Surety Bonding and the new Construction Act – what does a contractor need to know?

July 1, 2018 signals the beginning of a new age for construction in Ontario with the modernization of the Construction Lien Act. Now to be known as the '*Construction Act*', the first phase of the implementation of the Act changes the rules governing trusts, lien periods, holdbacks, and a host of other items.

Amongst the wave of changes taking effect is mandatory bonding for any contractor who enters into a public contract in respect of an improvement greater than $500,000. The *Act* goes a step further by prescribing new Performance and Labour and Material Payment Bond forms that contain accelerated response times for the surety to respond to a claim. These timelines impose rigid requirements to keep the process moving and mitigate the impact of the event.

On Performance Bond claims, a surety will now have 4 business days to acknowledge a claim, and 20 business days to respond with a position. On Labour and Material Payment Bond claims, a surety must acknowledge claims within 3 business days, pay any undisputed amounts within 10 business days and provide a written position on other disputed amounts the earlier of 10 business days after receiving information from the claimant (15 for second tier claimants) or 25 business days after the initial notice of the claim (35 for second tier claimants). The surety and claimant may mutually agree on a longer period. The goal is that claimants should get paid rightfully due amounts quicker.

Contractors should be mindful that the new time constraints will impose a burden on them to relay critical claim related information to their surety so those deadlines can be respected.

As a reminder, the new bond forms will only apply to public projects in the Province of Ontario. CCDC bond forms, federal bond forms, and private owner bond forms may still be used in other scenarios.

For contractors that already maintain bonding but expect to utilize their bond facility more frequently going forward, now would be a good time to refresh yourself on a few of the key terms of your bond program.

While most bond programs take into account the contractors overall backlog (bonded and unbonded projects), contractors who expect to be bidding more bonded work need to remember that most conventional bond facilities count the value of each bonded tender against the program's aggregate limit. If you are unsure whether you have sufficient bond capacity to accommodate an increase in tender bond activity speak with your surety bond representative about ways to increase your limit. Aside from the obvious steps (injecting cash or offering additional security), there are some creative solutions available that a good surety professional can utilize to garner the necessary support.

As to the cost, for contract bonds (Performance & Labour and Material Payment Bonds) the surety charges a rate per thousand dollars of contract price, inclusive of the HST. Contractors are likely familiar with their basic rates but may be unsure of when surcharges will apply. For example, sureties have historically applied a small surcharge on "broad" form Labour and Material Payment Bonds - such as the federal payment bond - which extends coverage to 2nd tier claimants. At the time of this writing the surety marketplace is still developing their position on whether the Act's Labour and Material Payment Bond form – which is a "broad" form extending protection to a 2nd layer of possible claimants - will attract a surcharge or not. Review the costs associated with your bond program on a regular basis and ask questions when you are unsure of surcharges applying or not.

A more active bond facility may also lead to the surety requesting more frequent and even more comprehensive reporting packages from their contractor clients. A surety's reporting requirements are generally a function of bond activity and the contractor's financial strength. Contractors should ask questions of their bond providers and ensure they are striking an appropriate balance to keep the bond relationship healthy. You want to provide sufficient information to allow the surety to properly assess the risk without overburdening your project and accounting teams in the process.

On a final note, contractors will be interested to hear that the new Construction Act allows for annual and phased release of holdback on large ($10M+), long term projects. The new Act also permits holdback to be held in the form of alternate security such as a letter of credit or bond, which is a radical change over the former Act. Where alternate security is in place, the owner need not hold back the standard 10% from every progress draw.

Does this mean we will see a sudden flood of Holdback Repayment Bonds issued in the marketplace? Possibly, but it's tough to predict how much traction these will ultimately gain. The owner must be agreeable to accepting the bond – the Act permits but does not require it – and given that Holdback Repayment Bonds are essentially financial guarantees, sureties will be reserved about offering these bonds, with approvals dependent on the nature of the contract and stature of the contractor.

Because of the cash flow benefits to the contractor, if the price of the bond is right, a Holdback Repayment Bond is an option many contractors should find worth exploring.

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