How subcontractors or materials supplier can use the surety bond contract

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That is what material suppliers want to know when general contractors with which they have contracted default on payment, particularly in bankruptcy cases. It is common practice for clients to require that the general contractor provide a surety bond to cover a significant breach of this nature.

Generally speaking, the purpose of a surety bond contract to cover payment for labour and materials is to guarantee that the workers, suppliers and subcontractors used by the general contractor are paid.[1]

In order to benefit from the protection provided by the surety bond, a claimant must disclose its contract to the surety, usually within 60 days from the date on which the claimant commences work or on which the materials are delivered. When a claimant has not been paid or anticipates not being paid, it must send the surety a notice of claim within the time specified in the contract, which is generally 120 days from the date on which the services were completed or the materials were delivered.

THE DECISION IN *PANFAB*

On June 26, 2018, the Court of Appeal again examined the principle that requires disclosure to the surety in order to obtain payment for labour and materials, in *Industries Panfab inc*. v. *Axa Assurances inc*., 2018 QCCA 1066.

In 2010, the Local Housing Bureau (the “Bureau”) retained Groupe Geyser inc. (“Geyser”) to construct three buildings in Longueuil with a total of 180 units. As stipulated in the construction contract, Geyser obtained a surety bond from Axa Insurance (“Axa”) to guarantee payment for

labour and materials.

Geyser subcontracted with Les Revêtements RMDL (“RMDL”) for the exterior cladding of the three buildings it was constructing. RMDL then signed a $330,000 contract with Industries Panfab inc. (“Panfab”) for it to supply metal sheathing boards. A few days before making its first delivery, Panfab informed Geyser, Axa and the Bureau of its contract to supply RMDL.

A few months after the first delivery, RMDL ordered additional sheathing boards that were not part of RMDL’s initial order from Panfab. Panfab made an additional disclosure to the surety and upped the total cost of its contract. Panfab made two additional disclosures, in each of which it stated the new, higher total cost of its contract.

Panfab’s total invoice for all of the materials came to $446,328.24, but it received only $321,121.84. Its claim was therefore for $125,206.40. RMDL declared bankruptcy in 2012 and, given the situation, Panfab sought to claim under the surety bond for payment for its materials.

Decision at trial

At trial, the Court found that Axa’s surety bond contract contained a stipulation for the benefit of third parties, based on which Panfab could characterize itself as a creditor under the contract and thus benefit from the guarantee provided by the surety bond.

However, the Court concluded that there was only one contract between the parties and that the increase in the value of the contract had been disclosed more than 60 days after the first delivery of materials. In fact, it characterized the amount claimed as an overpayment and limited the amount that it ordered Geyser and Axa to pay to $54,830.66, since the effect of a judgment for the overpayment would have been to alter the terms of the surety bond contract and add to the respondents’ contractual obligations.[2]

Appeal

In this specific case, the Court of Appeal found that the obligation of Geyser and Axa to jointly and severally pay the amount claimed for the materials to be used in the construction arose at the point when Panfab characterized itself as a creditor by making its first disclosure. The Court of Appeal held that the surety bond contract did not require that the value of the contract for the supply of materials be disclosed. The mandatory information to be provided was the type of work, the nature of the contract, and the name of the subcontractor.

Panfab disclosed its contract with RMDL, the subcontractor, within the 60 days allowed and thus complied with the time requirements. The obligation to pay Panfab arose at that point. Given that the surety bond contract did not require that the value of the contract be stated in the notice of disclosure, the Court was of the opinion that Panfab had demonstrated good faith and transparency in informing Geyser and Axa of the changes to the value of its contract with RMDL, by providing amended notices of disclosure. The claim could therefore not be limited on the ground that Panfab had stated the value of its contract in its notice of disclosure, when there was nothing that required it to do so.

The Court of Appeal therefore reiterated the principle that there is only one contract and thus only one notice of disclosure, notwithstanding the fact that Panfab sent the surety amended notices.[3] An order for reimbursement for the full amount to be paid does not alter the terms of the surety bond contract. The Court therefore concluded that the trial judge had erred by holding that the amended notices of disclosure sent by Panfab were time-barred and were necessary in order for the total

claim to be allowed.

The Court of Appeal took the opportunity to reiterate the scope of the duty to inform on the part of a materials supplier or subcontractor. Geyser submitted that Panfab had breached its duty to inform and that its breach was the reason for the shortfall in the amounts withheld for paying all of the subcontractors and suppliers. The Court did not accept that argument; it relied on *Banque canadienne nationale* v. *Soucisse* (1981),[4] which set out the foundation for a creditor's duty to inform, and on article 2345 C.C.Q., reiterating that a creditor is required to provide any useful information to the surety at the request of the surety. In this case, Geyser and Axa had never asked Panfab for additional information under that article.

To summarize, *Panfab* clarifies the already settled law regarding notices of disclosure to sureties, as stated in *Fireman's Fund* (1989)[5] and *Tapis Ouellet inc.* (1991), in particular: when a contract for the supply of materials is shown to exist between the parties and the materials have been incorporated into a construction project, the subcontractor may claim the amounts owed under the surety bond contract after sending a notice of disclosure that meets the requirements set out in that contract.

It must be kept in mind that any surety bond contract may contain specific clauses and that reference must be made to those clauses. That is why the Court in *Panfab* concluded that the information relating to the value of the contract was not mandatory in the notice to the surety, since, in that case, the surety bond contract did not require that the value of the contract be included in the notice of disclosure. Vigilance is therefore the order of the day when it comes to the terms of surety bond contracts.

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1. MONDOUX, Hélène, François BEAUCHAMP, "Les cautionnements de contrats de construction" in Collection de droits 2017-2018, École du Barreau du Québec, vol. 7, *Contrats, sûretés, publicité des droits et droit international privé*, Cowansville, Éditions Yvon Blais, 2017, p. 59.
2. *Industries Panfab inc*. v. *Axa Assurances inc*., 2018 QCCA 1066, para. 14.
3. *Ibid*. para. 22.
4. *National Bank of Canada v. Soucisse*, [1981] 2 S.C.R. 339.
5. *Fireman's Fund du Canada, cie d'assurances* v. *Frenette et frères Itée,* 1989 CanLII 815 (QC CA).