

## The Holdback Account

### 1. The New Provision

The old *Builders Lien Act* provided for a 10% holdback, but court cases decided under the old Act made it clear that the owner did not have to put money aside in a separate account. The new *Builders Lien Act* introduces a new provision, section 5, that expressly requires that:

- (a) a separate account be established;
- (b) the holdback amount be paid into this separate account; and
- (c) the owner administer the account "together with" the contractor.

### 2. Impact on Owners and Developers

The new provision will affect owners in the following ways:

- (a) *Cash flow.* Having to pay 10% into the holdback account will in most cases accelerate the cash flow required for projects, and thereby also increase the financing cost.
- (b) *Funding.* On some loans, the loan ceiling will be reached earlier, which might mean that the owner will have to inject funding earlier. On a "cost to complete" loan, the equity requirement will likely not be affected because the holdback amount would have been factored into the funding formula applied under the old Act anyway.
- (c) *Less control over holdback monies.* The holdback account must be administered by the owner together with the contractor. The owner can't release the money without the okay of the contractor.
- (d) *Trust obligation.* The new provision imposes trust obligations to all amounts deposited into the holdback account.
- (e) *Less security to the owner.* Under the new Act, holdback monies are released progressively. Therefore, nearing the end of the project, the amount left in the holdback account might be, say, 3 % of the contract price instead of 10%.

Of course, having a holdback is a basic contracting tool to ensure performance. Under the old Act, you could by contract agree that any Builder Lien Act holdback not used to satisfy liens could be used as contractual holdback. Now, there will be less money in the pot, in that circumstance. Therefore, owners might revisit the payment terms under their contracts. More on this in paragraph 5.c below.

- (f) *Administration.* Time and effort will be required to establish and administer the holdback account, particularly if the owner is dealing directly with numerous contractors. Owners would be well advised to keep a separate account for each contract, in order to track interest earned and to readily trace the application of monies.

### **3. In What Circumstances Will the New Provision Help Lien Claimants?**

So long as there is equity in the project, the owner would pay up the 10% so that the owner could clear liens filed against the project. The new provision was not needed, for this scenario.

The requirement for a separate holdback account will, in theory, help the lien claimant in the scenario where there is no equity in the project and the contractor is insolvent. I say "in theory" because, where there is no equity in the project and the contractor is in the throes of insolvency, frequently the owner and the contractor will fail to make a priority of paying money into the holdback account.

### **4. The Sanction for Failing to Set up a Savings Account**

Within a month after the new Act coming into force, there will be hundreds or thousands of owners who, through inadvertence or lack of funds or otherwise, will fail to open savings accounts. If you fail to set up the savings account, is that an offence?

Section 46 of the *Builders Lien Act* expressly excludes the application of the *Offence Act*. In other words, the sanction is not a criminal one, or a quasi-criminal one. Rather, the sanction lies in potential exposure to liability:

- (a) subsection 5(7) of the new Act provides that failure by the owner to comply with subsection 1 (b) constitutes an act of default and could entitle the contractor to suspend operations;
- (b) there is a risk that an owner might be responsible for demobilization and remobilization costs arising from the suspension of operations;
- (c) in certain circumstances, rights against sureties under performance bonds might be impaired;
- (d) the trust requirement might imply liabilities on directors and officers.

### **5. What Can Be Done to Minimize the Impact to Owners?**

Owners might minimize or manage the holdback account requirement in the following ways:

- (a) The Act clearly states how the amount of the holdback is calculated, but does not explicitly stipulate when the holdback account must be set up or when the holdback must be paid into the account. The Act contains a definition of "holdback period" that does not

indicate when the period starts. One plausible interpretation is that the period starts upon substantial completion, and runs for 55 days thereafter. If this interpretation is taken, then the owner's cash flow would not be affected very much, because it would be so late into the project.

Under section 5(3), the owner could seek directions from the court to clarify when the monies must be paid.

The contract documents could include a provision to the effect that if the contractor gives a 10 day notice under section 5(7), then at the instance of either party application will be made to court for directions and the 10 day period shall be extended until the matter is determined by a court order.

- (b) If notice were given under section 5(7), then the owner has 10 days to pay the required amount into the holdback account before the contractor can suspend the work. In practice, notice might never be given.
- (c) A possible solution, to deal with the impact of the new requirement on an owner, lies in the use of the contractual holdback as a basic contracting tool to ensure performance by the contractor. The owner could agree with the contractor on payment terms as follows:
  - (i) 80% progress draws paid to the contractor according to the value of the work as the project proceeds;
  - (ii) 10% *Builders Lien Act* holdback paid to an account that the contractor agrees to establish on behalf of the owner and the contractor and in satisfaction of the requirements of the Act. Contractual stipulations would be prescribed by the owner, as to release of monies from the holdback account;
  - (iii) 10% contractual holdback - these would be holdback monies "in excess of the required holdback", as contemplated under section 6(3).

If this solution were being considered, then a number of provisions should be included in the contract documents to deal with the items listed in paragraph 4 above.

Despite the foregoing, in some cases, lenders might insist that the holdback be paid up front.

## 6. Transition Projects

There is a specific transition provision relative to the holdback savings account. Section 48(3) stipulates that there is no obligation to create or maintain a holdback account on a transition project.

When is a project "commenced", so that section 48(3) would apply? If preloading has commenced, would that qualify? If tenders have gone out? If conceptual plans have been prepared?

**7. Miscellaneous**

- (a) *Exceptions.* The Act exempts the provincial government and improvements under \$100,000 from the holdback account requirement.
- (b) *Regulations.* The operation of the holdback account might be clarified by regulations made pursuant to section 47(2) of the Act. So far, no specific regulations relative to the holdback are contemplated.
- (c) *Will lenders administer the holdback accounts for you?* Sections 4(5) and 5(4) of the new Act contemplate that a lender can administer the holdback account. This subject is addressed more fully in another paper.

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