
  - (i) 3% of the first \$1,000,000.00 of the contract price;

(ii) 3% of the next \$1,000,000.00 of the contract price; and

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

(Under the Old Act, the thresholds were based on \$500,000.00.)

Under the New Act, a contract is deemed “completed” when the price to complete the contract is the lesser of:

(a) 1% of the contract price; and

(b) \$5,000.00.

(Under the Old Act, the \$5,000.00 figure was \$1,000.00.)

These changes mean that, depending on its dollar value, a contract might be “substantially performed” or “completed” earlier than under the Old Act. Consequently, although the period for registration of a lien has been extended by the New Act from 45 to 60 days, depending on the dollar value of the contract, the clock might start to run earlier due to the new definitions of “substantial performance” and “completion”.

It is worth noting that the New Act provides a mechanism for delaying payment of the basic and finishing holdbacks. If an owner publishes a “notice of non-payment of holdback” within 40 days of publishing the certificate of substantial performance, or within 40 days after the date the contract is completed, abandoned or terminated, and furthermore, notifies the contractor of the publication, the owner may delay payment. (Where

this type of delay occurs, the prompt payment and adjudication regimes addressed in Part III of this series will come into play.)

### **BONDING OFF**

The registration of a claim for lien or the serving of a notice of lien might disrupt an owner’s ordinary course of business because its construction or general lender may refuse to provide advances on a loan until all liens are removed from title and/or all notices of lien are withdrawn. Both Acts provide a mechanism that allows a party to pay amounts into court, which serve as substitute security for the lien claim. This process is known as “bonding off” and allows the lien to be removed from title or the notice of lien to be withdrawn without having to wait for the lien claim to be resolved. Owners often insist that their tenants use the bonding off procedure so that liens arising from tenant improvements do not encumber the owner’s title. Under the Old Act, to bond off, the party was required to post security (for example, cash, letter of credit or bond) for the full amount of the lien claimed plus the lesser of \$50,000.00 or 25% percent of the amount claimed (as security for costs). Under the New Act, the \$50,000.00 amount has escalated to \$250,000.00.

### **PART III**

Part III of this series will discuss the prompt payment and adjudication rules in the New Act. These rules establish a very new and different paradigm for the resolution of construction disputes in Ontario. Stay tuned.

*This publication is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss the issues in this publication with you, in the context of your particular circumstances.*



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