Affleck Greene Orr LLP

One First Canadian Place
Suite 840, P.O. Box 489
Toronto, Ontario
Canada M5X 1E5

T 416 360 2800
F 416 360 5960
www.agolaw.com

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Construction Bonds

Peter Greene, Affleck Greene Orr LLP.

INTRODUCTION

I have been asked to speak on the topic of construction bonds. In speaking to you today I shall attempt to avoid, where possible, boring you with endless legal jargon and precedents but concentrate on practical advice from one who has had to deal with a number of substantial bond claims in several Provinces of Canada, primarily acting for a Surety. From my experience, practical common sense in the face of difficulties in completing a construction project is far better medicine than resorting to the hiring of an expensive civil litigator/gunslinger, such as myself, to pursue matters before the Courts.

Given time restraints, my topic today will primarily deal with Performance Bonds rather than other types of bonds relating to construction contracts in that Performance Bonds are the primary Bonds when dealing with construction contract claims.

I must preface my remarks by telling you that there is a marked difference between United States of America jurisprudence versus Canadian relating to construction bonding claims. The primary difference is that south of the border most states have past legislation in this area, and when dealing with public construction projects the *Miller Act* and the *Little Miller Act* apply. The *Miller Act* applies to contracts for the construction, alteration and repair of any public building or public work of the United States. Much of the litigation in the U.S. is focused on the nature of a public work to determine whether the codified statutory provisions of the *Miller Act* apply. In Canada, work performed, especially for the Federal Government, requires bonds to be in a specific format, and as is typical when dealing with any level of government within this country, the substance and format of government Performance Bonds is something to behold. Prescribed Canadian Government Constructions Bonds are a minefield, absent of any practical or legal logic! Given time restraints I shall not be able to deal with that subject matter today. What I will try to deal with today is what I call private Performance Bonds dealt before our Courts primarily through the common law.

SIMPLIFIED TERMINOLOGY

Surety bonds, such as a Performance Bond, use defined terms, such as the Surety , the Principal and the Obligee . To better understand the bond and avoid legal terminology, one should simplify such terminology and use terminology such as the insurance company for the Surety (although a Surety is not an insurer at law and most Sureties do not like being referred to as such), the Principal as the Contractor and the Obligee as the Owner. Forget the lawyers let s use the simplified terminology.

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TYPES OF BONDS

Generally, the types of bonds issued by a Surety relating to construction projects are:

(i) ***Bid Bond***

A Bid Bond is an undertaking by a Surety to the Owner that if the Owner awards the contract to the Contractor bidding for the work and that Contractor fails to ultimately enter into the contract bid for, including the providing of the Performance and Labour and Material Payment Bonds (L&M Bonds) called for under the contract, the Surety who provided the Bid Bond is required to pay a stipulated amount, as stated in the Bid Bond to the Owner. This is usually to cover the Owner s costs of potentially re-tendering the entire contract.

(ii) ***Labour and Material Payment Bond***

These bonds, south of the 49th Parallel, are generally referred to as Payment Bonds. An L&M Bond is an undertaking given by the Surety to the Owner that if the Contractor fails to pay its subcontractors who performed work or provided services on the contracted work, the Surety will pay the claims of those subcontractors. Further, the Surety will vacate any Construction Liens filed on title to the Owner s lands by subcontractors pursuing claims against the Contractor. Claims under these bonds normally require specific notice of a subcontractor s claim, usually in writing. Additionally, if the subcontractor s claim is not paid an action must be commenced within a specified time or the claim against the Surety is contractually barred by the terms of the Bond. I shall discuss later in more detail our Court s recognition of contractual terms respecting the timely giving of Notice of a Claim under a Bond and the commencement of legal proceedings against a Surety which refuses to allegedly fulfil its obligations under a Bond. A word of caution be cognisant of these contractual limitation periods and do not miss them or you may lose the right to pursue a legal action under the Bond.

(iii) ***Lien Bond***

A Lien Bond is a Bond which is posted by a Surety with the Court to secure the discharge of Construction Liens filed on title to facilitate the title of the Owner s property being clear while litigation proceeds. If Judgment is rendered in favour of the Lien Claimant and that Judgment is not satisfied, the Surety is called upon under its Lien Bond to satisfy payment of the Lien Claimant s Judgment. The form and substance of a Lien Bond are prescribed by Statute.

(iv) ***Performance Bond***

A Performance Bond is a promise by a Surety to an Owner that if the Contractor defaults in the performance of the Contractor s contract with the Owner **and the Owner has fulfilled its obligations under the contract, the Surety will be obligated to**

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(a) remedy the contractor s default;

(b) complete the Contract; or

(c) put bids for completion of the contracted work to the Owner.

I shall discuss later in greater detail this subject.

INDEMNIFICATION AGREEMENTS

The fundamental agreement of Bonding law is the Indemnification Agreement. Although at common law a Surety is entitled to be indemnified for claims paid on behalf of a Contractor, all Sureties put in place a written Indemnification Agreement prior to the issuance of any Bonds. The existence of this Agreement is the essential difference between an Insurer and a Surety. A Surety, in modern times, in establishing a bonding facility for a contractor will **always** obtain a written Indemnification Agreement from the Contractor, any related companies to the contractor and the **personal** indemnities of the controlling shareholders of the Contractor and, dependent upon the financial abilities of the Contractor, the spouses of the contractor s principals. From my experience, although I do not totally agree with such, from a Surety s perspective, the Indemnification Agreement and the value supporting that Agreement (i.e. the net worth of the Indemnitors) is far more important in the eyes of the Surety than the substance of the construction contract which has been bonded.

Contractors, to maintain their ability to secure bonds from a Surety, are usually required on an annual basis to provide net worth and financial statements so that the Surety can be satisfied that there is value behind the Indemnification Agreement. As a Surety watch this in that most brokers are more concerned about their premiums than protecting the Surety s financial security under the Indemnification Agreement. In most instances when a Surety is put on notice of a bond claim, the first steps taken by the Surety will be to ensure that the Indemnification Agreement is in place and that it has value. An Indemnitor who does not have the financial wherewithal to satisfy a claim by the Surety under an Indemnification Agreement will be listened to less regarding decisions to be made by the Surety or its lawyers in responding to a claim under a Bond. An Indemnitor of financial substance will be treated far differently by a Surety because the Surety knows that ultimately such an Indemnitor will be responsible for reimbursing the Surety for payments made by it in responding to a legitimate bond claim.

The Surety in responding to a Bond claim, whether it be a Performance Bond claim by the Owner or an L&M Claim by one of the Contractor s subs, absent the Contractor s insolvency, will undoubtedly be at odds with the position of the Contractor regarding such claims. The Contractor s views *vis a vis* the Owner will be that the Owner has wrongfully placed the Contractor in default under the terms of the construction contract, and that if anyone is at default under those terms, it is the Owner (usually in not paying the Contractor). With respect to L&M Claims, a Contractor will convey to the Surety that the sub has not completed its work or completed its work in a shoddy manner, and as such is not entitled to any payment by the Contractor. However, the sub will undoubtedly file a lien, which if not removed in a timely fashion, would normally be a default under the Owner s contract with the Contractor, which in turn would be a reason for putting the bonding company on notice under the Performance Bond of the Contractor s default. The Surety must wade into such a conflicting mess with

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caution and in the first instance more as a mediator than an antagonist. The dispute must either be immediately resolved through a three way agreement (i.e. between the Owner-Surety-Contractor) or the Surety must take a side. Siding with the Contractor (subject to value in the indemnification) results in a legal dispute with the Owner. Whereas the Surety honouring its obligations to the Owner under the Performance Bond could impact upon its entitlement to claim against the Contractor/Indemnitor under the Indemnification Agreement. A Surety upon default is walking a very tight tight rope! This initial decision by a Surety is not an easy one but I can tell you that such is a decision which could have grave future financial consequences. This decision is usually made with complete ignorance of what factually has transpired in furtherance of performance of the contract prior to the Owner s alleged Notice of Default.

A Surety, to preserve its contractual rights under its Indemnification Agreement against the Indemnitors, must act in a reasonably prudent and businesslike manner. One of the leading Canadian decisions on this subject is the decision of *Guaranty Company of North American* v. *Beasse*[1]. In that decision Justice Rooke adopted within his judgment the following principle:

Where a party promises to indemnify another party against any costs, damages or expenses arising from a particular transaction, that promise will be seen to confer a right to recover all such charges **fairly and reasonably incurred** under the indemnity. However, an indemnifier will not be required to compensate the indemnified party **for remote or self-inflicted damage**. [Emphasis added.]

Although a Surety making payments under a claim advanced under either a Performance Bond or an L&M Bond need not meet the level of scrutiny of the Contractor in making such payments, a Surety must come close to wearing the hat of the Contractor if it is the Surety s intention to claim indemnification from the Contractor for such payments. The Surety is bound to act reasonably and with caution to protect the interests of the Contractor, which ultimately will be liable to repay the Surety for such payments under the terms of the Indemnification Agreement.[2] The Manitoba Court of Appeal in the decision of *British American Assurance Co.* v. *Redekopp* specifically opined on this subject matter by stating:

It does not seem to have occurred to the plaintiff bond company or its solicitors that, *vis a vis* Redekopp, (i.e. the Contractor), the surety had assumed the role of principal (i.e. the original Contractor Redekopp) and Redekopp (the original principal/Contractor) the role of surety. If the plaintiff company intended to use Redekopp s money in the ultimate event, it was bound to act properly towards him. It could not spend money with abandon on matters for which it, as surety, was not legally liable, and then try to fasten liability for those expenditures on Redekopp. After all, Redekopp, as indemnitor, could not here have a greater liability than the plaintiff as surety. [3] [Emphasis added]

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[1] Guaranty Company of North American *v.* Beasse *(1992),* 7 *C.L.R. (2d) 194*

[2] British America Assurance Co. *v.* Redekopp *(1975), 54 D.L.R. (3d) 619 (Man. C. of A.)*

[3] British America Assurance Co. *v.* Redekopp *(supra) at p. 626*

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At a trial of an action between the Surety and the Indemnitor/Contractor, the onus of proof will lie on the Surety to prove that any expenses incurred by the Surety in satisfying its obligations under the Bonds were reasonable, proper and required under the contracts bonded. The concept of reasonableness is akin in law to a party s duty to mitigate. A Surety must mitigate its losses for claims made under the Bonds.

I have on past occasions acted for Sureties primarily based in the U.S. respecting Performance and L&M Bonds issued on construction projects in Canada. Indemnification claims which proceed to litigation are treated substantially different by our Canadian Courts when compared to those of U.S. decisions, especially on the issue of the onus of proof. Indemnification Agreements used by Sureties are, for the most part, standardised throughout North America. Most contain a broad indemnity provision, such as:

The Undersigned shall indemnify and keep indemnified the company (i.e. surety) against any and all liability, loss and expense of whatsoever kind or nature, including, but not limited to, court costs, attorney s fees, and interest, which the company may sustain or incur (i) by reason of having executed or procured execution of any Bond or Bonds as surety for any of the Undersigned, (ii) by reason of the failure of the Undersigned to perform or comply with this Agreement, or (iii) to enforce any of the covenants and conditions of this Agreement. [4]

U.S. Courts have repeatedly upheld the above indemnity provision subject only to the condition that payment by the Surety is not the product of its fraud or bad faith.[5]

Under U.S. case law neither lack of diligence or negligence by the Surety establishes the bad faith necessary to void the Surety s right to contractual indemnification.[6] That is not the case in Canada as discussed above.

There is a fundamental difference in the manner in which U.S. Courts treat claims under Indemnification Agreements and how such claims are treated under Canadian law. Simply put, under U.S. law an Indemnitor has the onus of proof to prove that a Surety made payments in bad faith to avoid liability. Whereas the onus of proof in Canada will rest upon the Surety to prove that the expenses for which indemnification is sought were reasonable, proper and required by the Bond pursuant to which the payments were made. This onus of proof is something which in past occasions I have had difficulty explaining to my U.S. Surety clients

In dealing with bonding claims in which it is anticipated there will be an indemnification claim, where possible actively involve the Contractor/Indemnitor. As Surety, seek input and the opinion of the Contractor throughout all aspects of the handling of the bond claim with the Owner. Give the Contractor every opportunity to lessen the potential indemnification claim by involving the Contractor in payment decisions which are being made under the Bond and in the completion of the contract. This cooperative process should be documented in detail

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[4] Fidelity and Surety Committee of the International Association of Insurance Counsel Project Update *1995 at p. 261*

[5] Fidelity and Deposit Company of Maryland *v.* Bristol Steel & Iron Works, Inc., *1722 F. (2d) 1160, 1163 (4th) Cir. (1983)*

[6] Trans American Premium Insurance Company *v.* Nelson Premium, *878 P. (2d) 314 (Nev. 1994);* Employers Insurance of Wausau *v.* Able Green Inc., *749 F. Supp. 1100 (S.D. FLA. 1990)*

and confirmation letters to the Indemnitor/Contractor should be a practise adhered to. Copy the Contractor with letters between the Owner and the Surety. Keep the Contractor fully informed. Consultation with the Contractor is crucial. You will find that if the bonding company decides to fulfil its bonding obligations with the Owner, the Contractor will take a hardened position and be uncooperative. That fact should be documented in that such will provide crucial evidence in subsequent, if necessary, litigation under the Indemnification Agreement. It goes without saying that the Surety must maintain understandable (i.e. keep the Toronto accountants away from the record keeping) and legitimate accounting records of all expenditures for which indemnification will be sought from the Indemnitors.

THE PERFORMANCE BOND

(i) Owner s Obligation of Disclosure

The Owner does not owe a direct duty to the Surety to disclose any aspect of the contract to be bonded absent a specific request by the Surety to provide such. If an Owner, in response to requests made by a Surety, provides negligent responses to the Surety, arguably the response in itself creates a duty of care between the Owner and the Surety. Rarely does this situation ever occur in that it is the Contractor s obligation pursuant to the tendered contract to obtain the bonds which the Surety in large contractual projects undertakes to provide in providing a Bid Bond with the Contractor s tender. Most Contractors would take great exception to a Surety having any contact during the tendering process with the Owner in that at that time in the contractual cycle the Contractor s primary concern is securing the contracted work which may be impaired if the Contractor s Surety starts meddling in the process by in-depth inquiries made to the Owner. It is important to emphasize that although at law there is no duty of care between the Owner and the Surety, there is such a duty of care owed by the Owner to the Contractor whose rights upon default would be subrogated to the Surety. Thus, if the Owner during the tendering process has wrongfully misrepresented to the Contractor aspects of the work to be performed and the conditions for such performance, arguably such could be a fundamental breach by the Owner of the construction contract (i.e. going to the root of the contract a fundamentally different contract than that contracted for), which could be relied upon by the Surety in any claim by the Owner under the Bond.

(ii) Know the Contract You ve Bonded

This is an area of concern which from my experience in acting for Sureties should be of more concern to Sureties. In many instances Sureties have no idea of the contractual provisions within the contract which they have bonded. They know the value of the bonded contract and in **some** instances they will have within their underwriting file a portion of the construction contract, usually the Canadian standard construction contract (CCDC Stipulated Price Standard Contract Provisions), and with respect to an L&M Bond, the Stipulated Price Sub-Contract short form, also prescribed by the Canadian Construction Association. However, in most instances, especially with respect to the contract for which a Performance Bond has issued, the numerous Appendixes and Schedules attached to the Standard Provisions will not be known or possessed by the Surety. In most instances, especially with respect to performance delay penalties and liquidated damages clauses, those provisions will be within

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One First Canadian Place
Suite 840, P.O. Box 489
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F 416 360 5960
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the Appendix or Schedules to the Standard Provisions and will be of particular importance to not only the Owner but the Surety if a Performance Bond claim is made.

A recent decision of the Ontario Court of Appeal in *Whitby Landmark Development Inc.* v. *Mollenhauer Construction Ltd. and Zurich Indemnity Company of Canada*[7] is directly applicable to this subject matter. Briefly, the facts relevant to this discussion were that the construction contract between Whitby Landmark (the Owner) and Mollenhauer (the Contractor) provided for a guaranteed maximum price for the project of $17,640,969.00. The contract also included a provision whereby the Owner and Contractor would share any cost savings on the project in the following proportion: 75% to the Owner and 25% to the Contractor, but the contract contained no method for payment of the cost savings to the Owner. Mollenhauer went out of business and the issue on the bond claim was whether the Surety had an obligation to account to the Owner for Mollenhauer s cost savings which it had failed to remit to the Owner. The Court of Appeal in its reasons detailed the standard practice in the bonding industry as follows:

Zurich relies on the evidence given at trial as to the usual practice for making underwriting decisions on performance bonds for construction projects. The underwriter will ask a set of standard questions, including the dollar value of the project, the extent of the work to be performed by subcontractors, the start and end dates for the project and the reputation of the contractor. Where the construction contract is in the standard CCDC-2 form, as in this case, the usual practice in the industry is that the underwriter **will not read the construction contract when making its underwriting decision. Furthermore, the calculation of the premium on performance bonds is based on a mathematical equation that does not generally take into account the terms of the construction contract. The penal amount of the bond in this case was calculated as fifty per cent of the guaranteed maximum price of construction. There was no discussion between Mollenhauer and Zurich when the bonding arrangements were made as to whether the bond would respond to claims for cost savings under the construction contract. Zurich submits that this evidence shows that the parties did not intend the bond to cover a monetary claim for cost savings.** [8]
[Emphasis added.]

Most, if not all, Performance Bonds incorporate by reference the contractual terms of the contract between the Owner and the Contractor. The Ontario Court of Appeal in upholding the Trial Judge s decision in *Whitby Landmark* (on this issue), stated:

Zurich relies on a line of American authority for the proposition that the intent of the construction performance bond must be gleaned from its purpose, which is to ensure completion of construction, and that the obligation under the bond must be interpreted as so limited. The trial judge did not find these authorities of assistance and concluded: I am driven back to the language of this bond and it is from that source that I must discern the intention of the parties. In my view, the trial judge made no error in that conclusion. [9]

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[7] Whitby Landmark Development Inc. *v.* Mollenhauer Construction Ltd. and Zurich Indemnity Company of Canada *(2003), O.J. No. 4000, 26 C.L.R. (3d) 161*

[8] Whitby Landmark. *v.* Mollenhauer Construction Ltd, *supra, at para. 15*

[9] Whitby Landmark. *v.* Mollenhauer Construction Ltd, *supra, at para. 19*

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The Court of Appeal went on to hold that by reason of the construction contract being incorporated by reference into the contractual terms of the Performance Bond that there was no basis in the language of the bond or in the circumstances surrounding its negotiation or completion to suggest that the cost sharing provisions of the construction contract were not included in the bonded losses.[10] This case stands for the clear proposition that a Surety will be liable for the performance of all of the Contractor s obligations under a bonded contract the terms of which are incorporated by reference into the Performance Bond contractual provisions absent limitations expressed within the Performance Bond. Sureties in the audience will be happy to know that the Court of Appeal also overturned the Trial Judge s decision on the basis that timely Notice of Default had not been given by the Owner to the Surety and as such the claim on the Performance Bond by the Owner was contractually barred.

I strongly recommend that Sureties when issuing Performance Bonds, which are usually issued through brokers who have a relationship with the Contractor, especially for large monetary Performance Bonds, have brought to their attention any unusual terms and conditions within construction contracts, especially with respect to delay or liquidated damage obligations or cost savings or sharing provisions as existed in the *Whitby Landmark v. Mollenhauer* case. Ignorance respecting such provisions will not be a basis upon which a Surety can deny liability.

(iii) Owner s Obligations Upon Contractor s Default

The Owner, to preserve its right to make a claim under the Performance Bond **must**, for serious or major defaults, comply with the contractual notice of default provisions contained within the Standard CCDC contractual provisions. If the Owner fails to comply with its obligations under the construction contract regarding serious or major defaults by the Contractor, in any subsequent litigation between the Owner and the Surety, the Surety can argue that the Owner s failure to fulfil its contractual obligation prejudiced the position of the Surety and was a material alteration of the construction contract affording a legitimate defence to the Surety under the Bond. Under the provisions of the Bond, the Owner is obligated to give notice of such defaults to the Surety. The obligation of an Owner to place the Contractor in default and give notification of such to the Surety is dependent upon the degree or severity of the default. The leading Canadian decision is the decision of *Thomas Fuller Construction Co. (1958) Ltd.* v. *Continental Insurance Company.*[11] Justice Houlden in that decision, a decision accepted in later decisions of Canadian Courts, stated:

The word default is capable of a very wide meaning and could cover a very slight delay or defect on the part of Singer. It is obvious that the plaintiff could not be expected to inform the defendant of every slight default on the part of Singer. Counsel for the plaintiff suggests that in order for a default to be of such a nature that the bonding company should be notified, it must be a default that would entitle the plaintiff to repudiate its contract with Singer.

The general principle to be applied in interpreting a bond is that stated by Bovill, C.J. in *Coles* v. *Pack* (1969), L.R. 5 C.P. 65 at p. 70:

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[10] Whitby Landmark. *v.* Mollenhauer Construction Ltd, *supra, at para. 27*

[11] Thomas Fuller Construction Co. (1958) Ltd. *v.* Continental Insurance Company*, [1973] 3 O.R. 202 (Ont. Court of Justice, per Houlden, J.)*

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The document in question, like every other guarantee, must be construed according to the intention of the parties as expressed by the language they have employed, understanding it fairly in the sense in which it is used; and this intention is best ascertained by looking to the relative position of the parties at the time the instrument is written.

Looking at the bond in this way, what is the result? This was a bond guaranteeing the performance of a subcontractor on a large building. It is obvious that the subcontractor would not render perfect performance and that defaults, and most likely serious defaults, would occur from time to time on the part of the subcontractor. It would seem most reasonable to leave to the direction of the obligee when a default was serious enough to warrant the surety being notified.

On a careful reading of the bond, it is my opinion that the bond negatives any obligation on the part of the obligee to notify the defendant of defaults by Singer unless the default was of so serious a nature that the obligee deemed it proper to make a declaration of default and to call upon the bonding company to perform its obligations under the bond. At this stage, the plaintiff was required to give notice of default to the bonding company, but not otherwise. [12]

A mere technical breach of the terms of a bond by an Owner in advancing a claim will not permit a compensated Surety to escape liability under its contractual Performance Bond obligations where the technical breach complained of has not prejudiced the Surety.[13] However, it was recently held in the *Whitby Landmark v. Mollenhauer* decision that the failure of an Owner to make a timely declaration of default of a fundamental term of the construction contract, the very default upon which the Owner relies in making the claim against the Surety, if prejudice can be shown by the Surety, will be a complete defence to an Owner s claim under a Performance Bond.[14]

Practical advice to an Owner is to be safe rather than sorry. If the Contractor is in default, give Notice of Default under the terms of the construction contract. That notice should be given to both the Contractor and the Surety in that such notification after it is given can be subsequently waived. What is the downside in giving the notice compared to not giving the notice.

(iv) Watch Limitation Periods in Bonds for Commencing Actions

All L&M and Performance Bonds contain provisions for the timely commencement of legal proceedings if a Surety fails to respond to a notice of claim/default. If an Owner upon giving notice of default I recommend that a tickler system be immediately instituted to ensure that a legal action is commenced prior to the expiry of the contractual limitation period contained within the Bond. **Our Courts do uphold these contractual provisions.** The leading Canadian case on this subject matter dealt with a claim on a fidelity bond. In my view, the Court s reasoning in that decision would be applicable to claims under Performance and/or L&M Bonds. The Supreme Court of Canada s decision in *The Guarantee Company of North*

[12] Thomas Fuller Construction Co. (1958) Ltd. *v.* Continental Insurance Company, *supra, at pp. 216 & 217*

[13] Citadel General Assurance Company v. John-Manville Canada Inc. et al *(1983), 147 D.L.R. (3d) at p. 600 (S.C.C.)*

[14] Whitby Landmark. *v.* Mollenhauer Construction Ltd, *supra, at para. 29*

America v. Gordon Capital et al[15] is a recent and leading decision on this subject matter. The facts in that case are straightforward. Gordon submitted a dishonesty claim to its insurer, The Guarantee Company of North America, under a fidelity bond which had been purchased by Gordon from Guarantee. Gordon, as the insured, was required under the provisions of the bond to give written notice of the loss at the earliest practical moment, not to exceed 30 days, after discovery of the loss . The fidelity bond contained a provision that legal proceedings for the recovery of any loss **could not** be brought prior to the expiration of 60 days after the original proof of the loss was filed or after the expiration of 24 months from the discovery of the loss. Thus, there was a two-year limitation. Gordon who had a legal and an accounting firm acting for it at the time did not commence the action against Guarantee within the required 24 months. Guarantee in response to service of the Statement of Claim made a motion for summary judgment relying upon the 24 month limitation period contained in the Bond. The Motions Judge found in favour of Guarantee and dismissed the action based upon the limitation period. The Motions Judgment was overturned by the Ontario Court of Appeal and ultimately the case found its way to the Supreme Court of Canada. The Supreme Court of Canada overturned the Ontario Court of Appeal and in so doing held that the limitation period defence within the contractual terms between the parties was a complete defence to any action. The Court in finding for The Guarantee Company of North America stated:

Similarly we conclude that it would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold the intentions of the parties concerns the operation of the contractual limitation period in these circumstances.

To enforce the bargain made by the parties in these circumstances would not be unconscionable, unfair, unreasonable or otherwise violate public policy."[16]

A contract is a contract, especially when it involves sophisticated commercial actors. For those of you who have sympathy for Gordon s plight it was represented during the claim period by counsel and an accounting firm. There was after the Supreme Court decision a legal proceeding brought by Gordon which to my knowledge involved other insurance companies. The bottom line is watch your limitation periods.

(v) Practical Tips to Sureties Responding to Bond Claims

Bonding litigation, as is construction litigation, is an expensive proposition. The primary defence of a Surety to a Bond claim is that the Owner was in breach of its contractual obligations and as such there is very little difference between litigating as a defendant Surety versus litigating as a defendant Contractor *vis a vis* a claim brought by an Owner. When I am retained by a Surety to respond to Bond claims, my initial recommendation is to, if at all possible, come to a resolution, which as we all know will require compromise on the part of the Owner, the Contractor and the Surety. The Surety has leverage with both parties. With the Contractor there is the Indemnification Agreement but, of course, by that point emotion

[15] The Guarantee Company of North America v. Gordon Capital et al *(2000), 178 D.L.R. (4th) 1 (S.C.C.)*

[16] The Guarantee Company of North America v. Gordon Capital et al, *supra, at pp. 25 & 26*

rather than financial logic exists and the Owner and the Contractor usually at that point are at war!

The Surety also has leverage with the Owner given its contractual rights under the Bond. The Surety is entitled to complete the contract. Most Owners are reluctant to merely sit on the side lines while a bonding company retains a completing contractor to complete the contract. It never happens, absent the Owner s concurrence.

From my experience, when Bond claims are made they arise for two reasons: the insolvency of either the Owner and/or the Contractor; or as a consequence of there being a complete breakdown of the necessary relationship of trust and confidence between the Owner and the Contractor they don t like each other s nonsense.

If you are faced with the situation of insolvency of the Contractor, a Surety should first consider two alternatives: finance the Contractor to complete the contract or alternatively make a proposal to the Owner to buy back the Bond. If it appears that there is money left in the contract, financing the completion of the contract by the Sureties bonded Contractor may be the best financial alternative. If the contract is in a complete state of disarray, no Surety would assume the substantial downside and as such proposals should be made by the Surety to buy back its Bond, thus shifting the risk back to the Owner. The third alternative is to complete the contract with a new Contractor, usually someone who the Surety is already bonding. This is only a viable alternative if the Surety is able through amicable negotiations to get the Owner on side. Any Owner can make life difficult for any completing Contractor if such is their intent.

I have encountered at least three situations in which through financing of the original Contractor and profit sharing provisions between the Surety and the original Contractor, the Surety, to my amazement, realized a profit rather than what was originally anticipated, a substantial loss.

No matter what decision is made, it is absolutely imperative that that decision be made on the basis of a full understanding of the work to be completed and, more importantly, the money left in the contract. The first two to three weeks of any Bond claim, especially on major projects, will be hectic in that you will not only be facing a Performance Bond claim by the Owner, but undoubtedly numerous lien claims and L&M claims by the Contractor s sub-contractors on the contract, let alone other contracts involving the same Contractor which have undoubtedly been bonded by the same Surety.

CONCLUSION

I could go on for days and days on this subject matter, but I have limited time. Needless to say, the most important aspects of construction bonding from all parties perspectives are at the time the construction contract is agreed upon, in particular, that all parties fully understand the terms of the contract and that the terms of the contract contained within the Schedules or Appendixes to the contract are, at a minimum, considered. If litigation is to be avoided, all parties during the two to three weeks after Notice of Default is given must compromise their respective positions and ultimately conclude an arrangement, if possible, to complete the works to be completed under the construction contract. Isn t that more important than litigation! If an Owner merely digs in its heals and points to the Surety to

One First Canadian Place
Suite 840, P.O. Box 489
Toronto, Ontario
Canada M5X 1E5

T 416 360 2800
F 416 360 5960
www.agolaw.com

resolve all of its problems, I can assure you that litigation will be the only option, an option which net of the legal costs which will be incurred, will not be financially beneficial to anyone but for the lawyers!

I thank you.