

Update

Construction Law

Fall 2008

Construction Crunch

By Howard M. Wise

Over the past several months, we have seen a major change in the economy. All the sectors of the economy have been affected including the construction industry. While certain areas of the construction industry are more buoyant than others, there has clearly been a change in attitude sparked by the downturn in the economy. As such, owners, contractors, subcontractors, and suppliers must ensure that they take the appropriate steps to limit their risk. Set out below are ten steps that owners, contractors, subcontractors, and suppliers should consider:

1. What are the payment terms?

During the course of the last few years, payment terms have, in many instances, been extended out from 30 to 60 days and beyond. If possible, one should attempt to shorten the payment terms. Obviously cash flow is important to any construction project and the sooner the funds work their way into the construction pyramid, the better for all. As such, on all new work, contractors, subcontractors and suppliers should be negotiating the most favourable terms of payment to ensure an orderly and predictable cash flow.

2. Are the payment periods being missed?

Any delay from the agreed payment periods is a cause for concern. When payment extends from 30 to 45 days or from 60 to 75 days, it is often a sign that there are cash flow issues. The owner should be satisfied that the funds it

advances are being properly utilized and that the contractor is paying its subcontractors.

3. Is the account being paid in full?

Is the invoiced amount being paid in full? On a financed construction project, the billings are generally approved by a payment certifier and draws are based on those certifications. Assuming that one's work has been certified, there is no reason that the full amount of the certificate as it relates to a certain portion of the work does not flow through to the contractor or subcontractor who performed the work. Partial payment of an account, at any level of the construction pyramid, may be cause for concern.

4. Is there is a performance bond in respect of work being performed?

A performance bond is security that is provided to address the situation where the party contracting for the labour, services and materials, encounters a default on the part of the person supplying the bond ("Principal"). If the Principal under the bond defaults under the contract, the performance bond provides security to ensure completion of the contract. In the event of a major default by a contractor, subcontractor or supplier, having a performance bond will go a long way to ensure completion of that defaulted contract. One must have regard to the provisions of the contract to determine what constitutes a default.

5. Is there a labour and material payment bond?

A labour and material payment bond is intended to address non-payment from the contractor or subcontractor supplying the bond ("Principal") to its trades or material suppliers. Where a general contract calls for a labour and material payment bond, that bond will respond in the event the contractor fails to pay its sub-trades. It is most often

the sub-trades with privity of contract with the contractor (claimants under the bond) who are entitled to look to the labour and material payment bond for payment if the Principal defaults. It is important to note that for many projects, bonds are not necessarily provided and the subcontractor or supplier of materials may not be able to look to a bond in the event of a contractual default.

6. Have the bonds been signed, sealed and delivered?

Performance and Labour and Material Payment Bonds must be signed, sealed and delivered in order to be effective. Case law has held that where the bonds were not signed, sealed and delivered, that they could not be called upon where a default occurred.

7. What is the status of payments from the owner to the contractor and from the contractor to the subcontractor?

Various lien legislation allows a person who supplies labour, services or materials to a project to request certain information under the relevant lien act. This includes the current status of accounts, holdback amounts, as well as obtaining copies of any labour and material and payment bonds. (See for example Section 39 of the Ontario *Construction Lien Act*.)

8. Is there construction financing?

A search of title will help disclose whether or not a given project is being financed through construction financing. Various lien acts address priorities between lien claimants and construction financiers. Lien legislation also affords one who supplies labour, services and materials to the improvement to obtain information from the financier in respect of the status of the mortgage financing.

9. Have liens been registered against the property?

Non-payment to trades may be a sign that the owner, contractor or a subcontractor is encountering certain financial difficulties. Of

course this is not determinative and there are many reasons and issues that may result in non-payment to a contractor or subcontractor. However, the registration of numerous liens may be a sign of other problems on a project, leading to further enquiry. Conducting searches of title during the course of a project is a relatively inexpensive way of determining whether or not there are potential payment issues that have resulted in liens being filed against the property.

10. Has Notice been given under the Contract?

Regardless of where one is situated on the construction pyramid, one should ensure that, to the extent there are notice provisions under the Contract, Subcontract, or Purchase Order, the appropriate notice is given pursuant to that agreement. Failure to give notice, while not necessarily fatal, may prejudice or impair one's ability to recover should a claim be required.

If you have any questions with respect to the foregoing, please do not hesitate to contact:

Ira Berg iberg@goodmans.ca	416.597.4105
Joseph Cosentino jcosentino@goodmans.ca	416.597.4245
Ken Crofoot kcrofoot@goodmans.ca	416.597.4110
Derek McBean dmcbean@goodmans.ca	416.597.4130
Joseph K. Morrison jmorrison@goodmans.ca	416.597.4203
Carla Salzman csalzman@goodmans.ca	416.597.4150
Jerry P.K. Topolski jtopolski@goodmans.ca	416.597.5907
Howard Wise hwise@goodmans.ca	416.597.4281