

IN THE SUPREME COURT OF CANADA  
(ON APPEAL FROM THE COURT OF APPEAL OF ALBERTA)

BETWEEN:

VALARD CONSTRUCTIONS LTD.

APPELLANT  
(Appellant)

-and-

BIRD CONSTRUCTION COMPANY

RESPONDENT  
(Respondent)

-and-

SURETY ASSOCIATION OF CANADA

INTERVENER

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FACTUM OF THE INTERVENER, SURETY ASSOCIATION OF CANADA  
(Pursuant to Rule 42 of the *Rules of the Supreme Court of Canada*)

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## FACTUM OF INTERVENER, SURETY ASSOCIATION OF CANADA

### PART I – OVERVIEW AND FACTS

1. Surety bonds ensure responsible contract performance, financial security and are often an essential requirement in construction procurement.<sup>1</sup> Today, surety bonds are by far the most common means of securing contractual obligations in the construction industry.<sup>2</sup> Consequently, a decision of this Honourable Court that will impact how surety bonds function in the construction marketplace is of significant interest to the Surety Industry (defined below).

2. This Appeal of the Alberta Court of Appeal decision in *Valard Construction Ltd. v. Bird Construction Company* (the “Valard Decision”),<sup>3</sup> raises the purely legal question whether an Oblige under a CCDC-222 trustee form of labour and material payment bond (the “Payment Bond”) has a duty to notify Claimants of the existence of the Payment Bond. This is an important question for the Surety Industry and the resolution of this Appeal has far-reaching implications.

3. The Intervener, the Surety Association of Canada (“Intervener” or “SAC”) is the national trade advocacy association that represents the interests of various stakeholders involved in the issuance of surety bonds across Canada. SAC’s members include surety companies, reinsurers, brokers and claims professionals (collectively the “Surety Industry”) and its membership now represents surety companies operating in Canada that account for more than 90% of the approximate \$600,000,000 of surety premiums underwritten in Canada in 2016. SAC therefore brings to these proceedings a deep understanding of the implications of the potential answer to the legal question raised on the Appeal. SAC takes no position on the facts or on the ultimate disposition of the Appeal.

4. On this Appeal, the Payment Bond under consideration is in a trustee form that has been in use in Canada since at least the late 1960s<sup>4</sup> and was endorsed for use in 1979 by the Canadian

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<sup>1</sup> Canadian Construction Documents Committee, *A Guide to Construction Surety Bonds CCDC 1997 – 22*, Ottawa: CCDC, 1997, p. 22-1 [Intervener’s Book of Authorities (“IBA”) Tab 1]

<sup>2</sup> Canadian Construction Documents Committee, *A Guide to Construction Surety Bonds CCDC 2002 – 22*, Ottawa: CCDC, 2002, p. 1 [IBA Tab 2]

<sup>3</sup> 2016 ABCA 249, [2017] 2 W.W.R. 46, 2016 CarswellAlta 1584

<sup>4</sup> *Dominion Bridge Co. Ltd. v. Marla Construction Co. Ltd. et al.*, [1970] 3 O.R. 125 (Co. Ct.), 12 D.L.R. (3d) 453, 1970 CarswellOnt 743 at paras. 2-4 (“*Dominion Bridge*”)

Construction Documents Committee (“CCDC”).<sup>5</sup> The Payment Bond is currently in widespread use across Canada.

## **PART II – THE INTERVENER’S POSITION ON THE QUESTION IN ISSUE**

5. The issue on Appeal, of importance to the Intervener, is whether an Oblige under the Payment Bond has a duty to notify potential Claimants about the existence of the Payment Bond.

6. It is the Intervener’s submission that in light of the purpose of the Payment Bond, the purpose of the trust created in the Payment Bond and the role that the Payment Bond plays in the construction marketplace, no such duty exists in the Payment Bond.

## **PART III – STATEMENT OF ARGUMENT**

### **A. A Payment Bond is Intended to Benefit the Oblige**

7. The Payment Bond is required by an Oblige (primarily project owners, but in this case a general contractor) for its own benefit to see labour and materials paid on their project. The purpose the Payment Bond is to provide the Oblige with the assurance that suppliers of labour and materials used in a construction project would be paid by the surety provided that such suppliers complied with the terms of the Payment Bond. By guaranteeing payment for labour and materials, the Payment Bond assures the contractor’s credit and expedites the subcontractor’s performance. It reduces to a minimum the filing of liens and the loss of time and money necessary for enforcing liens by litigation.<sup>6</sup>

8. In the text, *Construction Lien Remedies in Ontario*, Kevin McGuinness reiterates that there are a number of considerations that may prompt an Oblige to insist that a Payment Bond be provided:

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<sup>5</sup> CCDC develops, produces, and reviews standard construction contracts, forms and guides. It is a national joint committee that includes representatives from across the Canadian construction industry. All CCDC documents are endorsed for use by SAC and a number of national construction associations including the Canadian Construction Association.

<sup>6</sup> Hass, Theodore, H., “The Corporate Surety and Public Construction Bonds” (1956-1957) 25 Geo. Wash. L. Rev. 206 at p. 210 (“Hass”) [IBA Tab 4]

- a) the owner may wish to ensure that the supplies of services and materials by subcontractors will not be interrupted as a result of a weakening in the financial condition of the contractor; and
- b) the owner may wish to protect his interest in the property on which the project is being constructed from construction lien claims;
- c) there may be some political motivation for insisting on a Payment Bond.<sup>7</sup>

9. The Payment Bond will also tend to lower subcontractor bid pricing because it eliminates the tendency of subcontractors (Claimants under the Payment Bond) to add amounts to their bid to cover the credit hazard of the general contractor.<sup>8</sup>

10. Thus, the purpose of the Payment Bond – namely that it is primarily for the benefit of the Obligee – frames the reasonable expectations of the Obligee and the Claimants that an Obligee would not intend to take on any liability by requiring the Payment Bond. It does not make practical sense that Obligees would choose to take on greater personal exposure directly to Claimants which would not otherwise exist by requiring the Payment Bond. Such a result is inconsistent with the purpose of the Payment Bond.

11. As explained by the Ontario Superior Court in *Base Controls Limited v. Bennett + Wright Group Inc.*,<sup>9</sup> the Obligee, in proposing a bonding requirement in its contract with the Principal, did not do so for the benefit of subcontractors but for its own benefit to:

...avoid the situation it now finds itself in – being dragged into litigation by unpaid subcontractors.<sup>10</sup>

12. While the Payment Bond in a sense protects subcontractors because it assures that they will be paid, it is important to note that Claimants pay no premium for the Payment Bond. The Obligee pays for the Payment Bond and ultimately the Obligee is the intended beneficiary. Although

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<sup>7</sup> Kevin Patrick McGuinness, *Construction Lien Remedies In Ontario* (Scarborough: Carswell Thomson Professional Publishing, 1997) at §9.33, p. 582 (“*McGuinness*”) [IBA Tab 5]

<sup>8</sup> *Hass, supra*, note 6 at 210 [IBA Tab 4]

<sup>9</sup> (2002), 20 C.L.R. (3d) 258 (Ont. S.C.), 2002 CarswellOnt 3682, affirmed (2003), 24 C.L.R. (3d) 95 (Div. Ct.), 2003 CarswellOnt 1350 (“*Base Controls*”)

<sup>10</sup> *Ibid* at para 9 (Ont. S.C.)

subcontractors also benefit, that is considered a by-product rather than the primary purpose of the Payment Bond.<sup>11</sup>

## **B. The Jurisprudence reflects this Purpose**

13. The judicial interpretation of the obligations of the Obligee as the trustee under the Payment Bond has been consistent with the purpose of the Payment Bond, namely for benefit the Obligee. With the result that the Courts have upheld that the Obligee, as trustee under the Payment Bond, does not owe any duties to Claimants, including the duty to notify a Claimant.

14. In considering whether such a duty to notify exists, the Courts have noted some practical concerns when refusing to find that an Obligee under a Payment Bond owed a duty to notify including: when did the duty arise; at what point of time; what exactly was that duty; must the obligee embark upon inquiries who were the labourers; who were the creditors; who were the suppliers; must the obligee seek out the creditors and suppliers; and if such a duty was found, the obligee would be required to acquire knowledge of all materials purchased, all labourers on the job from day to day and to keep a constant surveillance.<sup>12</sup>

15. The 1967 decision in *Dominion Bridge, supra*,<sup>13</sup> and the more recent decision in *Dolvin Mechanical Contractors Ltd. v. Trisura Guarantee Insurance Co.*,<sup>14</sup> dismissed actions by Claimants against Obligees by concluding that an Obligee under the Payment Bond does not owe a duty to notify a Claimant of the existence of the Payment Bond.

16. In his text, *Construction Lien Remedies in Ontario*, Kevin McGuinness confirms not only the purpose of the trustee wording, but also the absence of any obligation on the trustee to notify Claimants of the existence of the Payment Bond.<sup>15</sup>

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<sup>11</sup> Edward G. Gallagher, ed, *Payment Bond Manual*, (Chicago: American Bar Association, 1995) at pp. 3-4 (“Gallagher”) [IBA Tab 3]

<sup>12</sup> *Dominion Bridge, supra*, note 4, at para. 20

<sup>13</sup> *Dominion Bridge, supra*, note 4, at paras. 19-20 and 24

<sup>14</sup> 2014 ONSC 918, (2014), 36 C.L.R. (4<sup>th</sup>) 126, 2014 CarswellOnt 4708 at paras. 58-59

<sup>15</sup> *McGuinness, supra*, note 7, at §9.35, p. 584 [IBA Tab 5]

17. Thus, the approach in the Surety Industry and in Canadian Courts is that the Payment Bond does not create a duty upon the Obligee to notify the Claimants of the existence of the Payment Bond.

### **C. The Trust Contemplated in a Payment Bond is Limited**

#### **a. The Payment Bond is Designed to Circumvent the Third Party Beneficiary Rule**

18. As the popularity of payment bonds grew following the World War II, there was, in Canada, some concern that the suppliers of labour and materials could be caught by the rule preventing third party beneficiaries from enforcing a contract and therefore unable to enforce the right to collect under a payment bond. Conversely, in the United States the law is well settled that the third party beneficiary rule does not operate to prevent claimants from suing on a payment bond.<sup>16</sup>

19. The purpose for introducing the trust into the Payment Bond was therefore solely to circumvent the third-party beneficiary rule that would otherwise preclude a non-party entity (being the Claimant) from a direct right of action against the Surety under the Payment Bond. This purpose was recognized by this Honourable Court in *Johns-Manville Canada Inc. v. John Carlo Ltd.*,<sup>17</sup>

20. In *Alta Surety Company v. Harris Steel Ltd.*,<sup>18</sup> the Nova Scotia Court of Appeal considered a claim under a trustee form of payment bond and explained as follows:

...A trustee is required because at the time the bond is entered into, the identities of the claimants cannot be ascertained and for the purpose of circumventing the rule preventing third party beneficiaries of a contract from suing for breach of a contract to which they are not a party.<sup>19</sup>

21. In the more recent decision, *Ozz Electric Inc. v. Zurich Insurance Company Ltd. et al.*,<sup>20</sup> the Ontario Superior Court dismissed a motion to amend a Statement of Claim to make a direct

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<sup>16</sup> *Alta Surety Company v. Harris Steel Ltd.* (1993), 119 N.S.R. (2d) 61, 1993 CarswellNS 222 (CA) at para. 22 (“*Alta Surety*”)

<sup>17</sup> [1983] 1 S.C.R. 513, 1983 CarswellOnt 182 at para. 5

<sup>18</sup> *Alta Surety*, *supra*, note 16

<sup>19</sup> *Alta Surety*, *supra*, note 16, at para. 19

<sup>20</sup> 2016 ONSC 6331, 2016 CarswellOnt 15865



claim against the Obligee under the Payment Bond. The Court relied<sup>21</sup> on the description of the purpose of the Payment Bond and the trustee wording from *Scott and Reynolds on Surety Bonds*<sup>22</sup> to conclude there is no basis for a claim by a Claimant against an Obligee under the terms of the Payment Bond.

22. Similarly, in the Ontario Report of the Attorney General's Advisory Committee on the Draft Construction Lien Act, April 1982, the authors noted that the reason for the trust created in the Payment Bond was to allow the Claimants to sue upon it.<sup>23</sup>

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<sup>21</sup> *Ibid* at para. 15

<sup>22</sup> *Ibid* at para. 15. Kenneth W. Scott and Bruce Reynolds, *Scott and Reynolds on Surety Bonds* (Scarborough: Carswell, 1993) (loose-leaf 2008) at pp. 11-10.8 to 11-11 which states:

Labour and Material Payment Bonds provide that the surety must pay labour and material suppliers on the project who are owed money by the principal. As with other Surety Bonds, there is a penalty amount which limits the surety's liability. The standard form of Labour and Material Payment Bond provides that notice must be given within a certain time and that an action must be commenced within a certain time.

This bond is different from other types of bonds in that while it refers to the contract between the principal and the obligee, it is conditioned upon the payment by the principal of the accounts of labour and material suppliers on the contract. If those accounts are not paid, the surety's obligation arises. The standard bond wording constitutes the owner, who is the obligee, as a trustee for the labour and material suppliers. This "trustee" wording is designed to get around the third party beneficiary rule which says that strangers to a contract cannot enforce it. ...

There has always been concern that the Labour and Material Payment Bond, even with the trustee wording, might be unenforceable by reason of the third party beneficiary rule. ... Of course, the "trustee" wording provides that the claimant/beneficiary may join the obligee/trustee in its action to enforce the Labour and Material Payment Bond. Also, it has been held that the Trustee under the bond may bring an action itself to enforce the bond to the benefit of the claimants. ... In practice, the third party beneficiary issue rarely arises. In Ontario, the issue has been put to rest by s. 69(1) of the *Construction Lien Act* ...

<sup>23</sup> Report of the Attorney General's Advisory Committee on the Draft Construction Lien Act, April 1982, at pp. 164-166 [IBA Tab 6] which states:

While the purpose of the bond is to protect the suppliers and services or materials, those suppliers cannot sue upon it, at common law, because they have no contractual relationship with the bonding company. To remedy this problem a trust form of bond has recently become common. There may still be some doubt as to the effectiveness of this bond form. Section 71 removes all doubt and permits suppliers of services or materials to sue upon a labour and materials bond.

23. Accordingly the purpose for the trust created in the Payment Bond was only to circumvent the third party beneficiary rule.

**b. The Payment Bond Trust is a Bare Trust**

24. The trust referred to in the Payment Bond is limited in nature as was held by the Alberta Court of Appeal in the Valard Decision.<sup>24</sup>

25. The “limited trust” created in the Payment Bond can be best described as a “bare trust”. Bare trusts are characterized by the trustee’s limited obligation to convey trust property to a beneficiary on demand. With a bare trust, the trustee is not acting to the benefit of the beneficiary but in accordance with the terms of the trust. As stated by the Alberta Court of Appeal in *Ironside v. Smith*:<sup>25</sup>

An individual may hold property on behalf of another as bare trustee without taking on all the onerous trappings of a fiduciary. A bare trustee has no further duty to perform except to convey the property to the beneficiary on demand and, so long as he holds it, to exercise reasonable care over the property, by maintaining or investing it: D.W.M. Waters, *The Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984) at 27.<sup>26</sup>

26. The Alberta Court of Appeal also cautioned against adding fiduciary duties to the limited nature of a bare trust as follows:

It is not uncommon for each participant in an arm’s length commercial relationship to shoulder specific obligations. While they are contractually obligated to fulfill their responsibilities, participants neither relinquish their self-interest, nor act solely on behalf of the other parties by agreeing to do so. Parties may depend upon each other to fulfill contractual obligations, without becoming peculiarly vulnerable or at each other’s mercies. In a commercial environment, courts should be hesitant about grafting fiduciary duties onto contractual obligations, which are the very consideration for the parties’ bargain.<sup>27</sup>

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<sup>24</sup> Valard Decision, *supra*, note 3, at para. 14

<sup>25</sup> 1998 ABCA 366, [1999] 6 W.W.R. 256, 1998 CarswellAlta 1045

<sup>26</sup> *Ibid* at para. 71

<sup>27</sup> *Ibid* at para. 79

27. Consistent with the limited purpose of the trust created in the Payment Bond and the limited obligations of a trustee under a bare trust, in *Don Fry Scaffold Service Inc. v. Ontario*,<sup>28</sup> the Court (affirmed by the Ontario Court of Appeal) built upon an earlier decision in *Base Controls Limited v. Bennett + Wright Group Inc.*,<sup>29</sup> which found that the hallmarks of a fiduciary relationship, namely expectations of loyalty, trust, fidelity and confidence are not present between an Obligee and a Claimant.

28. Accordingly, the imposition of any duty on the trustee other than to deliver a copy of the Payment Bond if requested by a Claimant is not in accord with the limited nature of the trust created in the Payment Bond or the obligations of a bare trustee.<sup>30</sup>

#### **D. The Implications of a Departure from the Traditional Approach**

29. Imposing a duty upon an Obligee to give notice of the existence of the Payment Bond would have a number of practical implications including:

- a) Obligees, many of whom are public owners, would have to search out every possible Claimant to ensure that notice of the Payment Bond was received. Such an obligation would be onerous and costly for Obligees and contrary to the benefits intended to be acquired by the Obligee under the Payment Bond.
- b) The imposition of a duty to notify may deter Obligees from requiring a Payment Bond on construction projects in order to avoid a potential liability arising from the duty to notify. A reduction in the use of Payment Bonds would consequently reduce the possible recoveries by unpaid Claimants.
- c) A duty to notify would impose a new risk on the Obligee when the purpose of the Payment Bond is to mitigate the Obligee's risk.
- d) A Claimant (subcontractor or supplier) under the Payment Bond is best able to manage any risk associated with knowledge of the existence of the Payment Bond

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<sup>28</sup> (2007) 65 C.L.R. (3d) 310 (Ont. S.C.), 2007 CarswellOnt 5092 ("*Don Fry*"), affirmed [2008] O.J. No 410 (C.A.)

<sup>29</sup> *Base Controls*, *supra*, note 9

<sup>30</sup> *Don Fry*, *supra*, note 28, at para. 17

by simply requesting it from their counterparty at the time of entering into the subcontract or requesting it during the course of the project. In fact, a number of lien legislations across Canada codify the obligation of an Owner provide a copy of the payment bond if requested by the claimant.<sup>31</sup>

30. In the circumstances, it is respectfully submitted that there are practical considerations that would negatively impact the use of Payment Bonds if a duty to notify existed.

#### **PART IV – COSTS AND REQUEST FOR ORAL ARGUMENT**

31. The Intervener seeks no costs on the Appeal and asks that no costs be awarded against it. In accordance with the Order of Mr. Justice Moldaver dated July 11, 2017, the Intervener will present oral argument not exceeding five (5) minutes at the hearing of this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 22<sup>nd</sup> day of August 2017.

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<sup>31</sup> *Alberta Builders' Lien Act*, RSA 2000, c. B-7, s. 33(1); *British Columbia Builders' Lien Act*, SBC 1997, c. 45, s. 41(1); *Manitoba Builders' Lien Act*, CCSM c. B91, s. 58(1); *New Brunswick Mechanics' Lien Act*, RSNB 1973, c. M-6, s. 32(1); *Nova Scotia Builders' Lien Act*, RSNS 1989, c. 277, s. 32; *Ontario Construction Lien Act*, RSO 1990, c. C.30, s. 39(1); *Prince Edward Island Mechanics' Lien Act*, RSPEI, 1988, c. M-4, s. 32(5); *Saskatchewan The Builders' Lien Act*, SS 1984-85-86, c. B-7.1, s. 82(1)

**PART VI – TABLE OF AUTHORITIES**

<b>Case Authorities</b>	<b>Paras.</b>
<i>Alta Surety Company v. Harris Steel Ltd.</i> (1993), 119 N.S.R. (2d) 61 (C.A.), 6 C.L.R. (2d) 55, 1993 CarswellNS 222	18, 20
<i>Base Controls Limited v. Bennett + Wright Group Inc.</i> (2002), <a href="#">20 C.L.R. (3d) 258 (Ont. S.C.)</a> , 2002 CarswellOnt 3682, <a href="#">affirmed (2003), 24 C.L.R. (3d) 95 (Div. Ct.)</a> , 2003 CarswellOnt 1350	11, 27
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**Statutory Provisions**

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<a href="#"><u>Builders' Lien Act</u></a> , SBC 1997, c. 45, s. 41(1)	31
<a href="#"><u>Builders' Lien Act</u></a> , CCSM c. B91, s. 58(1)	31
<a href="#"><u>Builders' Lien Act</u></a> , RSNS 1989, c. 277, s. 32	31
<a href="#"><u>Construction Lien Act</u></a> , RSO 1990, c. C.30, s. 39(1)	31
<a href="#"><u>Mechanics' Lien Act</u></a> , RSNB 1973, c. M-6, s. 32(1)	31
<a href="#"><u>Mechanics' Lien Act</u></a> , RSPEI, 1988, c. M-4, s. 32(5)	31
<a href="#"><u>The Builders' Lien Act</u></a> , SS 1984-85-86, c. B-7.1, s. 82(1)	31

### Secondary Sources

Canadian Construction Documents Committee, <i>A Guide to Construction Surety Bonds CCDC 1997 – 22</i> , Ottawa: CCDC, 1997 Intervener's Book of Authorities "IBA" [IBA Tab 1]	1
Canadian Construction Documents Committee, <i>A Guide to Construction Surety Bonds CDC 2002 – 22</i> , Ottawa: CCDC, 2002, p. 1 [IBA Tab 2]	1
Gallagher, Edward G., ed, <i>Payment Bond Manual</i> , (Chicago: American Bar Association, 1995) [IBA Tab 3]	12
Hass, Theodore, H., "The Corporate Surety and Public Construction Bonds" (1956-1957) 25 Geo. Wash. L. Rev. 206 [IBA Tab 4]	7, 9
McGuinness, Kevin Patrick <i>Construction Lien Remedies In Ontario</i> (Scarborough: Carswell Thomson Professional Publishing, 1997) [IBA Tab 5]	8, 16
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