



PROTECTION FOR SUBTRADES – THE VALUE OF THE LABOUR AND MATERIAL PAYMENT BOND

A DCN article published in 2007 referred to estimates that sub-contractors in the US lose roughly \$3 billion annually as a result of general contractors defaulting on their payment obligations. Assuming that the Canadian Construction industry is about one tenth the scale, it is a reasonable guess that Canadian sub-contractors are losing \$250 to \$300 million annually to lack of payment from general contractors.

Research demonstrates that failure to collect accounts receivable and the resulting bad debts are among the primary causes of subcontractor bankruptcy. Each year in Canada, hundreds of sub-trades go broke, due at least in part to their failure to get paid. So what's a sub-contractor to do?

The best way sub-trades can protect themselves on a project is to ensure a labour and material payment bond has been issued by a reputable surety company on behalf of the general contractor to the owner. These bonds guarantee payment for work completed by sub-contractors providing they are directly contracted to a general, have fulfilled their contractual obligations and complied with the terms of the bond.

Sure, a sub-contractor can rely on his lien rights and the ability to attach to the holdback, and he can pursue the general through the court system, but these measures rarely deliver full reimbursement to the sub-trade and often involve expensive and protracted litigation. If the general is bankrupt, the unsecured creditors (sub-trades and suppliers) frequently end up with nothing as secured creditors get the first shot at recovery from the general's assets.

For the five years between 2001 and 2005, Canadian sureties paid out over \$275 million in claims, despite the fact these were strong years for both the Canadian economy and the construction industry. According to Ed Chasse of Baker, Bertrand, Chasse and Goguen, Canada's foremost surety claims adjusting firm, some 70% to 80% of the total dollars paid out on bond claims they settle relate to labour and material payment bonds. That means sureties have paid as much as \$200 million to sub-trade claimants during those five years, or an average of some \$40 million per year. Where would some of those sub-trades be without those funds? The answer is many more of them would be bankrupt or in serious financial difficulty.

Since a key role of the surety is to pre-qualify and "vouch" for the financial and technical capabilities of a contracting firm, it is reasonable to assume the amount of sub-trade loss on un-bonded contracts and for un-bonded general contractors is even higher. Sub-trades can take some comfort in the fact that a surety has reviewed the financial capabilities of a general and is prepared to guarantee the general will pay their bills. Some sub-trades actually offer a price discount when they know a job is bonded, or add in a risk factor premium when they know a job is not.

Still, a great deal of work in Canada is not bonded, even in the ICI sector. That explains much of the difference in the total estimated losses to subs of over \$250 million per year versus the bonding company payouts to subs of some \$40 million. If more work was bonded, how many more sub-trades would still be in business today?

Chasse also confirms that sub-trades enjoy a much higher rate of recovery for their unpaid receivables from labour and material payment bonds compared to situations where the subs have to rely solely on liens. Resolving a labour and material payment bond claim involves much less time and hassle in clear-cut default situations where the general contractor has failed in his obligations.

So what should sub-trades do? Insisting that owners require the general contractor to provide both a performance and a labour and material payment bond is a good start. Some owners, like the Region of Peel, require performance bonds only, which protect them, while waiving labour and material payment bonds to the detriment of the sub-trades. Insisting on getting a copy of the bond is another must. There are numerous examples of situations where the owner has "forgotten" to order the performance and payment bonds, they were improperly executed, or the general has simply not yet delivered them even though the work is well underway.

Worse yet, there are numerous owners in Canada who insist on the general providing a bid bond and/or an agreement to bond at the bid stage, only then to waive both the performance and labour and material payment bonds once they have awarded the work. The owner relies on the prequalification service provided by the surety and then saves the cost of the final bonds by waiving them, effectively



removing the sub-contractors protection. In those situations, a sub can be left high and dry even though he bid the job and started work thinking he had payment protection.

Obtaining a copy of the bond is also extremely important in the event the sub-contractor has to submit a claim on the bond. Labour and material payment bonds have prescribed time limitations and certain duties that must be fulfilled by the sub-trade making a claim. Sub-trades are advised to comply with the terms of the bond and to ensure they have met their obligations under their contract.

An emerging trend in Canada is the purchase of Contract Default Insurance ("Subguard") by general contractors to protect themselves against sub-trade failure. Some enterprising generals have been trying to convince owners that a combination of this policy and a small percentage performance bond can afford the owner with sufficient protection. The general encourages the owner to waive the purchase of the full performance and payment bonds as a cost saving measure although the general may benefit financially as well. Once again, this effectively strips the sub-contractors of payment assurance.

Labour and material payment bonds offer effective and valuable protection for sub-trades and are relatively inexpensive. While not a perfect tool in dispute situations, labour and material payment bonds afford the best payment assurance available to the sub-contracting industry in the event of general contractor failure.

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