Construction Bits and Bites

This is the third in a series of newsletters which we have named, “Construction Bits and Bites”. The series addresses topics of interest to the construction industry in a short, ‘bite-sized’ format. This newsletter describes the types of surety bonds one may encounter in the industry and also provides tips for making a good claim on a Labour and Material Payment Bond.

Introduction to Surety Bonds

Surety bonds are the most common form of contract security. There are various types of bonds available for use with construction contracts. Certain obligations and conditions must be met in order to obtain the protection provided by the bond.

There are three parties to any surety bond.

1. **Principal**: Person or entity on whose behalf the bond is given.
2. **Obligee**: The party to whom the bond is payable.
3. **Surety**: The entity that issues the bond (typically a surety company authorized to transact the business of suretyship in the province of the place of work). The Surety guarantees the performance of the obligations of the Principal under a contract, subject to the terms and conditions contained in the bond.

Surety bonds are not a form of insurance. If the surety suffers a loss, reimbursement will be sought from the Principal and any other indemnitors.

Types of Surety Bonds in Construction

1. Bid Bond

Function: To guarantee to the Obligee the good faith of the Principal when tendering.

How: If the Principal fails to enter into a formal contract after the bid has been accepted, then the Principal is obliged to pay the Obligee, either a fixed amount or the difference in money between his tender and the contract price of the contract the Obligee ultimately enters into. If the Principal doesn’t meet this obligation then the Surety must do so in accordance with the terms of the Bid Bond.

2. Construction Lien Bond (Financial Guarantee Bond)

Function: To stand in the place of the land as security in order to remove the registration of a construction lien from title.

How: This is permitted by section 44 of the Construction Lien Act and its form is prescribed by the Act. The Obligee is the Accountant of the Court with whom it is posted or filed. An order is obtained permitting the registration of the lien to be vacated from title. Under the Act any party may, without notice to any other party, obtain an order vacating the registration of a lien upon the posting of security in the amount of the lien plus 25% for costs (to a max of $50,000.00).

3. Performance Bond

Function: To guarantee to the Obligee that the Principal will properly perform its contract with the Obligee.

How: If the Principal fails to complete or properly perform its contract then the Surety will do so, provided that the Obligee has performed its obligations under the contract and has satisfied any conditions contained in the Performance Bond. The Surety’s liability is further limited to the face amount of the Performance Bond.

The Surety may cure the default by, (a) financing the principal (where lack of money is the reason for non-completion of the contract); (b) re-let the project to another contractor; or (c) let the owner finish the contract and reimburse the owner up to the limit of the Bond.

4. Labour and Material Payment Bond

Function: (a) To guarantee that all labour and material suppliers will be paid for labour and materials supplied to the Principal for use on the project; and

(b) In the case of a "Two Tier"/Federal Form of bond only, to guarantee that all labour and material suppliers will be paid for labour and materials supplied to the Principal or a subcontractor of the Principal. Typically, the claim of the "second tier" claimants will be limited to the equivalent of the holdback.

How: The Obligee in a Labour and Material Payment Bond is expressly designated as trustee for the suppliers who qualify as "claimants" under the bond. There are several preconditions to recovery by a claimant and the Surety's total obligation to the claimants is limited to the penal sum of the Bond.

Tips for Making a Good Claim on a Labour and Material Payment Bond

(a) Give notice in the manner and within the time limits contained in the Bond.

(b) Provide the following to the Surety in support of the claim:

- copy of contract/subcontract, purchase order and change order(s);
- all invoices rendered and details of all payments made;
- delivery tickets (materials supplied);
- copy of preserved lien, if any;
- details of deficiencies, back charges, credits, extras;
- date of last supply of services or materials;
- holdback applicable; and
- any other information which may assist in the settlement of the claim.

(c) If not settled, commence an action within the time limits contained in the Bond.

Right to Information

The existence of a labour and material payment bond may not be known to the potential claimant. Section 39 of the Construction Lien Act provides a mechanism for obtaining this information.

Pallett Valo LLP Construction Practice

Litigation risk management in the construction industry requires the advice and guidance of experienced construction lawyers. The Pallett Valo LLP Construction Practice has particular expertise in the resolution of all types of construction disputes. Their practical and timely advice assists our construction clients in meeting their day to day challenges.

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