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Holdback release for subcontracts, and after contract completion: two gaps in prompt payment

In a [recent article](#), I discussed a gap in the prompt payment provisions of the Construction Act related to P3s. In this article, I discuss two other gaps related to holdback release.

First holdback gap: contractors, but not owners, required to release holdback on subcontract lien expiry

The prompt payment system aims to ensure smooth back-to-back payment from the owner through the contractor and down the chain to subcontractors. But a gap in prompt payment system under the *Construction Act* (the “Act”) means that contractors may be stranded with liability to pay subcontractors following certification of completion of a subcontract, without the ability to recover from the owner.

The problem is that the Act’s scheme for payment of holdback requires payment of holdback by a party who is directly liable for payment on a subcontract any time all liens under **any subcontract** expire; but it requires holdback release from the owner **only** when all liens **under the contract** have expired. This means that a contractor can be liable for mandatory payment of holdback to a subcontractor following certification of completion of a subcontract, without the ability under the *Act* to require or obtain release of holdback from the owner.

Second holdback gap: no ability to enforce holdback release after contract completion

The prompt payment regime is enforced by way of adjudication, but the Act makes adjudication presumptively unavailable after a contract or subcontract is completed. The problem is that this is precisely when holdback is required to be released in some circumstances.

It makes little sense for adjudication to be available following publication of a certificate of substantial performance but not contract completion, or following a subcontractor’s last supply but not certification of completion of subcontract.

Background to the current mandatory holdback release provisions

Under the former *Construction Lien Act* (“CLA”), payment of holdback after the expiry of liens was permissive, not mandatory. Section 26 of the *CLA* provided:

26 Each payer upon the contract or a subcontract **may**, without jeopardy, make payment of the holdback the payer is required to retain by subsection 22 (1) (basic holdback), so as to discharge all claims in respect of that holdback, where all liens that may be claimed against that holdback have expired or been satisfied, discharged or otherwise provided for under this Act. [Emphasis added.]

Prior to lien expiry, a subcontractor was protected against an owner deducting amounts from the holdback, because section 21 provided that a lien was a charge on the holdback, and section 30 prohibited applying holdback funds to correct a contractor’s default.

However, once liens had expired, holdback funds became trust funds, and section 12 of the *CLA* permitted a trustee to exercise set-off rights against trust funds.

Collectively, these provisions led to the development of an unfortunate practice by some owners who would wait for the lien period to expire after certification of substantial performance before advising the contractor that they

intended to exercise set off right against the holdback. It was then too late for subcontractors to secure their right to payment by registering a lien. So subcontractors were put in the position of either needing to lien pre-emptively (which is not a great way to get repeat business), or to hold their breath and hope that the holdback would be paid – neither being particularly attractive options.

The new prompt payment scheme for holdback release

One of the important changes to the *Act* under prompt payment was to make payment of holdback mandatory following the expiry of lien rights. Section 26 now provides:

26 Subject to section 27.1, **each payer** upon the contract or a subcontract **shall make payment of the holdback** the payer is required to retain by subsection 22 (1) (basic holdback), so as to discharge all claims in respect of that holdback, where all liens that may be claimed against that holdback have expired or been satisfied, discharged or otherwise provided for under this Act.

There are two key points to note here:

- First, this obligation applies to any “payer” on a contract **or** a subcontract. A payer is a person who is **directly** liable for payment on a contract or subcontract.
- Second, the payment is mandatory “where all liens that may be claimed against that holdback have expired.”

This means that the expiry of liens in respect of holdback on a given contractor **or** subcontract trigger a mandatory obligation to pay holdback by the party which makes payment on that contract or subcontract.

And what if there is a reason not to pay holdback?

For payment of holdback to a contractor by an owner, the way for an owner to avoid mandatory payment is for the owner to publish a notice of non-payment ahead of lien expiry, and for the owner to notify the contractor of publication. The Act now provides:

27.1(1) An owner **may refuse to pay** some or all of the amount the owner is required to pay to a contractor under section 26 or 27, as the case may be, **if,**

(a) **the owner publishes a notice in the prescribed form** specifying the amount of the holdback that the owner refuses to pay, and the notice is published in the manner set out in the regulations **no later than 40 days after** the date on which,

(i) the applicable **certification or declaration of substantial performance** is published under section 32, or

(ii) if no certification or declaration of substantial performance is published, the date on which the **contract is completed, abandoned or terminated;** and

(b) the owner notifies, in accordance with the regulations, if any, the contractor of the publication of the notice.

[Emphasis added.]

The balance of section 27.1 flows down the mandatory obligation to pay holdback from the contractor through to subcontractors. Note that a contractor may refuse to pay holdback to a subcontractor only where the owner has refused to pay:

27.1(2) A **contractor may refuse to pay** some or all of the amount the contractor is required to pay to a subcontractor under section 26 or 27, as the case may be, **if,**

- (a) *the owner refuses to pay some or all of the amount the owner is required to pay* to the contractor under that section;
- (b) the contractor refers the matter to adjudication under Part II.1; and
- (c) the contractor notifies, in accordance with the regulations, if any, every subcontractor to whom the contractor is required to pay the amount that the amount is not being paid and that the matter is being referred to adjudication.

[Emphasis added.]

The problem

The problem is that, taken together, these provisions require holdback release from a payer on a subcontract when all liens on the subcontract have expired; but they do not require holdback release on account of that subcontract by the owner, because the owner is not a “payer” on the subcontract. The owner is only required to release holdback after all liens under the main contract have expired.

What’s more, a contractor can **only** refuse to pay holdback if the owner refuses to pay “some or all of the amount the owner is required to pay to the contractor under” section 26. But section 26 does not require the owner to pay anything when only a subcontractor’s lien rights have expired, because, as noted above, the owner is not a “payer” on the subcontract.

This creates a potentially serious cash-flow problem. Anytime a subcontractor can demonstrate that all liens on the subcontract have expired (by obtaining certification of completion of subcontract from a payment certifier, for instance), the payer (which could be a contractor or another subcontractor, depending on the level of the subcontract) becomes liable for payment under section 26, but has no ability to refuse to pay under section 27.1.

Mitigation strategy

A contractor could mitigate the effects of this gap in the prompt payment regime by requiring in the contract that the owner will release holdback on account of a subcontract when that subcontractor’s lien rights expire. The contractor could then deliver a proper invoice for the holdback amount, and if the owner refused to pay, it could take the owner to an adjudication.

If a subcontractor were also pursuing an adjudication for the payment of holdback, the contractor would be well-advised to require a consolidated adjudication under section 13.8(2) to avoid any inconsistency in the result.

On that point, however, there is another gap in the Act related to using adjudication to enforce holdback payment obligations after subcontract (or contract) completion.

Adjudication for holdback release following contract or subcontract completion

As noted above, holdback release from an owner to a contractor is mandatory following the expiry of a contractor’s lien rights. But the Act creates a potential issue if a contractor wants to enforce that mandatory release through adjudication.

Section 13.5(1)(6) makes adjudication available in the case of non-payment of holdback. However, section 13.15(3) of the Act provides, “An adjudication may not be commenced if the notice of adjudication is given after the date the contract or subcontract is completed, unless the parties to the adjudication agree otherwise.”

As we've seen above, holdback is released only when liens rights have expired. One of the ways that lien rights can expire is through the completion of a contract (section 31(2)(b)(i)) or the certification of completion of a subcontract (sections 31(3)(a)(iii) and 31(3)(b)(ii)).

The Act's language means that, by default, adjudication will not be available if holdback payment is refused following completion of a contract or subcontract.

The point of adjudication is to arrive at a swift and efficient interim result which will allow funds to flow. There is no good reason that this process should be available if holdback release is being triggered by the publication of a certificate of substantial performance or a subcontractor's last supply, but unavailable if a subcontract is certified complete or the contract is completed.

The Act should be amended to provide for an exception for adjudication of holdback release following completion.

Until that happens, contractors and subcontractors should include in their contracts and subcontracts and agreement that adjudication is available if the payer refuses holdback release.



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