Proving entitlement: No automatic right to payment in the face of deficiency claims

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Introduction

The Manitoba Court of King's Bench recently released its decision in *Sterling Parkway Residences Inc. v. Boretta Construction 2002 Ltd. et al.*, dismissing a motion by Sterling Parkway Residences (Sterling) to have money paid out of court that had previously been paid into court as lien security under the *Builders Liens Act*, C.C.S.M., c. B91 (BLA). The court's decision reaffirms that the purpose of the BLA is to create remedies; not to determine entitlement to payment.

Background

Sterling is the owner and developer of an apartment complex in Winnipeg, Manitoba known as The Link (the Project). Sterling retained Boretta Construction 2002 Ltd. (Boretta) to act as general contractor on the Project pursuant to two CCDC-2 Stipulated Price Contracts (the Boretta Contracts). As is typical under stipulated price contracts, Boretta engaged various subcontractors to perform the work. Construction began in June 2019.

On August 17, 2021, Sterling terminated the Boretta Contracts on the basis of alleged performance issues and delay. After terminating the Boretta Contracts, Sterling engaged another contractor to complete the Project.

Boretta registered two builder liens on the property (the Borretta Liens). Sterling then brought an application under section 55(2) of the BLA to have the Boretta Liens vacated. An Order was obtained vacating the Boretta Liens upon deposit into court of cash security in the amount of $2,343,371.01 (the Lien Security). Sterling paid this amount into court and the Boretta Liens were vacated. Importantly, rather than posting a lien bond or cash security with the court, Sterling deposited into court the statutory holdback it was required to maintain under section 24 of the BLA in respect to the Boretta Contracts.

In July 2022, Sterling commenced an action as against Boretta and its surety, Liberty Mutual Insurance Company (Liberty), seeking an unspecified amount in damages for

alleged performance issues, deficiencies, and delay related to the work performed under the Boretta Contracts (the Performance Bond Action). Liberty and Boretta defended the Performance Bond Action and Liberty issued a counterclaim as against Sterling.

The motion

After the Project achieved substantial performance on June 14, 2023, Sterling sought to have the Lien Security reduced to pay Boretta's subcontractors, which are the subcontractors that performed the work that Sterling alleged to be deficient in the Performance Bond Action. Sterling, along with several of the Boretta subcontractors, argued that the Lien Security was holdback and was therefore automatically payable under section 27(6) of the BLA, regardless of the quality of their work or their performance.

Liberty successfully opposed Sterling's motion. Liberty argued that the funds Sterling opted to pay into court are now security for liens, regardless of whether they were holdback funds, such that payment out of court requires a determination of liens on the merits—not at Sterling's discretion. Liberty further argued that, given Sterling's claim against Liberty which alleges Sterling suffered damages as a result of deficient work under the Boretta Contracts, the funds cannot be paid to the subcontractors because it is the subcontractors who performed the work for Boretta. In this regard, Liberty argued that the subcontractors are not entitled to any funds if Sterling's allegations are proven as Boretta would have valid set-off claims and claims over and against such subcontractors.

Interestingly, Sterling and the subcontractors maintained the position that holdback accrued is unconditionally payable after the applicable time period under the BLA expires, regardless of poor performance or defaults.

The decision

The court dismissed Sterling's motion and held that the Lien Security should remain in court until all accounts of the issues in dispute could be adjudicated on the merits as contemplated in section 65(1) of the BLA, which requires a judge, in an action on a lien, to resolve all issues related to the construction project. The court's reasoning was twofold. First, the Lien Security was not capable of being paid out at Sterling's discretion. For the Lien Security to be paid out of court, either consent or a determination on the merits is required. Second, the court confirmed that there is no automatic and unconditional entitlement to holdback under the BLA. Given Sterling's claims and the alleged damages sought in the Performance Bond Action, the holdback was not capable of being paid, absent consent or a determination on the merits, including with regard to claims for set-off and claims over against the subcontractors whose work Sterling put at issue.

This decision clarifies what appeared to be a misconception in the industry with regard to parties' rights to holdback funds. In particular:

1. Holdback (or any security for liens) paid into court to vacate liens must remain in court until the underlying liens are resolved or determined on the merits; and

2. There is no automatic or unconditional entitlement to accrued holdback. Where a subcontractor is alleged to have caused damages as a result of deficient work or a default, that subcontractor is not entitled to holdback funds and must prove its entitlement to payment.

For more information, please reach out to one of the key contacts listed below.

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