

Goodmans^{LLP} Update

General Contractors May Have a Duty to Disclose Existence of L&M Bonds

Notwithstanding what appears to be a robust construction industry, payment issues still persist on construction projects across Canada. To address this issue and the amount of time it takes for contractors and subcontractors to get paid, a number of provinces recently enacted prompt payment legislation. In addition to the new legislative remedies, an aggrieved party facing payment issues on a construction project may make a claim under a Labour and Material Payment Bond (“**L&M bond**”) to satisfy unpaid amounts owing to it, especially where an insolvency occurs.

In *Valard Construction Ltd. v. Bird Construction Co.*, the Supreme Court of Canada (“**SCC**”) considered the effect of a general contractor’s failure to disclose the existence of a L&M bond to the trades lower on the construction pyramid. A sub-subcontractor was unable to recover its unpaid invoices from the defaulting party and was not aware that the L&M bond existed.

The SCC held that, in certain instances, there is a duty to disclose the existence of L&M bonds to subcontractors and sub-subcontractors. As discussed below, the *Valard* decision should inform the standard practices of all parties working on Canadian construction projects moving forward.

Background

Suncor Energy Inc. hired Bird Construction Company (“**Bird**”) as general contractor for an oilsands construction project near Fort McMurray, Alberta. Bird subcontracted with Langford Electric Inc. (“**Langford**”) to perform electrical work on the project. Langford then hired a sub-subcontractor, Valard Construction Ltd. (“**Valard**”) to perform the directional drilling work.

Langford obtained a standard form CCDC 222-2002 L&M bond, which named Langford as principal, Bird as trustee for any subcontractors who had not been paid by Langford, and Langford’s subcontractors as beneficiaries.

Under the terms of the L&M bond, any subcontractor who had not been paid by Langford within 90 days after last providing labour or materials on the project could file a claim for payment with the surety. However, subcontractors needed to provide written notice of any such claims within 120 days after last providing labour or materials.

During the course of the project, Bird required a Valard representative to attend daily “toolbox meetings” at Bird’s on-site trailer, where Bird kept a bulletin board displaying various notices. The parties agreed that neither the bond, nor notice of it, was posted on the board. Furthermore, neither Bird nor anyone on its behalf notified Valard of the bond’s existence. Therefore, Valard was unaware of the bond throughout the entire window of time during which it could have benefitted from the bond.

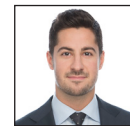
In the end, Langford failed to pay a number of Valard’s invoices. Although Valard ultimately received judgment against Langford for approximately \$600,000, by then Langford had become insolvent and Valard could not recover the full amount of its unpaid invoices.

Approximately seven months after Valard completed its work on the project (i.e., well after the 120-day notice period had expired), Valard’s project manager became aware the L&M bond existed. This was a surprise to the project manager, since he had never encountered a L&M bond on a privately-owned oilsands project. Valard made a claim under the L&M bond, but the surety denied the claim on the basis that Valard failed to give timely notice within 120 days.

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Valard sued Bird for breach of trust, alleging Bird breached its duty as a trustee under the L&M bond to fully inform the beneficiaries that the bond existed. At trial, the Alberta Court of Queen's Bench held that Bird did not have an obligation to notify Valard that the bond existed. The Alberta Court of Appeal reached a similar conclusion.

SCC Decision

There were two issues before the SCC:

1. Whether owners and general contractors (as trustees under L&M bonds) owe a duty to disclose the existence of L&M bonds to subcontractors (as beneficiaries under L&M bonds).
2. If such a duty is owed, what conduct is required of owners and general contractors to satisfy their duty to disclose the existence of L&M bonds?

Duty to Disclose Existence of L&M Bonds

The SCC held that a trustee (i.e., owner or general contractor) has a duty to disclose the existence of L&M bonds to beneficiaries (i.e., subcontractors). However, the duty is limited to situations where the subcontractors would be “unreasonably disadvantaged” by lack of disclosure about the bond's existence.

In this case, Valard was unreasonably disadvantaged by Bird's failure to disclose. The 120-day notice period expired before Valard ever learned of the bond, which effectively prevented Valard from making a claim against the surety and recovering its unpaid invoices.

Substance of Duty to Disclose

The SCC outlined the factors for determining whether a trustee (i.e., owner or general contractor) has met its duty to disclose the existence of L&M bonds. A trustee must take the steps a reasonably honest, prudent, and skillful trustee would take to notify potential beneficiaries (i.e., subcontractors).

The inquiry is fact specific and highly sensitive to the context of each case. In some circumstances (for example, projects where L&M bonds are commonly used), it may well be that very little, or even no, action will be required on the trustee's part to notify potential beneficiaries. In this case, the SCC determined that a reasonably honest, prudent and skillful contractor would have known that L&M bonds were uncommon on private oilsands construction projects. As such, Bird could have satisfied its duty by posting a notice of the bond on its on-site trailer, which Valard and other subcontractors attended for daily “toolbox meetings”. However, Bird did nothing. It filed the bond offsite, did not post it, and told nobody about it.

Liability

The SCC held that Bird was liable to Valard. Valard was entitled to be compensated for the sum it could have obtained under the L&M bond, had it been notified by Bird of the bond's existence. The case was returned to the trial court to assess the sum that would have been available under the bond during the 120-day notice period.

Implications

In light of the *Valard* decision, parties would be well advised to disclose the existence of L&M bonds to those who have the ability to make a claim against the bond. While the nature of the disclosure may vary from case to case, owners and general contractors should take reasonable steps to notify all potential beneficiaries under the L&M bond. For their part, subcontractors and sub-subcontractors should make inquiries of those above them in the construction pyramid to determine if L&M bonds have been posted. If posted, subcontractors should ensure they obtain a copy and comply with any time limits set forth in L&M bonds.

For further information concerning these developments, please contact either of the authors or any other member of our [Construction Law Group](#).