

# Goodmans<sup>LLP</sup> Update

## Prompt Payment under the *Construction Act*: The “Proper Invoice” and Strict Payment Deadlines

The *Construction Lien Amendment Act* was passed in December 2017 substantively changing the *Construction Lien Act*, now the *Construction Act* (the “*Act*”). The changes (i) modernize the existing *Construction Lien Act*; (ii) institute prompt payment legislation throughout Ontario; and (iii) introduce adjudication provisions for disputes arising in the course of a contract. For further information on the *Act* see our June 20, 2018 Update, [Construction Act: Here We Go!](#), our December 17, 2018 Update, [Bill 57 and Amendments to the Construction Act](#) and our May 21, 2019 Update, [Adjudication Under the Construction Act: Tight Timelines and Document Management](#).

### Prompt Payment

The new prompt payment regime introduced under the *Act* comes into effect on October 1, 2019 and will have significant implications for all levels of the construction pyramid in Ontario. Working in conjunction with the new adjudication provisions, the prompt payment provisions are intended to speed up the flow of payments on construction projects. All members of the Ontario construction industry need to ensure they are aware of these new timelines and have the proper systems and procedures in place to comply with this new regime.

The prompt payment provisions under the *Act* can be divided into four broad sections:

1. the requirements for a “proper invoice”;
2. the owner’s payment obligations to the contractor;
3. the contractor’s payment obligations to its subcontractors; and
4. the subcontractors’ payment obligations to their sub-subcontractors.

Under the *Act*, any party that has a direct contract with an owner is considered a “contractor”. This is the case even if a party does not necessarily carry out the functions of what people may colloquially refer to as a “general contractor”. As such, a trade contractor (for example, an electrical contractor) who has a direct contract with an owner is considered a general contractor under the *Act*. Similarly, the *Act* does not use the term “sub-subcontractor”. Any party that does not have a direct contract with an owner is classified as a “subcontractor”. This classification continues all the way down the construction pyramid. However, for the sake of clarity in this article, we will use the term “sub-subcontractor” for those parties who have subcontracts with a subcontractor.

### Which Contracts Are Subject to Prompt Payment?

Although the prompt payment provisions come into effect on October 1, 2019, these provisions will only apply to construction contracts and subcontracts where the prime contract was entered into on or after this date. For construction projects that were commenced by a tendering process, the prompt payment regime will only apply where the tendering process began on or after October 1, 2019.

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## What is a Proper Invoice?

The timelines under the prompt payment regime are initiated by the contractor's delivery of a "proper invoice" to the owner. Pursuant to section 6.1 of the *Act*, to qualify as a "proper invoice", the invoice must include:

- i. the contractor's name and address;
- ii. the date of the invoice and the time period during which the services or materials were supplied;
- iii. information identifying the contract or other agreement under which the services or materials were supplied;
- iv. a description of the services or materials supplied;
- v. the amount payable under the invoice;
- vi. the name, title, telephone number and mailing address of the person to whom payment is to be sent; and
- vii. any other information specified by the contract.

Unless the contract provides otherwise, a proper invoice must be given to the owner on a monthly basis (s. 6.3(1)). Importantly, although an invoice can be subject to review by a payment certifier, any requirement that a payment certifier approve an invoice before it can be considered a proper invoice, is of no force or effect under the *Act* (s. 6.3(2)).

## What are the Owner's Obligations to the Contractor?

Under the *Act*, the owner must pay the contractor within 28 days of receipt of a proper invoice (s. 6.4(1)). The owner can only defer or dispute payment if, within 14 days of receiving the proper invoice, the owner gives the contractor a notice of non-payment under the new Form 1.1 of the *Act* (s. 6.4(2)).

The owner's notice of non-payment must:

- i. specify the amount of the invoice that the owner is disputing; and
- ii. set out "all of the reasons for non-payment".

If the owner fails to provide this notice of non-payment within the 14 day deadline, it is obligated to pay the contractor all amounts set out under the proper invoice (s. 6.4(1)).

Although not specified under the *Act*, the requirement that the notice include "all of the reasons for non-payment" suggests that an owner will be unable to contest the contractor's invoice by relying on any other reasons not specified in the notice of non-payment.

## What are the Contractor's Obligations to its Subcontractors?

### The Contractor's Payment Obligations to its Subcontractors

If the contractor receives any payment from the owner, the contractor only has seven days to pay the subcontractors who supplied services/materials that were included in its "proper invoice" (s. 6.5(1) and (2)).

In accordance with s. 6.5(3) of the *Act*, if the owner only pays a portion of the contractor's proper invoice (and therefore also provided the contractor with a notice of non-payment) and more than one subcontractor supplied services/materials under the proper invoice, then the contractor must make payment to its subcontractors in accordance with the following rules:

1. If the owner's notice of non-payment specifies that the amount not paid relates to the services/materials of a specific subcontractor, then the remaining subcontractors are to be paid first, with any leftover amounts paid to the disputed subcontractors on a pro-rata basis; or
2. If the owner's notice of non-payment does not specify that the non-payment relates to the services/materials of a specific subcontractor, then the subcontractors are to be paid on a pro-rata basis.

Where the owner does not pay the contractor's proper invoice, or only pays a portion, the *Act* requires that, subject to the contractor providing its own notice of non-payment to its subcontractors (discussed below), the contractor must still pay the subcontractors whose materials/services were included in the proper invoice. This payment must be made within 35 days of the date the proper invoice was submitted to the owner (s. 6.5(4)).

## The Contractor's Notice of Non-Payment Obligations to its Subcontractors

Where a contractor disputes the amounts owing to its subcontractors (including because of non-payment by the owner) the contractor must provide its subcontractors with a notice of non-payment within seven days of receiving a notice of non-payment by the owner. If the owner does not provide the contractor with a notice of non-payment, but the contractor still disputes the amounts owing to its subcontractors, the contractor must provide the subcontractor with a notice of non-payment within 35 days of providing a proper invoice to the owner (s. 6.5(7)).

If a contractor fails to provide its subcontractors with a notice of non-payment, it must make full payment to its subcontractors (s. 6.5(4)).

Where a contractor decides not to make payment to its subcontractors because of non-payment by the owner, the contractor must provide its subcontractors with a "notice of non-payment where owner does not pay" under Form 1.2 of the *Act* (s.6.5(5)).

Under this notice of non-payment, the contractor must:

- i. state that some or all of the amount payable to the subcontractor is not being paid due to non-payment by the owner;
- ii. specify the amount not being paid to the subcontractor;
- iii. provide a copy of the owner's notice of non-payment; and
- iv. undertake to refer the matter to adjudication within 21 days.

Where a contractor decides not to make payment to a subcontractor because it disputes the amounts claimed by the subcontractor, the contractor must provide the subcontractor with a "notice of non-payment if dispute" under Form 1.3 of the *Act* (s. 6.5(6)).

Under this notice of non-payment, the contractor must:

- i. specify the amount not being paid; and
- ii. detail "all of the reasons for non-payment".

Similar to the owner's notice of non-payment, this requirement to provide the subcontractor with "all of the reasons for non-payment" suggests that a contractor will be prohibited from contesting the subcontractor's invoice by relying on any reasons not specified in the notice of non-payment.

Importantly, the *Act* makes no exception for the often used “pay-when-paid” clauses. While this issue will likely end up being settled by the courts, from the wording of the prompt payment provisions, a contractor who does not receive payment from the owner must rely on the procedure set out above and will be unable to simply point to a “pay-when-paid” clause in the subcontract.

## **What are a Subcontractor’s Obligations to its Sub-Subcontractors?**

### The Subcontractor’s Payment Obligations to its Sub-Subcontractors

If a subcontractor receives any payment from the contractor, then the subcontractor only has seven days to pay its sub-subcontractors who supplied services/materials included in the contractor’s proper invoice (s. 6.6(1) and (2)).

Similar to the rules for contractors, in accordance with section 6.6(3) of the *Act*, if the contractor only pays a portion of the amount payable to the subcontractor under the contractor’s proper invoice and more than one sub-subcontractor supplied services/materials to the subcontractor, then the subcontractor must make payment to its sub-subcontractors in accordance with the following rules:

1. If the contractor’s notice of non-payment specifies that the unpaid amount relates to the services/materials of a specific sub-subcontractor, then the remaining sub-subcontractors are to be paid first, with any leftover amounts paid to the disputed sub-subcontractors on a pro-rata basis; and
2. If the contractor’s notice of non-payment does not specify that the non-payment relates to the services/materials of a specific sub-subcontractor, then the sub-subcontractors are to be paid on a pro-rata basis.

Where the contractor does not pay the subcontractor, or only makes a partial payment, the *Act* still requires that, subject to the subcontractor providing a notice of non-payment to its sub-subcontractors (as discussed below), the subcontractor pay the sub-subcontractors whose materials/services were included in the contractor’s proper invoice. This payment must be made within 42 days of the date the proper invoice was submitted to the owner (s. 6.6(4)).

### The Subcontractor’s Notice of Non-Payment Obligations to its Sub-Subcontractors

Similar to a contractor’s obligations, where a subcontractor disputes the amounts owing to its sub-subcontractors (including because of non-payment by the contractor), the subcontractor must provide its sub-subcontractors with its own notice of non-payment within seven days of receiving a notice of non-payment by the contractor. If the contractor does not provide the subcontractor with a notice of non-payment, but the subcontractor still disputes the amounts owing to its sub-subcontractors, the subcontractor must provide the sub-subcontractors with a notice of non-payment with 42 days of the contractor providing a “proper invoice” to the owner (s. 6.6(8)).

If a subcontractor fails to provide its sub-subcontractors with a notice of non-payment, it must make full payment to its subcontractors (s. 6.6(4)). Because a subcontractor may not know when the contractor submitted its “proper invoice”, in accordance with section 6.6(10) of the *Act*, upon the request of the subcontractor, the contractor must advise of the date the “proper invoice” was given to the owner.

Where a subcontractor decides not to make payment to its sub-subcontractors because of non-payment by the contractor, the subcontractor must provide its subcontractors with a “notice of non-payment where owner does not pay” under Form 1.4 of the *Act* (s.6.6(6)).

Under this notice of non-payment, the subcontractor must:

- i. state that some or all of the amount payable to the sub-subcontractor is not being paid due to non-payment by the contractor;
- ii. specify the amount not being paid to the sub-subcontractor;
- iii. provide a copy of the notice of non-payment received by the subcontractor; and
- iv. unless the failure of the contractor to pay is as a result of non-payment by the owner (in which case, the contractor will already have been obligated to refer the non-payment to adjudication), provide an undertaking to refer the matter to adjudication within 21 days.

Where a subcontractor decides not to make payment to its sub-subcontractors because it disputes the amounts claimed by the sub-subcontractor, the subcontractor must provide the sub-subcontractor with a “notice of non-payment if dispute” under Form 1.5 of the *Act* (s. 6.6(7)).

Under this notice of non-payment, the subcontractor must:

- i. specify the amount not being paid; and
- ii. detail “all of the reasons for non-payment”.

Again, just as with the owner and contractor’s notice of non-payment, it is likely that a subcontractor will be prohibited from contesting the sub-subcontractor’s invoice by relying on any reasons not specified in the subcontractor’s notice of non-payment.

## **How Can You Prepare for the Prompt Payment Regime?**

The new prompt payment regime places considerable time constraints on owners, contractors and subcontractors to review invoices quickly and decide whether the invoice will be paid and, if so, by how much. Where a party disputes an invoice, it is no longer acceptable to simply refuse to pay the receiving party and worry later. Rather, the new notices of non-payment require parties to specify all reasons for the non-payment or risk being barred from raising these issues later.

Therefore, parties need to ensure their document management systems are accurate and organized, and that invoices can be processed quickly and analyzed for errors or other grounds of dispute.

Because the prompt payment regime places considerable emphasis on the date the contractor provides a “proper invoice” to the owner, subcontractors and sub-subcontractors need to ensure they know at the beginning of the project whether the contractor will be submitting invoices on a monthly basis, or on some other schedule set out under the prime contract. Furthermore, all parties should diarize the dates “proper invoices” are submitted to ensure they do not accidentally miss any of the deadlines mandated by the *Act*.

Finally, payment certifiers need to be keenly aware of the time constraints they are under in carrying out their duties. The owner’s deadline to pay or dispute a proper invoice is not paused while a payment certifier reviews the invoice.

For further information concerning these developments, please contact either of the authors or any other member of our [Construction and Infrastructure Law Group](#).