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GLAHOLT BOWLES
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IN THIS ISSUE

Getting Priorities Straight: Judicial Interpretation of Section 78 of the *Construction Act*

Introduction

When money is tight, who gets paid first: the lender or the builder? Under what conditions do mortgages take priority over construction liens, and how far does that priority extend?

The answers to these questions lie in s. 78 of the *Construction Act*, which is a complete code for the determination of lien priority disputes with mortgages. However, while s. 78 appears to be straightforward, its application can be fraught with challenges.

These challenges are illustrated by the Superior Court of Justice's treatment of two recent cases – *Kingsett Mortgage Corporation v. Mapleview Developments Ltd.*, 2024 ONSC 6477, and *Peoples Trust Company et al v. Vandyk-Backyard Queensview Limited et al.*, 2024 ONSC 6648. In these decisions, the court provides important insight into the conditions determining the priority relationship between:

a. Building Mortgages (mortgages securing the financing for the actual construction or

improvement of the premises) and construction **liens** arising from that construction or improvement generally – governed by s. 78(2) of the *Act*; and

b. Subsequent Mortgages (mortgages registered after the first person supplies services or materials to the construction or improvement) and both **registered** and **non-registered** construction liens arising from the construction or improvement on the premises – governed by ss. 78(5) and 78(6) of the *Act*.

Case 1: *Kingsett Mortgage Corporation v. Mapleview Developments Ltd.*, 2024 ONSC 6477

Released seven days prior to *Peoples Trust v. Vandyk-Backyard, Kingsett v. Mapleview* analyzes both subsections 78(2) and 78(6) of the *Act*.

Factual Background

Mapleview Developments Ltd. ("**Mapleview**"), along with others, was developing a residential townhome project. To finance the development, Mapleview arranged for Kingsett Mortgage Corporation ("**Kingsett**") to provide funding. Kingsett agreed to finance the project's land servicing, development, and construction and later advanced funds for these purposes, which were secured by two registered mortgages.

Kingsett later registered a new mortgage – which secured all funds advanced under the two prior mortgages and charged additional lands – and, shortly after, deleted the prior two mortgages. Essentially, Kingsett consolidated its debts under this new mortgage to avoid a multiplicity of registered mortgages and simplify certain subordination agreements. At the time Kingsett advanced funds, there were no preserved or perfected liens.

Priority Issue and Analysis

When the project entered receivership, the lien claimants asserted that their construction liens had full priority over Kingsett's mortgage, principally arguing that it did not satisfy the exceptions to the *Act*'s general priority rule for liens.

Section 78(2) Analysis

Justice Cavanagh held that s. 78(2) applied to Kingsett's mortgage, meaning that it had priority over the liens except for any deficiency in the holdback.

Following the Court of Appeal's reasoning in *Bianco v. Deem Management Services Limited*, 2021 ONCA 859, Cavanagh J. held that s. 78(2) is an exception to the general rule under s. 78(1) and explicitly rejected the lien claimants' argument that s. 78(2) creates a super-priority in addition to the priority given under s. 78(1).

Addressing the lien claimants' alternative argument, Cavanagh J. found that Kingsett's mortgage was a building mortgage, satisfying s. 78(2). For this argument, Cavanagh J. distinguished *Bianco*, emphasizing that Kingsett's mortgage was taken with the intent to continue securing funds, which were already advanced for the improvement. Unlike *Bianco* – where the mortgagee was securing previously unsecured, but already advanced, funds – Kingsett's consolidation of its debts under a single mortgage established a consistent intention to continue to secure the financing of the improvement that had been already advanced.

Section 78(6) Analysis

Justice Cavanagh also held that s. 78(6) applied to Kingsett's mortgage, which has the same effect as s. 78(2) by virtue of the application of s. 78(5).

While the Kingsett mortgage was registered after the first lien arose on the project, making it a subsequent mortgage, the lien claimants argued that no advance was made "in respect of" that mortgage, relying on caselaw interpreting s. 78(6) to support their position.

However, Cavanagh J. distinguished these cases, noting that they involved mortgages securing a guarantee of debt owed by a separate entity, where no advance was ever made by the guarantor. Rather, the evidence showed a direct connection between the advances made under Kingsett's original mortgages and its new mortgage, which secured repayment of the same debt. As a result, Cavanagh J. concluded that the advances were made "in respect of" the Kingsett mortgage, satisfying the requirements of s. 78(6).

***Case 2: Peoples Trust Company et al v. Vandyk-Backyard Queensview Limited et al.*, 2024 ONSC 6648**

Following shortly after *Kingsett v. Mapleview, Peoples Trust v. Vandyk-Backyard* does a deeper dive into s. 78(6).

Factual Background

Vandyk-Backyard Queensview Limited developed a condominium project but was left with 21 unsold units after construction. To finance these remaining units, Vandyk-Backyard secured a condominium inventory term loan from Peoples Trust. Under the term loan, Peoples Trust advanced funds after the

project's completion and registered a corresponding mortgage. However, after the advance and mortgage registration, various lien claims were registered against the unsold units, triggering a default under the mortgage.

Priority Issue and Analysis

In this case, similar to *Kingsett v. Mapleview*, when the project entered receivership, two of the lien claimants asserted that their construction liens had full priority over Peoples Trust's mortgage.

Section 78(6) Analysis

Similar to the Kingsett mortgage, Osborne J. found that s. 78(6) applied to People Trust's mortgage. Additionally, he rejected the lien claimants' arguments that a mortgagee has a duty to make further inquiries that could override the *Act's* clear priority rules.

At the outset of his reasons, Osborne J. described s. 78 as a complete code for resolving lien priority disputes with mortgagees. He found that s. 78(5) and (6) are largely determinative when applied to the facts. In this case, it was undisputed that the Peoples Trust mortgage was a subsequent mortgage, and, at the time funds were advanced, neither lien claimant had preserved or perfected their liens (through registrations on title), nor had Peoples Trust received any written notice of lien.

Under a plain reading of the *Act*, Peoples Trust had priority over the lien claimants due to the lack of registered liens on title. Justice Osborne affirmed this interpretation, holding that the *Act* does not require mortgagees to conduct additional inquires beyond a title search to secure priority over unregistered liens, emphasizing that s. 78(6) "provide[s] a complete, fundamental, yet easily understandable code." Ultimately, lien claimants or mortgagees can protect their position through actively registering their respective interest on title.

While Osborne J. affirmed the *Act's* plain reading, he also found that even if Peoples Trust had conducted further inquiries, it would not have discovered any pending liens. At the time, both lien claimants were still considering whether to assert their lien rights and had consciously chosen not to do so.

Finally, Osborne J. found that the funds advanced were made "in respect of" Peoples Trust's mortgage, noting that for s. 78(6) the advanced funds do not need to be used on the improvement in contrast to s. 78(2).

Equitable Liens and Section 78

Briefly, Osborne J. reviewed and rejected the lien claimants' arguments that they could assert an equitable lien with priority over Peoples Trust's mortgage. Citing *Talbot v. Pawelzik*, 2005 CanLII 4844 (Ont Sup Ct), he noted that equitable liens should not be created when a statutory lien regime already exists. Further, he stated that any equitable lien would not have priority over a prior-registered mortgaged: equitable liens arise when imposed by the court, and s. 93(3) of the *Land Titles Act* states that a mortgage, when registered, takes priority over all unregistered interests in the land, which includes an equitable lien.

Takeaways from the Cases

- Despite unclear wording, s. 78(2) is an exception to the general priority rule for liens under s. 78(1).
- Consolidation of prior-registered mortgages, which secure funds advanced for the improvement, into a single mortgage will satisfy the statutory conditions for priority under s. 78(2) if the consolidating mortgage is registered prior to the discharge of the prior-registered mortgages.
- Under s. 78(6), the words "in respect of" should be interpreted broadly. However, the interpretation does not extend to mortgages where no advance is made by the mortgagee, which can include mortgages guaranteeing other debts (known as "collateral mortgages").
- Subsections 78(5) and (6) do not require mortgagees to conduct additional inquiries beyond a title search; both lien claimants and mortgagees can protect their priority position through registration of their respective interest on title.
- Courts will be hesitant to impose an equitable lien in light of the *Construction Act's* lien regime. Additionally, equitable liens will not take priority over prior-registered mortgages.

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Lawyer liability and appealing costs orders under the *Construction Act: Viceroy Homes*

Ontario's *Construction Act* provides that a court can impose costs liability on a lawyer in certain circumstances. When are lawyers personally liable for preserving or perfecting a lien? Should a lawyer be liable if they register a lien which they objectively should have known was without foundation or wilfully exaggerated? Or must a lawyer subjectively know the lien was bad to be liable? Can a lawyer be liable where they recklessly, or with wilful blindness disregard facts establishing that they are preserving and perfecting a bad lien? Good questions, however, there was surprisingly little caselaw in Ontario addressing these issues.

These questions were recently answered in *Viceroy Homes v. Jia Development Inc.*, 2024 ONSC 1608, (the "**Superior Court Decision**"). Associate Justice Wiebe held that the test for lawyers' liability for preserving or perfecting a bad lien is subjective. The Superior Court Decision was appealed. In *JIA Development Inc. v. 2708320 Ontario Ltd. (Viceroy Homes)*, 2024 ONSC 6519 (the "**Divisional Court Decision**"), the Divisional Court held that leave was required to appeal the Superior Court's decision on costs pursuant to s. 86(1) of the *Act*. The Divisional Court denied leave.

KEY TAKEAWAYS

1. For a lawyer (or other representative) who preserves or perfects a lien to be held personally liable for costs under s. 86(1)(b)(i) of the *Construction Act*, the lawyer must subjectively know that the lien is without foundation, frivolous, vexatious, an abuse of process or for a wilfully exaggerated amount at the time of preservation or perfection, or have been reckless or wilfully blind to the defects in the lien.

2. Leave is required to appeal a costs order made under s. 86 of the *Construction Act*.

THE VICEROY HOMES CASES

The underlying lien claim

Viceroy Homes instructed their lawyers to register a claim for lien in the amount of $3,310,000 for 39 days of work. Viceroy's principal provided their lawyers with a copy of a signed contract for $20 million in work to be done within eight months in which Viceroy was exposed to liquidated damages of $50,000 per day of delay. But the contract also stated that construction costs were not to exceed $500,000 until a collateral transaction concerning the project lands was finalized; that transaction was never completed, so the condition remained unfulfilled.

Viceroy's lawyers received from Viceroy a breakdown of the $3.3 million in work it allegedly performed for the defendants. The lawyers questioned why the price of the work exceeded the $500,000 cap when the condition was not fulfilled, and Viceroy's principal explained that there had been a subsequent unsigned agreement for a higher cap and that Viceroy had been instructed by the defendants to perform the work. Viceroy did not supply any further supporting documents before the lien was preserved. Viceroy's principal only showed Viceroy's lawyers chat messages between him and the defendant's principal on his phone.

Viceroy's lawyers sent to Viceroy's principal an authorization and direction form with the draft lien attached. He signed and returned the form, and the lawyers registered the claim for lien.

After preserving Viceroy's lien, Viceroy's lawyers pursued Viceroy's principal for supporting documents to substantiate the lien before perfecting it. Viceroy's lawyers requested, amongst other documents, contracts, correspondence, invoices, pictures, and videos. Viceroy's principal repeatedly promised he would provide the supporting evidence but delayed in doing so. He met with one of Viceroy's lawyers at a coffee shop and showed her videos, pictures of the work, and chat messages with the defendant's principal on his phone. He promised to send these recordings and more, but he did not follow through.

Faced with the impending deadline to perfect the lien, Viceroy's lawyers proceeded to prepare a statement of claim and send the claim to Viceroy's principal who reviewed it and gave comments which were incorporated into the claim. The lawyers again asked for Viceroy's supporting documentation, but Viceroy's principal failed to provide it. With time running out, the lawyers had the statement of claim issued and, at Viceroy's principal's instruction, served the claim on the defendants.

Shortly after, Viceroy's lawyers received a letter from one of the defendants' counsel saying that the work Viceroy claimed it had done had not been done at all. The defendants said Viceroy's claim for lien was frivolous, vexatious, and abusive. They demanded that the lien be discharged, otherwise the defendant would initiate a cross-examination under s. 40 of the *Act*.

Viceroy's lawyers sought Viceroy's instructions on the letter. Viceroy's principal denied the allegations, insisted that he would provide proof of the claim, and said he was willing to attend cross-examination. The lawyers again sought from Viceroy documentary corroboration of its claim. In response, Viceroy's principal sent materials receipts, a signed subcontract, and chat messages with a would-be project manager.

Viceroy's principal was eventually cross-examined after the cross-examination had been postponed twice at his request. On cross-examination, it came to light that the defendants were right—Viceroy had not done large parts of the work described on Viceroy's claim for lien.

Viceroy's lawyers advised Viceroy that some of its lien, at the very least, was indefensible. The lawyers emphasized the importance of delivering corroborating evidence and answering the undertakings to support the remainder of the lien. Viceroy's principal promised to provide that.

The defendants then gave Viceroy's lawyers notice of a motion to discharge Viceroy's lien. After further attempts to obtain supporting documentation from Viceroy's principal, it became clear to Viceroy's lawyers that Viceroy could not substantiate its lien. The lawyers strongly advised Viceroy to voluntarily discharge the lien before the defendants' motion or they would take themselves off the record. Viceroy did not give instructions to voluntarily discharge the lien, so Viceroy's lawyers removed themselves from the record before the defendants' discharge motion was heard.

Associate Justice Wiebe heard the motion. Viceroy was now unrepresented and did not attend the hearing of the motion, which proceeded uncontested. The associate justice held that Viceroy's lien was indeed frivolous, vexatious and an abuse of process. He ordered that the lien be discharged. He then ordered that Viceroy's principal should pay the defendants' costs on a substantial indemnity basis along with Viceroy.

The defendants' motion for costs against the lien claimant's lawyers

The defendants then brought a motion for the court to order that Viceroy's lawyers pay costs to the defendants pursuant to s. 86 of the *Act*. They argued that Viceroy's lawyers should have known the lien was frivolous because of the high value of the lien for the short duration of work, because Viceroy exceeded the $500,000 cap stated in the signed contract, and because of the paucity of supporting documentary evidence provided by Viceroy to their lawyers at the time of preserving and perfecting the lien. The lawyers, the defendants argued, had a duty as a gatekeeper to avoid registering bad liens, and they failed in that duty.

The statutory language

The motion decision revolved around the language of s. 86(1)(b)(i) of the *Act*:

> **Costs**
>
> 86 (1) Subject to subsection (2), any order as to the costs in an action, application, motion or any other step in a proceeding under this *Act* is in the discretion of the court, and an order as to costs may be made against, […]
>
> (b) a person who represented a party to the action, application or motion, where the person,
>
> (i) knowingly participated in the preservation or perfection of a lien, or represented a party at the trial of an action, where it is clear that the claim for a lien is without foundation, is frivolous, vexatious or an abuse of

process, or is for a wilfully exaggerated amount, or that the lien has expired,

[emphasis added]

The Superior Court Decision

Associate Justice Wiebe held that no order for costs should be made against Viceroy's lawyers because:

a. For costs to be ordered against the lawyers, they must have actual knowledge or be reckless or willfully blind to the baselessness of Viceroy's lien;

b. There was no evidence that the lawyers subjectively knew the Viceroy lien was baseless when it was preserved and perfected, and that point was not disputed; and

c. There was simply nothing that indicated a high risk that the Viceroy lien was groundless.

The Appeal to the Divisional Court

The defendants appealed. They argued that:

1. Leave was not required to appeal the Superior Court Decision on costs. They argued that s. 86 of the *Construction Act* made the entitlement to costs a substantive issue, not interlocutory. They relied on s. 71 of the *Construction Act*, which provides that an appeal lies to the Divisional Court from a judgment under that *Act*, to argue that they could appeal the decision as of right.

2. The lien claimant's lawyers had a duty as a gatekeeper to determine whether their client's lien was valid, and they failed to do so. They argued that Viceroy's lawyers ought to have known the lien was frivolous and without foundation and that Associate Justice Wiebe was wrong in holding that s. 86 required the lawyers to subjectively know the lien was bad to be personally liable for costs for registering a frivolous, baseless or exaggerated lien.

LawPro counsel argued for Viceroy's lawyers that leave was required to appeal the Superior Court Decision because s. 133(b) of the *Courts of Justice Act* stipulates that leave is required to appeal discretionary costs orders. By the express words of s. 86, the order was a discretionary costs order. Section 71 of the *Construction Act*, LawPro counsel argued, was not inconsistent with s. 133 of the *Courts of Justice Act* because s. 133 dealt specifically with costs orders, while s. 71 related to appealing judgments to the Divisional Court, generally.

On the substantive issue, LawPro counsel argued that the test for lien representatives' liability under s. 86(1)(b)(i) was subjective for three reasons:

1. The language "knowingly participated" in s. 86(1)(b)(i), in its entire context, could only be reasonably construed as subjective knowledge;

2. The caselaw interpreting s. 86; and

3. Good policy and the wider law on balancing lawyers' duty to their clients and to the court.

The Divisional Court's decision

Justice O'Brien gave the judgment of the Divisional Court, with Justices McSweeny and Davies concurring.

The Divisional Court agreed with LawPro counsel; leave was required.

Section 133(b) requires leave to appeal the discretionary costs order and nothing in the *Construction Act* is inconsistent with that provision. Section 71 of the *Construction Act* relates to a "judgment" and Rule 1.03 of the Rules of Civil Procedure defines a judgment as "a decision that finally disposes of an application or action on its merits." The Divisional Court held that the costs order did not constitute a judgment because it was an order that followed the result in the lien proceeding and not a separate action or application.

Further, s. 71 of the *Construction Act* does not address costs, whereas the *Courts of Justice Act* expressly requires leave be obtained from an order only as to costs that are in the discretion of the court. Subsection 86(1) of the *Construction Act* states that costs under that provision are "in the discretion of the court".

COMMENTS

Lawyers' liability when registering liens

Associate Justice Wiebe's decision in *Viceroy Homes*, expands upon Master Albert's decision in *Brian T. Fletcher Construction Co. Ltd. v. 1707583 Ontario Inc.*, 2009 CanLII 81402 (Ont Sup Ct) ("***Fletcher***"), the leading case on lien representatives' liability when preserving and perfecting liens.

The Superior Court Decision in *Viceroy Homes* makes it clear that the standard for liability of lien representatives when preserving and perfecting liens is not mere negligence. Negligence involves an objective standard, but s. 86(1)(b)(i) imports a subjective test.

Lawyers should take note, however, that while actual knowledge that a lien is baseless or wilfully exaggerated is an essential precondition to a costs order against a lawyer for preserving or perfecting that lien, actual knowledge could be imputed if the lawyer is reckless or wilfully blind to major issues with the lien. Recklessness or wilful blindness requires a level of knowledge that is the moral equivalent of actual knowledge. While such conduct is well beyond mere negligence or laziness underlying a failure to inquire, Associate Justice Wiebe said recklessness and wilful blindness involves knowledge of an actual risk that is at the level of a "clear probability" and then a failure to act to avoid the risk or make inquiries.

Associate Justice Wiebe's comments on recklessness and wilful blindness are the first commentary in Ontario jurisprudence on the applicability of the judicial concepts of recklessness and wilful blindness to a costs determination under s. 86(1)(b)(i). Counsel undertaking a retainer for a lien claimant will need to be mindful that they do not "turn a blind eye" to facts that would lead the lawyer to understand that the lien is without foundation or exaggerated. Otherwise, counsel risk liability for costs due to such reckless or wilfully blind conduct.

The authors believe that the Superior Court Decision is consistent with good policy. It aligns with the general principle that an order of costs should only be made against a lawyer rarely and only where serious misconduct has been shown. As Master Albert observed previously in *Fletcher*, putting lawyers at risk of costs orders against them personally would have a chilling effect on the lawyer-client relationship; the presumption is that the lawyer followed the client's instructions.

Lawyers could be liable to their clients for failing to preserve the client's lien rights in time. There are strict statutory deadlines for preserving and perfecting liens. To preserve their client's rights in time, lawyers may sometimes have to register liens without the benefit of perfect information.

However, it would be a mistake to conclude that *Viceroy Homes* had diminished the lawyer's gatekeeping role. Lawyers should require supporting documentation from their clients at the earliest opportunity, then assess the validity of the lien with reasonable diligence and promptness and advise their clients accordingly. If a client has misled their lawyer into registering a bad lien, the lawyer should advise the client that the lien may have to be voluntarily discharged, or the lawyer may have to take steps to remove themselves from the record. If a lawyer becomes aware of facts that, unless ignored, would lead them to conclude that their client has misled them into registering a bad lien, it is time to contact their insurer, or risk exposure to liability for costs arising from reckless disregard of a lien they would know to be without foundation but for their wilful blindness. These are all elements of the important gatekeeping role of a lawyer acting for a lien claimant.

Leave to appeal costs orders

The Divisional Court Decision now makes it clear that leave is required to appeal costs orders made under s. 86 of the *Act*. Although only s. 86(1)(b)(i) was at issue in *Viceroy Homes*, the Divisional Court's ruling, in our view, will apply to all costs orders made under s. 86 because, by the

express words of that section, s. 86 orders are in the discretion of the court. Section 133(b) of the *Courts of Justice Act* stipulates that leave is required to appeal all discretionary costs orders. The Divisional Court Decision also reinforces the position that a costs order is not a substantive "judgment".

In the authors' view the Divisional Court's ruling requiring leave to appeal is a reasonable limit on the right to appeal a discretionary costs order made under s. 86 of the *Construction Act*. It would be odd if an action brought under the *Construction Act* was the only type of proceeding in Ontario Superior Court which allows discretionary costs orders to be appealed as of right. We believe this finding should be understood as confined to discretionary costs orders made under s. 86, and that this decision does not undermine precedent where the Court of Appeal has applied a broader definition of "judgment" for the purposes of s. 71 of the *Construction Act* in different context than a discretionary costs order.

CONCLUSION

The Superior Court Decision and the Divisional Court Decision in *Viceroy Homes* will be useful precedent on making and appealing costs orders against lien representatives going forward. We can expect that in future cases the issue will be to what extent counsel has recklessly disregarded or wilfully blinded themselves to facts that show that they are preserving, perfecting, or representing a lien claimant at trial, with a bad lien. Even though *Viceroy Homes* solidifies a subjective standard for lawyer liability when registering liens, lawyers should remain vigilant—an ounce of prevention is better than a pound of the cure.

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Demikon v. Oakleigh: Clarifying Direct Payments to Subcontractors under the *Construction Act*

Background

Demikon Construction Ltd. (the "**Plaintiff**") registered a lien for $5,035,812.66 with respect to a condominium project in Orillia, Ontario ("**Project**"), which was owned by Aurelia Limited Partnership and Oakleigh Holdings Inc. (the "**Defendants**").

The Defendants vacated the lien by posting security of $5,085,812.66, being the full amount of the Plaintiff's lien plus $50,000 as security for costs.

Demikon's Motion to Reduce Security Based on Direct Payments to Subcontractors

In *Demikon Construction Ltd v. Oakley Holdings Inc et al.*, 2024 ONSC 2151, the Defendants brought a motion under s. 44(5) of the former *Construction Lien Act* (the "***Act***") to reduce the security they previously posted to vacate the Plaintiff's lien.

The Defendants argued that they should be entitled to reduce the security in court because they made a series of payments to subcontractors who supplied to the improvement pursuant to s. 28 of the *Act*. Section 28 permits an owner, contractor or subcontractor to "jump a rung" of the construction pyramid making payments directly to a subcontractor and being credited for those payments. However, a direct payment will only be considered a s. 28 payment if it is made to a person having a lien for amounts owing to that person and cannot be used to reduce any holdbacks required to be retained by the payer. Section 28 of the *Act* provides as follows:

> Where an owner, contractor or subcontractor makes a payment

> without obligation to do so to any person having a lien for or on account of any amount owing to that person for services or materials supplied to the improvement and gives written notice of the payment or the intention to pay to the proper payer of that person, the payment shall be deemed to be a payment by the owner, contractor or subcontractor to the proper payer of that person, but no such payment reduces the amount of the holdback required to be retained under this Part or reduces the amount that must be retained in response to a written notice of lien given by a person other than the person to whom payment is made. (emphasis added)

The Defendants submitted that they had made $4,276,503.50 in direct payments to subcontractors, which included $2,165,321.14 in holdback. The Defendants acknowledged that $722,278.67 of those payments were not included in the Plaintiff's lien and argued that security posted to vacate the lien should be reduced by $3,554,224.83 to $1,531,587.83.

In response, the Plaintiff argued that s. 28 did not apply to the subcontractor payments because the subcontractors were not lien claimants.

The motions judge held that the payments should be applied to reduce the security. To reach that conclusion, the motions judge found that Aurelia had made direct payments without an obligation to do so "to subcontractors who either had a lien or had monies owing to them for services or materials supplied to the Project." (emphasis added)

The Plaintiff's Appeal

The Plaintiff appealed the motions judge's decision to the Divisional Court, arguing that the motions judge erred because s. 28 only allows for payments to persons having a lien. The Plaintiff argued that, except for one of those payments, there was no evidence that the payments were made to persons having liens, and indeed that payments were made to subcontractors who did not have lien rights.

Additionally, the Plaintiff submitted that the motions judge erred by reducing the lien security due to the amounts paid to subcontractors for holdback. Section 28 specifically provides that direct payments do not reduce the holdback required to be retained by the payer.

Direct Payments Can Only Be Made to Subcontractors with Lien Rights

Justice Lococo, writing for the Divisional Court (2024 ONSC 6261), held that the motions judge made an extricable error in law in his interpretation of s. 28 of the *Act*, which applies only to payments to a person having a lien for any amount owing to that person. The motion judge erred in expanding the scope of s. 28 to include payments to those who do not have liens, who could theoretically include (1) subcontractors who supplied services that did not form part of an improvement and are therefore not lienable, or (2) subcontractors with expired lien rights.

Given that the court had found that the motions judge erred in his interpretation of s. 28 of the *Act*, the court declined to address any of the Plaintiff's other submissions relating to payment of holdbacks.

Tips for Advising on Direct Payments Under Section 28

Demikon v. Oakleigh is both a cautionary tale and a helpful guide for navigating direct payments to subcontractors under s. 28 of the *Act*. Here are some key considerations for payors who are contemplating making a direct payment to a subcontractor pursuant to s. 28:

1. The payment must be made to a person having a lien on account of amounts owing to that person (that person being the person who has a lien). The subcontractor must have supplied lienable services to the improvement and have live lien rights.

2. The party making the direct payment must give notice to the proper payer. The *Act* requires that the party making the s. 28 direct payment give notice of the payment or the intention to make payment to the proper payer of the subcontractor receiving the direct payment.

3. The direct payment will not reduce the holdback the payer is required to be retained. Section 28 payments cannot be used to reduce statutory holdbacks or amounts required to be retained pursuant to a written notice of lien.

4. Consider obtaining a written acknowledgement from the proper payer prior to making a direct payment to its subcontractor.

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Coverage Capped: Pro-Demnity has introduced coverage limits where contracts have a mandatory arbitration clause

Pro-Demnity has introduced sub-limits on policy coverage for architects, specifically affecting contracts that include a mandatory arbitration clause. Those sub-limits apply to damages and claims expenses, capping coverage at $50,000 per claim and $100,000 for all claims within an annual insurance period. The changes apply to contracts signed on or after July 1, 2024.

Pro-Demnity has long advised architects against accepting client-imposed dispute resolution processes, as they increase claims costs and lead to higher premiums for all Ontario architects. This policy change is intended to discourage mandatory arbitration agreements an promote a fairer distribution of risk.

Key recommendations for architects

To avoid the impact of the sub-limit, Pro-Demnity advises architects to:

1. **Avoid client-mandated dispute resolution clauses** in contracts.
2. **Ensure arbitration is optional and requires mutual consent**, rather than being mandatory.
3. **Remove contract language that could trigger the sub-limit**—it is preferable to leave the contract silent on arbitration.

Reference to OAA Document 600-2021A

OAA Document 600-2021A, developed with Pro-Demnity's input, includes appropriate dispute resolution provisions: Specifically, GC 16.4, 16.5, and 16.6 should remain unchanged, as they require mutual consent if the parties proceed to arbitration. Practically, the requirement for "provisions satisfactory to the Architect" should be treated as meaning "approved by Pro-Demnity Insurance Company in writing."

To learn more about this policy change, review the bulletins on Pro-Demnity's website:

- Mandatory Arbitration Jeopardizes Your Coverage with the Stroke of a Pen and Handcuffs your Defense - Pro-Demnity - Architect Liability Insurance - Pro-Demnity – Architect Liability Insurance
- NEW: Refreshed Policy Wordings - Pro-Demnity - Architect Liability Insurance - Pro-Demnity – Architect Liability Insurance

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Boomerang Orders on Summary Judgment Motions: *Saxberg v. Seargeant Picard Incorporated,* 2024 ONCA 931

The fundamental purpose of motions for summary judgment is to provide proportionate, cost-effective and timely dispute resolution. Disputes that do not present a genuine issue requiring trial based on the evidence before the court ought not to be dragged through the courts and waste scarce judicial resources.

One of the risks associated with such motions is the possibility that a court will not only dismiss the order sought, but actually make an order against the moving party, so that the party that brought a motion for summary judgment ends up with a summary judgment order against itself.

While that is generally uncontroversial if the respondents brought a cross-motion for such relief, there are circumstances when such orders are appropriate, at least in Ontario, where no cross-motion has been filed. Such orders are known as "boomerang" orders.

Some jurisdictions generally prohibit such orders. The New Brunswick Court of Appeal, for example, in *Abrams v. RTO Asset Management*, 2020 NBCA 57, held that unless compliance with that province's motion requirement is dispensed with by an order, a boomerang summary judgment is not an option:

> A motion, formal or informal, is a condition precedent to a summary judgment under Rule 22, and an order dispensing with that requirement, which is not a matter of form, will be appropriate only in exceptional circumstances Unless compliance with the motion requirement under Rule 22 is dispensed with by an order under Rule 2.01, a "Boomerang" summary judgment is not an adjudicative option. A motion, formal or informal, is a condition precedent to a summary judgment under Rule 22, and an order dispensing with that requirement, which is not a matter of form, will be appropriate only in exceptional circumstances.

Therefore, in that province, a motion judge's role is limited to either granting the summary motion if he or she is satisfied that no genuine issue requiring a trial exists, or denying the motion if the moving party has failed to demonstrate the absence of such an issue: *Chiasson-Basque v. Enterprise Rent-A-Car Canada Ltd. / Enterprise Location d'Autos Canada Ltée*, 2024 NBKB 214; Alfred Whiffen v. Mariner Partners Inc., 2024 NBKB 22. They generally cannot grant summary judgment to the respondent.

The Ontario Court of Appeal has gone another way and allows such orders in certain circumstances. As the court made clear in *Saxberg v. Seargeant Picard Incorporated*, 2024 ONSC 1079, however, courts must ensure that another main purpose of summary judgment motions is respected: the achievement of a fair and just result.

A fair and just result will generally not be achieved if the party on the receiving end of a boomerang order had absolutely no idea that such an order could be coming. That was the case in *Drummond v. Cadillac Fairview Corporation Limited*, 2019 ONCA 447, where the motion judge had failed to put the respondent on any kind of notice that he might grant judgment against it or afford it an opportunity to address that litigation risk. Similarly, in *Gordashevskiy v. Aharon*, 2019 ONCA 297, which was cited by the court in *Saxberg*, the Court of Appeal was critical of what

it called the "unfortunate practice employed by some motion judges of deciding, on their own initiative and without consultation with the parties, to grant a boomerang order notwithstanding the absence of a cross-motion by the respondent to the summary judgment motion". Again, it was the lack of any kind of notice to the parties that precluded a fair and just outcome.

Where the respondent could have seen it coming, however, the Court of Appeal has confirmed that boomerang motions can be appropriate. In *Saxberg*, it was clear that the motion judge canvassed the issue of a "boomerang" order with the parties given the Saxbergs' request for one in their factum, and SPI's counsel agreed that one could be made if his client's summary judgment motion was dismissed.

In *1062484 Ontario Inc. v. McEnery*, 2021 ONCA 129, counsel, through participation in case conferences dealing with the scheduling issues, were effectively on notice that the plaintiffs' motions might be unsuccessful, and summary judgment could be ordered in the respondent's favour.

In *Meridian Credit Union Ltd. v. Baig*, 2016 ONCA 150, even though there was no cross-motion asking for summary judgment, the Court of Appeal held that the motion judge did not err by granting summary judgment, since counsel for the appellant submitted that all of the relevant evidence was before the court and explicitly invited the motion judge to render a decision in favour of either party.

Litigants in Ontario therefore need to be aware of the possibility that their motion for summary judgment might backfire.

AUTHOR:

Summary Judgment and Contributory Fault: *Arcamm Electrical Services Ltd. v. Avison Young Real Estate Management Services LP*

In *Arcamm Electrical Services Ltd. v. Avison Young Real Estate Management Services LP*, 2024 ONCA 925, the Court of Appeal analyzed the interplay between contributory fault and summary judgment. Specifically, the court held that where contributory fault is raised, summary judgment cannot be awarded without determining that issue.

Background

The defendant, 4342 Queen St. Niagara Holdings Inc. ("**Queen**"), owns a commercial property in Niagara Falls, Ontario. In June 2021, there was an electrical failure at the property that resulted in a complete power outage.

The defendant, Avison Young Real Estate Management Services LP ("**Avison**"), managed the property and engaged the Plaintiff, Arcamm Electrical Services Ltd. ("**Arcamm**"), to restore power, which involved the removal and replacement of two transformers. Arcamm performed the work and issued a series of invoices for payment.

Queen's insurer, Aviva Insurance Company of Canada ("**Aviva**"), had been paying the Arcamm invoices but stopped when it learned that Arcamm might have improperly stored the original transformers, resulting in them being irreparably damaged.

In January 2022, Arcamm sued Avison and Queen for the unpaid invoices (the "**Arcamm Action**"). In Queen's statement of defence, it alleged that Arcamm failed to properly store the transformers and raised a contributory fault defence.

In June 2022, in a separate action, Queen sued Aviva for a declaration that Queen was entitled to payment from Aviva for all amounts that

Queen might be liable (the "**Queen Action**"). In July 2022, in another separate (subrogated) action, Aviva sued Arcamm in relation to the damaged transformers (the "**Subrogated Action"**).

Also in June 2022, Arcamm brought a motion for summary judgment in the Arcamm Action, which was returnable in January 2023. Arcamm's position was that its invoices should be paid because it was not disputed that Arcamm had performed the work. Arcamm indicated that trial was not necessary to decide that issue.

Queen opposed the motion and contended that its contributory default defence raised a genuine issue for trial. Specifically, Queen indicated that this defence would impact Arcamm's recovery, and that granting the motion would risk inconsistent and contradictory findings in the Subrogated Action.

The motion judge acknowledged that determining liability for the transformer failure would require a full evidentiary record, but nonetheless awarded summary judgment. The court focused on the fact that the invoiced work had been performed by Arcamm. The court concluded that Queen had benefited from that work and that liability for the invoices was not an issue that required trial.

Queen appealed, arguing that the motion judge failed to consider whether contributory fault could reduce or negate Arcamm's claim for payment, and whether that issue required trial.

Contributory Fault – A Genuine Issue for Trial

The Court of Appeal held that contributory fault, though often associated with negligence in tort claims, also applies in contract disputes.

In its contributory fault defence, Queen alleged that Arcamm mishandled the transformers by improperly storing them in a humid and/or dusty environment. According to Queen, this resulted in extensive damage to the transformers.

The court found that these were contested facts and concluded that they could not be resolved on a summary judgment motion.

The Risks of Summary Judgment

The Court of Appeal emphasized the procedural risks of deciding matters on summary judgment. The court noted that the evidentiary record included complex, disputed facts requiring expert analysis. A determination of contributory fault demanded credibility assessments and witness testimony, and these issues were ill-suited for the summary judgment process.

The court also found that granting summary judgment risked inconsistent findings in the Queen Action and/or Subrogated Action, which involved similar questions about liability and damages.

For these reasons, the Court of Appeal set aside the judgement of the lower court and dismissed the motion for summary judgment.

Conclusion

This decision highlights challenges to the summary judgment framework, particularly in cases involving complex and disputed facts. Certain claims and defences, such as contributory fault, may inevitably raise genuine issues requiring trial.

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Arbitrator Bias: *Aroma Franchise Company, Inc. v. Aroma Espresso Bar Canada*

Introduction

A recent decision from the Court of Appeal for Ontario (2024 ONCA 839) has clarified the test for determining whether there is a reasonable apprehension of bias on the part of an arbitrator, as well as the test for determining whether circumstances have given rise to justifiable doubts in the arbitrator's impartiality.

The court held that failure on the part of an arbitrator to disclose a circumstance which may give rise to a reasonable apprehension of bias is a relevant but not a determinative factor indicating bias.

The Facts

In 2007, Aroma Espresso Bar Canada Inc. ("**AE**") and Aroma USA, Inc. entered into a Master Franchise Agreement, which Aroma USA, Inc. subsequently assigned to Aroma Franchise Company Inc. ("**AF**"). AE was the master Canadian franchisee, acting as a "middleman" between AF and the individual Aroma franchise owners in Canada.

A dispute arose when AE cancelled supply orders from its sole supplier for the last 12 years, and AF took steps under the Master Franchise Agreement to terminate the agreement and assume AE's role itself. AE also alleged that AF had breached the agreement prior to delivery the notice of default to AC.

The Master Franchise Agreement contained an arbitration clause which provided, among other things, that, "[t]he arbitrator must be either a retired judge, or a lawyer experienced in the practice of franchise law, who has no prior social, business or professional relationship with either party."

After terminating the agreement, the parties began discussions around arbitration and selecting an arbitrator. There was significant correspondence regarding the selection of an arbitrator, as counsel for AE wanted the arbitrator to have no prior relationship not only with either party, but also with counsel for either party.

Eventually, the parties selected an arbitrator with no relationship with either party, counsel, or counsel's firm. The arbitration took place and went on in the normal course. However, issues arose shortly before the release of the Final Award. The arbitrator emailed the parties to advise them there were some costs to be paid before the Final Award could be released; in this email, he mistakenly added another lawyer to the email chain. This lawyer was at the firm representing AF, but was not part of the arbitration between the parties.

When counsel for AE asked about this new individual on the email thread, it was revealed that 17 months into the arbitration, the firm representing AF engaged the arbitrator as an arbitrator in another matter. The arbitrator explained to counsel that the two arbitrations contained completely different parties and were in regard to completely unrelated events and contractual relationships.

Despite this, counsel for AE advised, after receipt of the Final Award, that they would be applying to set aside the Final Award on multiple bases, including a reasonable apprehension of bias.

The Application Judge's Decision and Errors

Justice Steele of the Ontario Superior Court of Justice heard the application to set aside on January 11-13, 2023, and released Her Honour's decision on March 20, 2023.

In coming to the decision, Justice Steele applied article 12(1) of the *UNCITRAL Model Law* on International Arbitration, which provides that "[the arbitrator] shall disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence," and article 12(2), which permits a challenge to an arbitrator or to an award "if circumstances exist that give rise to justifiable doubts about the arbitrator's impartiality."

The first question before the court was whether there was a duty to disclose the subsequent appointment. In answering this question, Justice Steele also relied upon the International Bar Association Guidelines on Conflicts of Interest in International Arbitration; specifically, she quoted General Standard 3(a), which provides that, "[i]f facts or circumstances exist that may, in the eyes of the parties, give rise to doubts as to the arbitrator's impartiality or independence, the arbitrator shall disclose such facts or circumstances to the other parties…" [emphasis added].

Because Justice Steele applied this standard, Her Honour looked at the email correspondence between the two parties while they were in the process of selecting an arbitrator. Her Honour found that since the two parties were very clear about not only not wanting the arbitrator to have any relationship with the parties, but also with counsel, the arbitrator did have a duty to disclose the second arbitration.

The second question before the court was whether the arbitrator's failure to disclose the other arbitration amounted to justifiable doubts about his impartiality. Justice Steele made her finding on this issue based on the same circumstances of her finding on the first question: that, because of the parties' insistence on an arbitrator unknown to the parties or their counsel, and the arbitrator's failure to disclose his subsequent relationship with counsel for AF, that a reasonable person in the respondents' position would have lost confidence in the fairness of the arbitrator, and that there were justifiable doubts about his impartiality which allowed Her Honour to set aside the Final Award of the arbitrator.

In the result, Justice Steele granted the application to set aside the Arbitrator's awards.

The Court of Appeal's Analysis

The decision of Justice Steele was appealed to the Court of Appeal for Ontario. The two issues on appeal were the same as on the application:

1. Was there a duty to disclose the arbitrator's subsequent appointment?

2. Did the circumstances give rise to justifiable doubts / a reasonable apprehension of bias?

In answering the first question, the court looked at the correspondence between the parties and the arbitrator, not the correspondence between the parties to which the arbitrator was not privy. The court found that Justice Steele erred in relying upon correspondence between the two parties where there was no way for the arbitrator to have known about such correspondence. The court noted that in the instructing letter to the arbitrator there was no mention of the parties' desire to have an arbitrator who had no relationship with the parties, their counsel, or the firms of their counsel.

The test for disclosure under article 12(1) of the *Model Law* is an objective test, not a subjective one. The language in article 12(1) provides that an arbitrator has a duty to disclose any circumstances likely to give rise to justifiable doubts, rather than the General Standard applied by Justice Steele, which requires circumstances

that in the eyes of the party give rise to justifiable doubts.

The language clearly provides for an objective test which does not look at the subjective opinions of what the parties believe would give rise to justifiable doubts, but what a fair-minded and informed observer would believe would give rise to justifiable doubts.

In this case, the court found that there was no duty to disclose the subsequent appointment, since the two arbitrations had completely separate issues, parties, and counsel, and the parties had not communicated to the arbitrator that such a circumstance would require disclosure.

The next question the court had to answer was whether the circumstances gave rise to justifiable doubts about the impartiality of the arbitrator. In answering this question, the court clarified that a failure to disclose does not automatically amount to justifiable doubts about impartiality. The question to be asked is, "What would a fair-minded and informed observer think in the circumstances?" The Court of Appeal found that a fair-minded and informed person would consider the facts and circumstances that were objectively known, none of which, in this case, gave rise to justifiable doubts of the impartiality of the arbitrator.

Conclusion

After applying the objective tests, the Court of Appeal found that, in these circumstances, there was no duty for the arbitrator to disclose the subsequent arbitration, and there were no circumstances in this situation which gave rise to justifiable doubts about the arbitrator's impartiality. The court remitted the matter back to the Superior Court to make findings on other grounds on which AE applied to set aside the arbitral award.

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Notable Case Law

***Vento Motorcycles, Inc. v. Mexico*, 2025 ONCA 82**

A reasonable apprehension of bias in one member of a three-member tribunal is sufficient to disqualify the whole tribunal. The decision to set aside an award does not depend on a demonstration that the participation of the disqualified member affected the outcome or cast the deciding vote in a split decision, since it is impossible to know whether or to what extent the participation of a biased member affected a panel's decision. It cannot be left to conjecture, nor can it be ignored by assuming that the presumed impartiality and independence of the other two members of the panel rendered it harmless. The parties to an arbitration are entitled to an independent and impartial tribunal, not simply the decision of a quorum of panel members who are unbiased. The application judge erred in finding that there was a reasonable apprehension of bias, but exercising her discretion to decline to set aside the tribunal's award. There was a reasonable apprehension of bias for one of the three arbitrators, and the court had no choice but to set aside the award.

***Soo Mill & Lumber Company Ltd. v. Pozzebon*, 2024 ONSC 5950 (Div. Ct.)**

Orders dismissing (or partially dismissing) motions under rule 45.02 are interlocutory. There being no specific authority on the question, the Divisional Court considered the most closely analogous cases, including *Deltro Group Ltd. v. Potentia Renewables Inc.*, 2017 ONCA 784 (order dismissing motion for interlocutory injunction is interlocutory) and *1476335 Ontario Inc. v. Frezza*, 2021 ONCA 82 (order dismissing motion for certificate of pending litigation is interlocutory).

In the underlying action, Soo Mill had claimed, pursuant to the trust provisions of the *Construction Act*, a declaration that all amounts paid or owing to the defendants, in relation to homes constructed in the subdivision, were held in trust for Soo Mill, as well as damages for breach of trust. While the sale of three homes was pending, Soo Mill moved under rule 45.02 for an order that the proceeds of sale of the home be held in court as security for its claim. The order dismissing the motion being interlocutory, the appeal was quashed.

***Backyard XP Inc. v. Cesario-Valela*, 2024 ONSC 130 (A.J.)**

The test for leave for a motion for security for costs is similar to the threshold test the moving party must meet on the underlying motion for security for costs concerning Rule 56.01(1)(d). That threshold test is that the defendant must prove that there is "good reason to believe" that the plaintiff corporation has insufficient assets to pay costs. Where there is "good reason to believe" the lien claimant cannot pay the defendant's costs, there is a necessity to establish procedural fairness, as the lien claimant has the security of the land for its lien.

***Greyfield Construction Co. Ltd. v. TVM Construction Management Inc.*, 2024 ONSC 5344 (S.C.J.)**

Security for costs was denied despite the fact that the plaintiff had admitted it did not have the cashflow to pay into court the amount requested; it refused to answer questions relating to its finances and to produce its financial records and had not filed any related material; it was a defendant in three other actions in which the damages claimed against it exceeded $636,240.68; its lawyer admitted that he had no expectation that he would be paid in full; and the plaintiff had provided no evidence relating to its assets. Despite all that, having considered the merits of the claim, the financial circumstances of the plaintiff and the possibility of an order for security for costs preventing a *bona fide* claim from proceeding, the court was satisfied that granting the order would be unjust.

***Arcamm Electrical Services Ltd. v. Avison Young Real Estate Management Services LP*, 2025 ONCA 84**

As a general principle, costs follow the event. Thus, when an appeal is allowed in the Court of Appeal, that court's general practice is to set aside the costs order below and award the successful appellant costs below and of the appeal.

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