Prompt Payment Explained: A Simple Guide for Contractors and Suppliers

Payment disputes are a fact of life in the construction industry. Historically, however, one of the challenges for contractors and subcontractors was not simply whether they would ultimately be paid, but when.

Ontario's *Construction Act* addresses this issue through its prompt payment regime. Once a contractor submits a "proper invoice" to an owner, the Act establishes a series of mandatory payment deadlines that flow down the construction pyramid. If a party disputes payment, it cannot simply remain silent or indefinitely withhold payment of the invoice. It must respond within prescribed timelines, including, where applicable, by delivering a formal notice of non-payment.

The result is a relatively simple concept: pay on time <u>or</u> explain on time why you are not paying.

It Starts With a "Proper Invoice"

A "proper invoice" is a written bill or other request for payment for services or materials supplied in respect of an improvement under a contract that contains the information prescribed by the Act, together with any additional requirements permitted under the contract.

Importantly, even if an invoice does not satisfy the requirements of a proper invoice, the recent amendments to the Act will nevertheless deem it to be a proper invoice for the purposes of the prompt payment provisions unless, within 7 days after receiving the invoice, the owner gives the contractor written notice identifying the deficiency.

In other words, an owner cannot simply treat a deficient invoice as invalid and ignore it. If the owner considers that the invoice does not satisfy the statutory or contractual requirements for a proper invoice, it must identify the deficiency within the prescribed period. Otherwise, the invoice is deemed proper, and the prompt payment regime applies.

Prompt Payment Regime applicable to an <u>Owner</u>

The statutory prompt payment deadlines are tied to the owner's receipt of a proper invoice. Once a proper invoice has been received the statutory clock begins to run.

i. The 14-Day Deadline: Owner's Notice of Non-Payment

If the owner disputes all or part of a proper invoice, it must act quickly.

Under section 6.4 of the Act, an owner wishing to withhold all or any portion of an amount payable must give the contractor a written notice of non-payment within <u>14 days</u> after receiving the proper invoice. The prescribed document is Form 1.1 – Owner Notice of Non-Payment.

The notice must identify the amount that will not be paid and detail the reasons for non-payment. Importantly, a notice of non-payment only permits the owner to withhold the amount identified in the notice. The owner must still pay any portion of the proper invoice that is not the subject of a valid and timely notice of non-payment, in accordance with the payment deadlines under the Act.

ii. The 28-Day Deadline: Owner Pays Contractor

Unless a valid notice of non-payment has been given, the owner must pay the amount payable under the proper invoice within 28 days after receiving it.

This is the first stage of the prompt payment cascade.

Prompt Payment Regime Applicable to a Contractor (and those down the Construction Pyramid)

The Act does not stop at payment from the owner to the contractor. Where the contractor receives payment from the owner, it has 7 days from receipt of that payment to pay its subcontractors whose work was included in the proper invoice. Similar 7-day payment periods continue down through subsequent levels of subcontractors.

The intended effect is that money received at the top of the construction pyramid flows relatively quickly to the parties that performed the work.

For example, assuming that full payment is made on the last permissible day at each level, and there are no payment disputes:

Day 0 – Proper invoice submitted to owner
Day 28 – Owner pays contractor
Day 35 – Contractor pays subcontractor
Day 42 – Subcontractor pays its sub-subcontractor
Day 49 – Sub-subcontractor pays its supplier

Critically, these are the latest payment dates in this example, not fixed dates prescribed by the Act. The downstream deadlines are tied to the date payment is actually received. Accordingly, if the owner pays the contractor before Day 28, the contractor’s 7-day payment period begins earlier, and the subsequent payment deadlines move forward accordingly.

What Happens When the Owner Does Not Pay?

If the owner does not pay some or all of a proper invoice and the contractor intends to withhold the corresponding amount from a subcontractor, the contractor cannot simply rely on the owner's non-payment as an unconditional shield to avoid downstream payment.

The contractor must give the subcontractor a prescribed notice of non-payment stating that payment is being withheld because of the owner's non-payment, specifying the amount being withheld, and undertaking to refer the dispute with the owner to adjudication within 21 days after giving the notice. The applicable prescribed form is Form 1.2 – Contractor Notice of Non-Payment Where Owner Does Not Pay.

The timing of that notice is critical. If the owner has issued a notice of non-payment, the contractor must give its downstream notice within 7 days after receiving the owner's notice. If the owner has not issued a notice of non-payment but nevertheless fails to pay, the contractor must give its notice before the expiry of the applicable 35-day payment period.

This is an important feature of the regime. Although the Act permits an owner's non-payment to be passed downstream in certain circumstances, it does not create an automatic “pay-when-paid” mechanism. A contractor seeking to rely on the owner's non-payment must comply with the notice requirements and, importantly, undertake to actually pursue the upstream payment dispute through adjudication.

What if the Contractor Has Its Own Dispute with the Subcontractor?
The situation is different where the contractor itself disputes the subcontractor’s entitlement to payment. In that case, the contractor may issue a notice of non-payment identifying the amount being withheld and setting out the reasons for non-payment.

The distinction between the two types of non-payments is important:

1. **Owner Non-Payment**: the contractor seeks to pass the upstream non-payment downstream and must comply with the requirements discussed above, including the obligation to pursue the upstream dispute through adjudication.

2. **Contractor - Subcontractor Dispute**: the contractor independently takes the position that the subcontractor is not entitled to some or all of the amount that would otherwise be payable.

Different prescribed forms apply, and the obligations accompanying those notices are different. In the second scenario, the prescribed document is Form 1.3 – Contractor Notice of Non-Payment if Dispute.

At first glance, the second scenario may seem unusual. After all, if the contractor has already included the subcontractor’s work in the proper invoice submitted to the owner, and receives payment from the owner, why would it subsequently dispute the subcontractor’s entitlement to payment? While this may arise less frequently, there are several possible explanations or scenarios. For example, after submitting the proper invoice, the contractor may discover defective or deficient work, or circumstances may arise that give the contractor a claim for set-off against the subcontractor. The Act therefore provides a mechanism for the contractor to withhold payment based on its own dispute with the subcontractor, rather than merely because it has not been paid by the owner.

The Notice Requirements Continue Downstream
The same basic framework continues further down the construction pyramid. Where a subcontractor does not pay its own subcontractor because it has not been paid upstream, Form 1.4 applies. Where the subcontractor independently disputes its downstream subcontractor’s entitlement to payment, Form 1.5 applies.

Why the Notice of Non-Payment Matters
The notice of non-payment is more than an administrative formality. The Act requires the prescribed form to be used, requires the amount being withheld to be identified and, where the withholding party disputes entitlement, requires all reasons for non-payment to be detailed.

Parties should not assume that ordinary project correspondence disputing an invoice satisfies the Act. Even where the correspondence identifies the amount being withheld and the reasons for non-payment, a failure to use the prescribed form may render the notice ineffective, with potentially significant consequences for the withholding party.

Conclusion
For owners, the critical initial dates are 14 days to dispute and 28 days to pay. For contractors and subcontractors, payment and notice obligations can then arise in increments of only seven days as payment (or non-payment) moves down the construction pyramid.

The practical lesson is simple: parties should have procedures in place to identify when a proper invoice is received, immediately diarize the applicable payment and notice deadlines, and ensure that any notice of non-payment is prepared and delivered in the prescribed form.

Where there is any uncertainty, it is always advisable to seek expert advice.

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