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Owners' Obligations Under Labour and Material Payment Bonds

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In *Valard Construction v Bird Construction*, released yesterday (February 15, 2018), the Supreme Court has revealed a long-held misunderstanding in the construction industry (at least 48 years) about duties owed by Owners to subcontractors (or by General Contractors to sub-subcontractors) with respect to Labour and Material Payment Bonds. The court found that the wording of L&M bonds creates obligations down the construction pyramid to parties who not only have no contractual relationship, but who may not know each other's identity.

Bonds Generally

On large projects, Owners often require GCs to post L&M bonds at a value equal to 50% of the contract price. The bonds stand as security for the benefit of all subcontractors and suppliers who have direct contracts with the GC. Bonds are typically written by insurance companies using a standard form, and allow unpaid subcontractors and suppliers to claim against the bond if they make a timely claim. Bonds use trust language, because otherwise claimants would have no legal basis to claim against the bond. Subcontractors and direct suppliers can claim against the bond if the GC will not or cannot pay for the goods or services supplied to the bonded job.

The timelines in the bonds typically require notice of a claim to be received within 120 days of the claimant's date of last supply, and require an action to be commenced to recover under the bond within one year.

Generally speaking, Owners like L&M bonds because they provide payment security for unpaid subcontractors, making it less likely that the subcontractors will walk off the job and/or exercise lien rights in the event of non-payment.

Since at least the early 1970s, the understanding has been that the subcontractor has an obligation to find out for itself if an L&M bond exists. Ontario's lien legislation includes a statutory obligation on an Owner to advise of the existence of a bond, but only if that information is asked of it.

Throughout Canada (until now), no court has held that, in the construction context, the Owner (called the “trustee” in the bond), has the obligation to inform the subcontractors (“beneficiaries” under the bond) of the existence of the bond.

Valard Construction v Bird Construction

The facts of this case were slightly different than the usual bonding situation, in that the bond was not posted by the GC at the request of the Owner, to be claimed against by subcontractors (as is typical), but rather was posted by the subcontractor at the request of the GC (who became the trustee under this bond), to be claimed against by sub-subcontractors (the beneficiaries). Nonetheless, the caution for Owners presented by this case is the same as in the typical case.

Bird was the GC on an Alberta oilsands project owned by Suncor. Bird’s standard practice was to require L&M bonds for projects over $100,000, and so required its subcontractor Langford to obtain a bond naming Bird as trustee. The bond was written in the CCDC’s standard form (222-2002).

Valard had a contract with Langford. Langford stopped paying Valard, and eventually the debt owing by Langford to Valard grew to about $660,000.00. Valard sued Langford and obtained default judgment, but was not able to collect.

Valard eventually asked Bird about the existence of an L&M bond, and was told that in fact one did exist (apparently an anomaly in Alberta oilsands projects). However, by the time Bird provided this information to Valard, the 120 day notice period had long expired, and the claim was denied by the bonding company. Valard believed it had been wronged by Bird’s failure to advise it of the L&M bond during the project (or prior to the expiry of the 120 day notice period), and so sued Bird.

The trial level and Alberta Court of Appeal, following case law from Ontario, decided that Bird had no obligation to notify Valard or any other subcontractor of the existence of the bond. The Supreme Court of Canada disagreed.

SCC’s Decision

This will hardly be new ground for estates lawyers and others who deal with trusts on a daily basis, but the Supreme Court approached this case with fiduciary duty front of mind. The hallmark of a trust is the fiduciary duty by which the trustee holds property solely for the beneficiary’s enjoyment, and the case law in the area (that is, outside of the construction context) is rife with examples of a trustee’s obligation to inform a beneficiary of the existence of a trust (for example when a beneficiary’s interest is conditional on attaining the age of majority). The court noted the trustee’s fiduciary duty includes an obligation to disclose the existence of the trust wherever it would be to the unreasonable disadvantage of a beneficiary not to be informed of a trust’s existence.

Justice Brown, writing for the majority, held that Bird as trustee had an obligation to take steps to inform Valard (and, presumably other beneficiaries) of the existence of the trust (that is, the right to claim under the L&M bond). Bird did not do so (until explicitly asked), and instead simply filed the bond away in a drawer in an offsite location.

Justice Brown did not state that Bird had to ensure that every potential beneficiary knew of the trust, just that it took reasonable steps to that end. What is "reasonable" will depend on the circumstances of each case, but the majority noted that, in these circumstances, Bird could have discharged its duty by posting a copy of the L&M bond at the on-site work trailer.

Unanswered Questions

Going forward, given the finding of the majority, it would be prudent for Owners to post the bond in a conspicuous place where it can be seen by all subcontractors and to document the posting. In her dissenting reasons, Justice Karakatsanis notes that because "reasonableness" is determined by the circumstances of each case, the result is unnecessary uncertainty which may undermine the value of the bond in the first place. In fact, this uncertainty about what they are required to do in any particular case may cause Owners to cease requiring L&M bonds, which would likely result in more work stoppages (subcontractors will be unwilling to continue to work "unpaid" without the security of the L&M bond), as well as more subcontractors exercising lien rights.

Justice Karakatsanis also questioned what a trustee will have to do if there are multiple worksites and how a trustee will satisfy its obligations to subcontractors who are not physically on site. Justice Brown did not address these questions in his reasons.

However, the biggest question mark right now is the liability Owners may have to subcontractors on projects that have already been completed. It is difficult to be precise with the number, but there have been hundreds - if not thousands - of L&M bonds issued using the CCDC form that was under consideration in *Valard*.

Given the understanding in the industry over the last 48 years, Owners likely took the steps Bird did when they received the L&M bond: that is, just filed the bond away, and may have done nothing to make beneficiaries aware of its existence unless specifically asked. Those unknown beneficiaries are like floating sea mines for an unaware Owner.

We anticipate significant judicial ink will be spilled on the issue of the limitation period for a beneficiary (subcontractor) to advance a claim against the trustee (owner), including when a beneficiary ought to have reasonably known (or should have made inquiries) of the existence of a bond. In Ontario the general limitation period is 2 years, but this is subject to discoverability, and an ultimate limitation period of 15 years. Worse yet, while the *Limitations Act* would allow an Owner facing this type of liability to send a notice of possible claim out to start the limitation period running, there is no reliable way for an Owner to ensure that it has a full list of all subcontractors.

Most in the industry would say it is unlikely that an Owner could face claims from unknown (and potentially unknowable) subcontractors on projects up to 15 years old. However, prior to the Supreme Court's decision, most would have also thought it unlikely that an Owner could have any stand-alone notice obligation to the subcontractor under an L&M bond.