

PERFORMANCE BONDS: THE NEW FORM 32 UNDER SECTION 85.1 OF THE ONTARIO CONSTRUCTION ACT

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Following up on our previous bulletin, [Performance Bonds: What Project Finance Lenders Should Know](#), in this bulletin, we compare the widely used Canadian Construction Documents Committee's Performance Bond Form 221-2002^[1] ("**CCDC Form**") with the new Form 32 – Performance Bond that is mandated for certain projects by the *Ontario Construction Act*^[2] ("**Form 32**").

Background

Pursuant to section 85.1 of the *Construction Act* and section 12 of the accompanying *General* regulation, all "public contracts" with a contract price of \$500,000 or more require the contractor to furnish both a performance bond and a labour and materials bond that, in each case, must be in the prescribed forms and have coverage limits of at least 50% per cent of the contract price.^[3] The Act defines a "public contract" as a contract where the owner is the Crown, a municipality or a broader public sector organization, but excludes contracts where the contractor is an architect or engineer from the application of that section.^[4] Thus, the provision is meant to capture all government-procured construction contracts with a contract price of \$500,000 or more.

In the context of public-private partnership ("**P3**") and alternative financing and procurement ("**AFP**") projects, section 1.1(4) of the Act clarifies that the "public contract" for the purposes of section 85.1 is not the typical project agreement between a special purpose vehicle and the government entity, but rather the "dropdown" construction contract or design-build contract between that special purpose vehicle and the contractor.^[5] Section 3 of the *General* regulation further stipulates that the minimum coverage limits for the bonds are capped at \$50 million for P3 or AFP projects – i.e., the 50% requirement does not apply to projects with a contract price greater than \$100 million.^[6]

As with the other new provisions of the Act, the requirements of section 85.1 do not apply to contracts where the procurement process was commenced before July 1, 2018.^[7] Under section 1(4) of the Act, a procurement process begins whenever a request for qualifications, request for quotation, request for proposals, or a call for tenders is first made.^[8] In the context of projects procured by Infrastructure Ontario, for example, this would

be the date that the request for qualifications is issued for a typical procurement. Notably, a market sounding or a Request for Expression of Interest issued by Infrastructure Ontario does not on its own constitute the commencement of a procurement process.^[9]

Form 32

Form 32 to the *Construction Act* was developed by the Ministry of the Attorney General of Ontario in close consultation with the Surety Association of Canada and other industry stakeholders. It is intended to be a complete, detailed code of conduct governing the relationship between the surety, the owner, and the contractor, and is designed to address some of the deficiencies of the very short and potentially ambiguous CCDC Form.

Form 32 is significantly longer and more detailed as compared to the CCDC Form. Unlike the CCDC Form, which is a 1 page document, Form 32 (in blank form, together with Schedules and Appendices) is 12 pages long. It sets out a detailed claims regime addressing, among other things: specific parameters for written notice (including various prescribed forms), a mandatory pre-notice meeting and post-notice conference, specific timelines for the surety's investigation and response, a regime for necessary interim work and mitigation work, specifics regarding the owner's direct expenses to be paid by the surety, and a detailed checklist of documents that must be delivered to the surety when a claim is made.

Mandated Timelines

A key new feature of Form 32 is that it introduces mandatory timelines for notice, investigation, and response following an alleged default. The CCDC Form does not mandate such timelines, instead relying on the reasonableness of the parties. Under the new Form 32, after receipt of a demand under the bond from the owner in the form of Schedule A to Form 32, the Surety must, within four business days, deliver to the owner an acknowledgement in the form set out at Schedule B. Furthermore, within twenty business days, the Surety must deliver a complete written response to the demand, based on its investigations and review, in the form of Schedule C. The surety must also propose a "Post-Notice Conference" within five business days or such longer period as may be agreed.

Other Differences between the CCDC Form and Form 32

An apparently minor but consequential difference between Form 32 and the CCDC Form is the definition of "Contract" in the preamble. Form 32 incorporates not only the underlying contract but also "amendments made in accordance with its terms". This language is not effectual on its own but where the underlying contract includes terms allowing minor variances and amendments, this more incorporative language may offer better protection against a surety who claims to having been discharged due to a variation in the contract

without their consent.

As noted above, article 1 of Form 32 imposes an express notice requirement and details the necessary procedure for declaring a principal in default. While notice to the surety was always a functional requirement due to the need to declare the principal in default, this new term makes this requirement express and adds procedural clarity. Section 1.2 also establishes a procedure for notice in cases with multiple sureties.

Article 2, which requires a “Pre-Notice Meeting”, and article 5, which requires a “Post-Notice Conference”, provide the parties with a mandatory regime for meetings and communications both before and after the declaration of default. This appears to codify, and reinforce, the common recommendation that the bond parties communicate openly and often in respect of the bonded work and any potential issues.

Article 3 imposes an express obligation on the surety to investigate a declared default and sets a timeline for their response to the obligee’s notice. This codifies the surety’s common law right to investigate defaults prior to responding to a claim but notably circumscribes that right by imposing a time limit on any investigations and establishing requirements for the response.

Article 4 and sections 5.2 to 5.7 of Form 32 allow the obligee/owner to unilaterally undertake certain work during the claim process. Article 4 creates the concept of “Necessary Interim Work” that an owner may undertake to ensure people’s safety, protect the work from deteriorating, or to comply with applicable laws. Sections 5.2 to 5.7 create the concept of “Mitigation Work”, which is work that an owner has assessed must be done to mitigate recoverable costs under the bond. These provisions address certain points of the common law related to performance bonds. Most notably, they provide contractual protections for obligees from claims that work subsequent to a default has materially prejudiced the surety in some way, thus discharging them. This is clear from sections 4.3 and 5.7, which prohibit the surety from raising the fact that the work was done as a defence to an owner’s claims.

There are also noticeable differences between the two bonds when it comes to a surety’s traditional options once it has accepted liability. Article 6 of Form 32 modifies the surety’s traditional third option – obtaining bids for completion contracts – to reduce the surety’s scope of liability under the bond. The CCDC Form requires the surety to cover both the costs of completing the principal’s obligations but also an obligee’s expenses that are incurred as a direct result of the principal’s default in performance of the underlying contract. This latter obligation to pay non-“bricks-and-mortar” damages is excluded in Form 32. Instead, Form 32 only adds in section 6.1(c)(ii) that the cost of completion includes applicable value-added taxes. This concept is further reinforced in article 7 as well.

Article 7 of Form 32 limits the surety’s liability to certain kinds of damages and expressly excludes liquidated, indirect, or consequential damages and damages due to delay or non-performance. This provision seems

designed to contract out of the broad interpretation of sureties' liabilities adopted by the Ontario Court of Appeal in *Whitby Landmark Developments Inc. v. Mollenhauer Construction Ltd.*^[10] in favour of the restrictive approach adopted by the Saskatchewan Court of Appeal in *Lac La Ronge Indian Band v. Dallas Contracting Ltd.*^[11]

Form 32 also more formally and explicitly sets out the conditions precedent to claiming under the bond. Specifically, section 8.1(d) adds a requirement that the obligee must agree to pay the balance of the contract price to the surety. This is noteworthy because whether or not payment of the balance of the contract price was a condition precedent before the surety honoured the bond was not clear in the CCDC Form and had been the subject of some commentary and discussion in the past.

Another important difference between the two bonds is the limitation on surety's liability in article 10 of Form 32. This article adds a general limitation on the surety's liability applicable both to the principal's breach of the underlying contract and the surety's breach of the bond itself. This is a departure from the CCDC Form which provides a face amount for only the bonded obligations. The face amount represents the liability of the surety in the normal course but does not cap the surety's liability for breach of contract, negligence, or other claims. The new limit of liability appears intended to contract out of the case law that has held that, without such a term, the surety can face liability greater than the face amount of the bond for its own breach of a bond's terms.

The new Form 32 bond also includes a number of other changes that are less specific to the law of performance bonds but which generally appear to modernize the bond contract and clarify how it should be used. Such changes include common contractual terms such as the addition of choice of forum and choice of law clauses as well as the inclusion of prescribed forms of the obligee's required notice, the surety's required acknowledgement, and the surety's required statement of its position on a declaration of default, which are discussed above.

Taken altogether, the changes contained in Form 32 represent a significant step forward compared with the CCDC Form and other forms of performance bond. These changes not only clarify the parties' obligations and rights but also provide them with a detailed process for performing the bond contract. As a result, one may expect claims to proceed more predictably and efficiently under the new form of bond. Indeed, while Form 32 is only applicable to a limited range of public projects, its terms may provide a useful precedent for lenders, builders, and owners to use with other construction projects as well.

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[1] Canadian Construction Documents Committee, "Performance Bond Form 221-2002" (CCDC, 2002) (standard surety performance bond form guaranteeing performance of the contract by the contractor).

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[2] Ontario, "[Form 32 – Performance Bond under Section 85.1 of the Act](#)" (2018).[ps2id id='2' target="/]

[3] *Construction Act*, RSO 1990, c C.30, s 85.1 [Construction Act]; *General*, O Reg 304/18, s 12 [*General*].[ps2id id='3' target="/]

[4] *Construction Act*, *supra* note 3, ss 85.1(1), 85.1(3)[ps2id id='4' target="/]

[5] *Ibid*, s 1.1(4).1.[ps2id id='5' target="/]

[6] *General*, *supra* note 3, s 3.[ps2id id='6' target="/]

[7] *Construction Act*, *supra* note 3, s 87.3.[ps2id id='7' target="/]

[8] *Ibid*, s 1(4).[ps2id id='8' target="/]

[9] Ontario, Infrastructure and Lands Corporation, *Procurement Policy* (June 1, 2018), s 4.5.[ps2id id='9' target="/]

[10] *Whitby Landmark Developments Inc v Mollenhauer Construction Ltd*, 67 OR (3d) 628, 2003 CanLII 50085 (CA).[ps2id id='10' target="/]

[11] *Lac La Ronge Indian Band v Dallas Contracting Ltd*, 2004 SKCA 109, 35 CLR (3d) 236.[ps2id id='11' target="/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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