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The Risk Management Committee is pleased to provide this risk management article for the members of the Canadian Design Build Institute (CDBI). The following article addresses the risks and issues associated with surety bonding claims when a contracting party becomes insolvent and is subject to receivership.

The article does reference a general contractor, conducting business in a traditional design–bid–build environment; however, the circumstances and challenges referenced in this paper can readily occur in a design-build contract environment. For the members of CDBI that are Owners, the article highlights the value of surety bonds in mitigating the risk of contractor default. In particular, when reading the article, imagine the difficult environment that could occur if there were no surety bonds, and the surety company had not arranged for the completion of the project. The Owner would have likely faced significant lien claims against its project, as well as demands for funds from the secured creditors, and probably would have not had a completed project.

The Risk Management Committee of CDBI will continue to circulate articles of this nature to members as they become available. We trust this will be found to be of interest and beneficial to the members.

**What's on the Horizon? Case comment: Re Horizon Earthworks Ltd.**

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Horizon Earthworks Ltd. ("Horizon") was an Alberta based contractor that specialized in road construction. In or about November, 2009, a Receiver was appointed in respect of Horizon's property. Subsequently, in April, 2010, Horizon was assigned into bankruptcy.

At the time that Horizon was assigned into bankruptcy, it had several incomplete projects throughout Alberta including a project for the Municipal District of Greenview ("Greenview"). As part of the contract with Greenview, Horizon was required to post a Performance Bond and Labour and Material Payment Bond each in the amount of $761,662.22. Prior to delivering the said bonds, Horizon had executed an indemnity agreement with its bonding company, namely, Western Surety.

Just prior to Horizon having been assigned into bankruptcy, Western Surety sent Greenview a letter indicating that as a requirement of the indemnity agreement, Horizon had assigned, to Western Surety, all funds due to Horizon under its contract with Greenview. In or about December, 2009, Greenview declared Horizon to be in default. At the time Greenview declared Horizon in default, Greenview estimated that there was $774,260.92 unpaid to Horizon. Greenview then made a claim on the Performance Bond for costs to complete the project.

Western Surety arranged for a replacement contractor to complete the outstanding work. As a consequence of Horizon's bankruptcy, Greenview received notices from unpaid subcontractors/suppliers of Horizon. These notices totaled approximately $922,807.12. Western Surety paid these claims under the Labour and Material Payment bond and took an assignment of the claims.

At all times, Horizon had two primary secured creditors. Both held security (i.e. a GSA) over all present and after acquired personal property of Horizon. The indebtedness owed to the secured creditors was greater than the funds on hand with Greenview. Eventually, the 2 secured creditors and the Receiver entered into an agreement wherein the Receiver assigned its interest in the Greenview receivable to the 2 secured creditors, and in exchange, the 2 secured creditors gave a credit against Horizon's indebtedness.

The secured creditors and Western Surety each made a claim to the funds held by Greenview.

In its application to the Alberta Court of Queen's Bench, Greenview, with the support of Western Surety, proposed that the funds it held be paid to Western Surety given that Western Surety had, in effect, "stepped into the shoes" of the unpaid subcontractors of Horizon. By contrast, the secured creditors made claim to the funds by virtue of the assignment by the Receiver to them of the Greenview receivable and by virtue of the GSA.

In its decision, the Court rejected Greenview's proposal on the grounds that the payment by Greenview would have the effect of preferring the unsecured creditors over secured creditors. The Court characterized Greenview's proposal as a "private reorganization" that violated the provisions of the ***Bankruptcy and Insolvency Act***.

Further, the Court also held that by virtue of the secured creditors having entered into the GSA with Horizon in May, 2008, the GSA granted the secured creditors a security interest in all of Horizon's present and after acquired property including accounts receivable. The secured creditors registered their security interest in accordance with Alberta's ***Personal Property Security Act*** prior to Horizon entering into the contract with Greenview. By contrast, Western Surety had taken no steps to register its indemnity agreement with ***PPSA***. As such, Western Surety could not take priority over the secured creditors.

The result in this case clarifies the entitlement of the competing interests in the monies "earned but not yet paid" by an Owner to an insolvent contractor. In order to have any hope of establishing an entitlement, a party must register under the ***PPSA***, to the extent possible, its interest in the funds, or be entitled to a priority to those funds by virtue of the ***BIA***. This result also underscores the need for sureties to "know their client". Sureties should underwrite the risk properly and obtain the appropriate forms of security, and take proper steps to perfect the security interest.

The decision also leaves some question unanswered. For example, if the unpaid subcontractors to Horizon had been lien claimants, and the surety had taken an assignment of the lien claims, would that have made a defence in the entitlement of the surety to the funds held by the Owner?

The case is under appeal; therefore, what lies on the horizon is unclear.