

December 19, 2024

Does a Direct Payment to Subcontractors Under Section 28 of the Construction Act Reduce Lien Security? It Depends.

Key Takeaways

Reliance on a direct payment pursuant to s. 28 of the *Construction Act, R.S.O. 1990, c. C.30* (the “**Act**”) is only valid if that payment was made to a person “*having a lien*”. A person does not ‘have a lien’ if their lien is expired or has otherwise been resolved by the *Act*. Failing to ensure compliance may not result in such a payment being a proper basis to reduce lien security posted into court.

If a payor wants to avail themselves of direct payments to subcontractors/suppliers under s.28 of the *Act*, they should consider the following:

- Ensure the payees are persons “having a lien”.
- Provide the required written notice of the payment (or intention to pay) to the proper payor.
- Consider getting the proper payor’s input on the amounts owing to the subcontractor/supplier.
- Where appropriate, obtaining an acknowledgment and direction from the proper payor to make the direct payment.

Background and the Motion Judge’s Decision

On December 13, 2024, Ontario’s Divisional Court in [Demikon Construction Ltd. v. Oakleigh Holdings Inc., 2024 ONSC 6261](#) set aside the motion judge’s order ([2024 ONSC 2151](#)) which held that the direct payments from the owner, Aurelia Limited Partnership (“**Aurelia**”), to subcontractors of Demikon Construction Ltd. (“**Demikon**”), decreased Demikon’s lien security.

Demikon entered into a construction management agreement with Aurelia for a mixed-use condominium project. Demikon was responsible for engaging and paying its subcontractors.

Aurelia terminated Demikon due to allegations of delay and deficiencies, and Demikon subsequently preserved and perfected a lien in the amount of \$5,035,812.66 (which included \$50,000 as security for costs). Aurelia vacated the lien by posting the required security in the form of a lien bond into court.

By Notice of Motion dated December 23, 2022, Aurelia sought an order that its lien security be reduced from \$5,085,812.66 to “*a lesser and reasonable amount determined by the Court pursuant to s. 44(5) of the Construction Act.*”

Aurelia’s evidence was that it made payments directly to Demikon’s subcontractors in the period between March 5, 2021 (shortly before Demikon’s termination) and April 6, 2022 (more than a year after the termination) totaling \$4,276,503.50. These payments included:

1. \$2,165,312.14 for payment holdbacks; and
2. Demikon's lien accounting already credited an amount of \$722,278.67 from the payments made by Aurelia prior to the registration of the lien. Accordingly, the net reduction in security sought was \$3,554,224.83 (i.e., \$4,276,503.50 less the previously credited amount of \$722,278.67).

Aurelia relied upon s. 28 of the Act (reproduced below) to be the basis to reduce the security posted into court for Demikon's lien:

Direct payment to person having lien

28 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 Motions judge ordered the security be reduced by \$3,554,224.83 because the payments were made to “subcontractors who either had a lien or had monies owing to them for services or materials supplied to the project” [emphasis added].

The motions judge determined that s. 28 of the Act applies to payments made to any subcontractors, regardless of whether they were to persons “having a lien”.

Demikon appealed.

Divisional Court of Appeal's Decision

The Divisional Court set aside the motions judge's order to reduce Demikon's security because:

- The statutory purpose and intent of s. 28 of the Act was limited to persons “having a lien”. The reference to “or on account of any amount owing to that person” was intended to relate to only persons “having a lien”. It cannot relate to subcontractors who did not have a lien because (i) they supplied equipment or other chattels (or related services) that did not form part of an “improvement”, or (ii) their liens have expired or resolved otherwise.
- There was no evidence (save for one) that the payments were made to subcontractors who had a lien, because they were either expired or resolved otherwise.

In particular, the Divisional Court noted that “*once the liens expire, there is no practical reason under the Construction Act to allow payors to ‘jump the rung’ to avoid privity of contract, which is what s. 28 permits. This analysis is consistent with the conclusion that s. 28 ‘merely provides a*

method of preventing the registration of a lien or to facilitate the removal of a lien already registered’.”

This decision is significant as there is a dearth of guidance on the application of s. 28 of the *Act*, in particular, how and when a party can rely on the direct payment provision.

If a payor wants to avail themselves of direct payments to subcontractors/suppliers under s.28 of the *Act*, they should consider the following:

- Ensure the payees are persons “having a lien”.
- Provide the required written notice of the payment (or intention to pay) to the proper payor.
- Consider getting the proper payor’s input on the amounts owing to the subcontractor/supplier.
- Where appropriate, obtaining an acknowledgment and direction from the proper payor to make the direct payment.



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