

THINK TWICE BEFORE OBTAINING A LABOUR AND MATERIAL PAYMENT BOND – NEW LIABILITY FOR AN OLD SECURITY

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The old practice of just filing away a procured labour and material payment bond without taking proactive steps to notify potential claimants of the bond's existence now exposes owners and others arranging for such bonds to claims from unpaid subcontractors.

The Supreme Court of Canada majority decision in *Valard Construction Ltd. v. Bird Construction Company*^[1] has found that "obligees" under labour and material payment bonds owe "claimants" under such bonds a positive obligation to inform of the bond's existence in circumstances where claimants may not have expected a bond to have been obtained.

The Facts

Bird Construction Company ("**Bird**") was the general contractor for Suncor Energy Inc. at an oilsands construction project near Fort McMurray, Alberta. Bird subcontracted work to Langford Electric Ltd. ("**Langford**"), which, in turn, subcontracted work to Valard Construction Ltd. ("**Valard**"). Pursuant to its subcontract with Bird, Langford obtained a labour and material payment bond in the CCDC 222-2002 standard form for the benefit of Langford's subcontractors.

Langford became insolvent and Valard, which had obtained default judgment against Langford for non-payment, remained unpaid for work performed. Almost a year after having completed its work, Valard happened to learn of the labour and material payment bond's existence. Apparently, Valard never availed itself of statutorily available information requests as against Bird and others in the construction pyramid to inquire of project bonding while working for Langford.

Accordingly, upon learning of the bond's existence, Valard made a claim under the bond against the "surety", Guarantee Company of North America, for payment of amounts owed for work performed. The claim was denied as being outside the standard 120 day period following the last supply of services to the "principal" (i.e., Langford).

Valard then claimed against Bird, the obligee, under the bond for breach of trust. Valard alleged that Bird

breached its fiduciary duty (as trustee) owed to Valard (as beneficiary) to inform Valard of the existence of the bond and Valard's right of action against the surety provided by the bond.

The trial judge dismissed Valard's claim. Valard appealed the trial judge's decision. The majority of the Alberta Court of Appeal dismissed Valard's appeal. Valard then appealed to the Supreme Court.

The Majority Decision

Applying general principles of trust law to the bond, the majority found that Bird, as the obligee (which the bond also identifies as a trustee), owed Valard, as one of the claimants (which the bond also identifies as beneficiaries) a proactive duty to disclose the existence of the bond (i.e., the subject trust) where such claimants would be unreasonably disadvantaged if not informed. Valard, as beneficiary, had the right to hold Bird, as trustee, to account for Bird's administration of the "trust property" (i.e., the claim against the surety) and enforce the terms of the trust (i.e., the bond) against Bird.

The decision at first instance referenced the Valard project manager's testimony that in his 10 years of experience, he had not encountered a labour and material payment bond at an oilsands project. The majority relied on this reference for the proposition that such bonds were uncommon on oilsands projects. As such, the majority found that Bird's obligation to advise claimants of the bond's existence was engaged.

The majority held that what a trustee must do to discharge its obligation to beneficiaries is "highly sensitive to the context". In this case, the majority considered that Bird could have discharged its obligation to notify claimants under the bond of the bond's existence by posting a copy of it in Bird's on-site trailer.

Bird, like many obligees before it, however, took no proactive steps to advise Valard of the bond's existence. Accordingly, the majority found that Bird had breached its fiduciary obligation owed as trustee to Valard as beneficiary.

The majority rejected Bird's argument that a proactive duty to disclose the existence of the trust would be inconsistent with the trust's sole purpose, which is "to protect the trustee [i.e., Bird] ...from the risk and expense of liens and work stoppages."

The Dissent

Justice Karakatsanis dissented. Justice Karakatsanis found that there was no language in the bond requiring Bird to take proactive steps to advise claimants of the bond's existence. Her Honour explained that bonds employ trust language to avoid the third-party beneficiary rule. As such, a trustee's obligations under a bond are to be construed narrowly. Her Honour found that labour and material payment bonds are commonly used in the construction industry and that the common industry practice, aided by construction lien legislation, is

for claimants to enquire of others in the construction pyramid of whether a bond has been obtained.

Justice Karakatsanis reasoned that “imposing a mandatory obligation on the trustee to inform potential claimants of the bond’s existence transforms what was a beneficial risk-management tool into a significant liability”. Her Honour further reasoned that introducing a context-specific obligation to proactively advise of a bond’s existence creates “unnecessary uncertainty”.

Take-aways

1. Owners and others that have already procured labour and material payment bonds ought to consider publicly posting such bonds where potential claimants are likely to see them – for example, a notice board in a construction trailer. Where an inquiry is made as to the existence of a labour and material payment bond or any request for information is made under construction lien legislation, obligees ought to consider responding by providing a copy of the bond. Consideration may also be given to contractually obligating contractors to advise their subcontractors of the bond’s existence.
2. Subcontractors have been afforded a new option to obtain payment for unpaid services.
3. Owners and others considering the use of labour and material payment bonds as a means of protecting construction projects from disruption must now balance this protective measure against the obligations now accompanying such instruments.

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[1] 2018 SCC 8.[ps2id id='1' 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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