Investigating performance bond claims: Lessons learned from Graphic Packaging v. 2477621 Ontario Inc.

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The recent case of *Graphic Packaging International Canada, ULC v. 2477621 Ontario Inc. et al*.[1] (Graphic Packaging) was described by the Ontario Superior Court as "fundamentally a straightforward construction case". However, the case, which involved the interpretation of a bespoke form of performance bond not typically used in Canada, resulted in a less than a straightforward decision. Respectfully, the Court made generalized statements regarding certain principles of surety law with only limited analysis of the underlying facts and issues, and without reference to the applicable jurisprudence. Therefore, while it is important to consider the fundamental issues of surety law discussed in the case, the outcome of the case was largely driven by its unique facts, such that its application should be limited accordingly.

Background

Graphic Packaging International Canada ULC (Graphic) sold a contaminated former paper mill in Jonquière, Quebec, to 2477621 Ontario Inc. (247) under an Agreement of Purchase and Sale (the APS). Although title to the property transferred to 247, Quebec environmental legislation required Graphic, as the last operator of the mill, to complete a full site rehabilitation. The APS recognized this ongoing statutory obligation while assigning responsibility for demolition of the mill to 247. Although not provided for in the APS, it was 247's intention to extract and sell certain high-value metals from the mill structures and equipment onsite.

Under the APS, 247 was required to deliver a scope of work for the demolition within 30 days and complete the specified demolition work within 24 months. The APS also required 247 to obtain a performance bond to secure its obligations, naming Graphic as obligee. 247 obtained the required bond from Talisman Casualty Insurance Company LLC (Talisman), acting as surety. The form of performance bond issued by Talisman (the Bond) differed substantially from the forms commonly used on Canadian construction projects. Instead of using the standard CCDC form of performance bond, the Bond was based on the AIA A312-2010 form used in the United States. It also included a number of modifications to the American form that were negotiated by 247. For example, the Bond removed the requirement that Graphic terminate the APS as a

condition for triggering the surety's obligations. The Bond also imposed notice requirements upon 247 that are not required by the bond forms commonly used in Canada, and it included a condition precedent requiring Graphic to agree to pay the "Balance of the Contract Price", which was defined as "those monies due and payable to the Purchaser per the terms of the [APS]".

Having procured the Bond, 247 began its planned salvage operations; however, it did not deliver the required scope of work within 30 days. In fact, it did not deliver the required scope of work within 24 months, nor did it even hire a demolition contractor to start the work before the expiry of the 24-month period. In April 2017, Graphic wrote to 247 to express serious concerns with 247's commitment to honouring the demolition obligations and document 247's failure to provide the scope of work proposal within 30 days, as required. While 247 pointed to harsh winter conditions, thefts of salvaged metals, and a months long work stoppage following a fatal workplace incident as reasons for the delays, it did not dispute that it had not provided the scope of work proposal and had not demolished the mill within the specified timeframes.

On July 12, 2017, Graphic formally notified Talisman of the missed 30-day deadline and expressed its concern that 247 would default on the demolition work because of the looming 24-month deadline. Graphic requested a conference with Talisman and 247 to discuss 247's performance, as provided for in the Bond. Talisman did not respond. The Court found that the July 2017 letter clearly expressed Graphic's intention to declare 247's default, as required by the Bond. Talisman's failure to respond to the request for a conference was found to be, at the very least, a waiver of an opportunity to cure Graphic's default, realized or anticipated.

On September 21, 2017, Graphic sent a further letter to Talisman. Although the specific content of this letter is not set out in the decision, the Court noted that the Bond required Graphic to "declare the contract default and notify Talisman of same" and it held that Graphic "issued such a default, referring to the July 12, 2017 notice".

On October 6, 2017, Talisman wrote to Graphic to request various documents to verify Graphic's claim. Although Talisman later argued that Graphic failed to identify the nature of 247's default as part of its defence in the litigation, the Court noted that Talisman's request for information contained no indication that Graphic had failed to identify the default. The Court therefore described Talisman's position that Graphic failed to identify the nature of 247's default as "utterly disingenuous". The Court also described Talisman's document request as "boilerplate" and noted that Graphic was given ten days to produce "a long and broadly worded" list of documentation and information that the Court described as "largely irrelevant" and "telegraphed the surety's intention to renege on its performance bond".

The Court went on to note that the Bond contained no provision entitling Talisman to make the document request, drawing a distinction from the standard requirements upon an insured in reporting a loss to an insurer.

Graphic responded on October 24, 2017, and stated that it required more than ten days to provide all of the information and documentation requested. On March 9, 2018, Graphic provided some of the requested documents and confirmed that 247 had indeed failed to complete the demolition by the December 2017 deadline, which had since passed. As a result, Graphic made a formal declaration of 247's default under the Bond

(presumably in connection with the missed 24-month deadline) and, because time was of the essence, Graphic informed Talisman and 247 that it had started the process of soliciting bids from replacement contractors. The Court noted that the solicitation of bids from other contractors was one of the Surety's remedial options under the Bond, and that it would have been hard to fault Graphic for taking the initiative because Talisman had not taken any remedial action itself.

The Court found that the correspondence between Graphic and Talisman left no doubt that Graphic had complied with the requirements of the Bond in declaring 247 in default, both with respect to the 30-day scope of work requirement and the 24-month demolition requirement. Having found that Graphic declared and notified Talisman of these defaults, the Court turned to Talisman's argument that the surety obligation remained untriggered because Graphic had yet to inform Talisman that it agreed to pay the Balance of the Contract Price to the Surety or to a contractor selected to perform the work. Talisman had raised this issue in correspondence sent to Graphic in March of 2018; however, Graphic did not confirm its agreement to make the Balance of the Contract Pirce available until August of 2018. That was apparently because, in the meantime, events occurred that raised hope that 247 would finally comply with its demolition obligations.

As Graphic communicated to Talisman in May 2018, 247 had finally prepared a draft demolition plan. The plan was not immediately approved by the Québec Environment Ministry (the Ministry), but a meeting was scheduled to address the Ministry's requirements. Ultimately, a demolition plan submitted by Graphic, as adapted from 247's plan, was approved by the Ministry in June 2018, and a demolition permit was issued. However, 247 did not start the work, even after Graphic obtained an extension of the time for doing so from the Ministry. In early August, 2018, under mounting pressure from the Ministry, Graphic wrote to 247 and Talisman and advised that, if 247 did not start work before August 6, 2018, Graphic would proceed with a replacement contractor it had hired. In response, 247 asserted that the presence of stakeholder representatives on site "sufficed as the start of demolition activities". On August 21, 2018, Graphic informed 247 and Talisman that the Ministry was dissatisfied with 247's lack of progress on the demolition and advised that Graphic's replacement contractor would begin to perform the demolition work on August 27, 2018. Graphic noted in its correspondence that Talisman had not indicated that it would obtain its own bids and that Graphic assumed that Talisman was in agreement with Graphic's proposed course of action. Graphic at that point addressed an issue previously raised by Talisman regarding payment of the Balance of the Contract Price, which Graphic asserted was "nil" in accordance with the terms of the APS.

Rather surprisingly, Talisman wrote back and asserted that 247 was in fact taking "significant action" to demolish the mill and had "diligently moved forward". However, since 247 had failed to satisfactorily progress the work, Graphic obtained an interlocutory injunction in September 2018 authorizing it to retake possession of the site and perform the demolition work itself. In November 2018, Graphic excluded 247 from the site.

On March 15, 2019, Talisman provisionally denied liability under the Bond unless Graphic provided the outstanding information listed in its October 2017 request within ten days. This information was ultimately provided by Graphic to Talisman on April 30, 2019, on the condition that Talisman not share the information with 247. While Talisman

acknowledged the sufficiency of the information, it took issue with the condition imposed by Graphic with respect to sharing the information with 247. On July 24, 2019, Talisman formally denied liability under the Bond, alleging that Graphic was in default of the APS and that, in any event, Graphic had failed to satisfy the Bond's conditions precedent to liability, namely by failing to declare 247 in default in a proper or sufficient manner and failing to comply with the requirement to agree to pay the Balance of the Contract Price. In the alternative, the letter outlined several reasons to excuse Talisman from liability on the basis of alleged prejudice, including alleged prejudice arising from "grace periods" provided by Graphic to 247.

In the face of Talisman's denial of liability, Graphic moved for summary judgment to enforce its claim against 247 for the expenses it incurred to complete the demolition work, and its claim against Talisman for breach of the Bond. Talisman responded by seeking an order dismissing Graphic's motion by way of "boomerang" summary judgment, on the ground that Graphic's failure to provide 247 a remediation plan and failure to agree to pay the Balance of the Contract Price for the demolition separately each prevented the triggering of Talisman's obligations.

The Court's decision

A significant portion of the Court's decision is devoted to analyzing the sequence of Graphic and 247's respective obligations under the APS. The Court ultimately concluded that, as of December 24, 2017, the deadline for completing the demolition work, the only party in breach of the APS was 247.

The Court then turned to a consideration of Talisman's duties under the Bond and ultimately rejected each of Talisman's defences. While the Court's conclusions are largely tied to the unique (and arguably extreme) circumstances of the case, the Court's analysis of the applicable principles of surety law warrants closer scrutiny.

1. The surety's right under a performance bond to request documents as part of its investigation of a claim

Although the Court makes broad statements regarding a Surety's right to investigate claims under a bond, these comments must be interpreted in light of the "snowblower approach" the Court found Talisman to have adopted in its document request. The Court stated that the Bond "contained no provision entitling Talisman to make the document request", suggesting that a surety has no right (or at least a limited right) to request documents relating to the principal's alleged default in the absence of express bond language to that effect. However, it has long been recognized at common law that the very nature of performance bonds gives rise to the surety's right to perform such an investigation and make such document requests. Viewed in this light, the Court's comments should be understood as simply reflecting its conclusion that Talisman intended to "bury Graphic in a documents and data request resembling a documentary discovery request in litigation" and not that a surety cannot make reasonable requests for information and documents as part of its investigation.

Any broad conclusion regarding limitations on a surety's right to request information from an obligee is inconsistent with longstanding Canadian (and American) authority recognizing that a surety's right to investigate under a performance bond arises from the

nature of the bond itself – not the presence or absence of express language providing the surety with such a right. As the British Columbia Supreme Court recognized in *Fraser Gate Apartment Ltd. v. Western Surety Co.*:

> Generally the surety will be entitled to […] properly investigate the contractual and factual circumstances of the claim, with particular regard to the question of whether the principal is in default under the contract, and whether the obligee has performed its obligations under the contract. That such an investigation, and reasonable time within which to do it, is required must be evident from the very nature of the bond.

The Court's reasoning in *Graphic Packaging* may have been coloured by an apparent conflation of performance bonds with letters of credit, which of course is a distinct credit instrument. Indeed, elsewhere in the decision, the Court characterizes performance bonds as "the construction equivalent of a bank letter of credit." With respect, that analogy is inappropriate. The defining feature of letters of credit is that they are demand instruments. Letters of credit are intended to ensure prompt payment and an issuer's obligation is consequently triggered by the presentation of stipulated documents and deliberately insulated from any disputes concerning the underlying contract. As a result, investigation of contractual performance is unnecessary and, indeed, antithetical to the commercial purpose of the instrument. In contrast, the surety's liability under a performance bond is conditional and dependent upon, among other things, an actual default under the bonded contract and the obligee's proper declaration of the same. The triggers can therefore be complex and will require multiple determinations. It is for this reason that the surety has a right to investigate, which has long been recognized at common law.

In the circumstances of the case, the Court's comments regarding Talisman's right to request documents relating to Graphic's claim should not be treated as supporting any deterioration of this right. Rather, they are tied to the specific document request made by Talisman, which, as noted above, the Court found to be overly broad and largely irrelevant to the issue of whether 247 or Graphic was in default of their obligations under the APS, or indeed any other issues relating to Talisman's liability under the Bond. The Court also noted that Talisman did not request any information regarding the nature of the alleged default or raise the absence of this information as an issue at the outset. Therefore, the appropriate conclusion to be drawn from the Court's decision is simply that a surety is not entitled to make overly broad and irrelevant document requests as part of its investigation. However, a surety is clearly entitled at law to investigate any claims under a bond with appropriate document requests to investigate whether the conditions for liability under the bond have been met.

2. The distinction between notice of default and declaration of default

It is clear from the existing jurisprudence that a surety's obligation to respond promptly under a performance bond does not arise until a formal demand has been made of the surety. Such a demand must be clear, direct, and unequivocal. Prior to a proper claim being made, the surety does not have a duty to investigate – or even a right to unilaterally intervene in a dispute between the principal and obligee. The application of this principle is critical. It ensures that the obligee, not the surety, bears responsibility for deciding whether the principal's conduct warrants escalation. As Canadian courts have

consistently held, until a formal declaration is made to the surety, the "clock does not start ticking" on the surety's obligations (*Fraser Gate*).

While the language of the Bond regarding notice and declaration of default differs from that in the standard forms used across Canada, the crucial distinction between declaring the principal in default, and then making a claim under the bond, appears to be preserved. § 3.1 of the Bond required Graphic to "provide notice to [247] and [Talisman] that [Graphic] is considering declaring a Contractor Default." §3.2 of the Bond required Graphic to "[declare] a Contractor Default and [notify Talisman]" as a condition precedent to Talisman's liability. However, the distinction between "notice" and "declaration" of default is not reflected in the Court's analysis. It is also not clear from the decision when Graphic first declared 247 to be in default and called upon Talisman to perform under the Bond. On the one hand, the Court held that Graphic's September 21, 2017 communication satisfied the § 3.2 requirement that Graphic "declare the Contractor default," but the Court later held that Graphic made its "formal declaration of 247's contractor default" when Graphic delivered some of the requested documents on March 9, 2018, which is obviously inconsistent.

The Court faults Talisman for alleged inaction long before March 2018. As the decision does not describe the contents of the September 21, 2017 letter, it is not clear whether the contents of the letter satisfied the requirements of the Bond. However, if a proper declaration of default was not made before March 2018, or if Talisman didn't make a claim under the Bond before March 2018, such a criticism would be unwarranted. The subtle but critical distinction between notice and declaration of default is important, as Canadian law does not impose an obligation on a surety to respond under a performance bond until default has been declared and a claim has been made to the surety.

3. Material variation and prejudice to the surety in cases of extension of time for performance

The Court also rejected Talisman's argument that, by providing 247 with grace periods, Graphic extended the time for performance of the underlying contract and thereby materially varied the contract, prejudicing Talisman and discharging it from liability. The Court correctly recognized the principle that a change that imposes additional risk on the surety without its consent will discharge the surety from its obligations under a performance bond.

However, respectfully, the Court erred in commenting that granting the contractor "more time to perform the work, even past the deadline for completion, cannot prejudice the surety." This simple proposition misstates the law of material variation. While extensions of time may be benign, or even benefit the surety in some circumstances, it is not the case that such changes to the time for completing the underlying contract "cannot" prejudice the surety. As the British Columbia Supreme Court noted in *MGN Constructors Inc. v. AXA Pacific Insurance Company*, extensions of time can carry real consequences for the surety's risk, such as increased overhead or prolonged exposure to adverse weather. As a result, and as the Supreme Court of Canada acknowledged in *Ferrara v. National Surety Co.*, where a bonded contract provides a fixed time for performance, and this period is extended by the obligee and principal without the consent of the surety, the surety will have grounds to be discharged on the basis of material variation of contract if it suffers prejudice as a result.

The Court may well have been correct that, in this particular case, given 247's pervasive non-performance, no prejudice was actually suffered. However, the broader holding to the effect that extensions of time "cannot" prejudice a surety is inconsistent with longstanding surety law principles.

Conclusion

Although the result in *Graphic Packaging* may be justifiable based on the specific facts of the case, particularly the extraordinary delays and the extent of non-performance by 247, as well as the unique form of the Bond that was issued by Talisman, the decision diverges from well-established Canadian surety principles in terms of:

1. The conclusion that the Bond provided the surety with "no right" to make a document request;
2. The apparent blurring of the distinction between notice and a declaration of default; and
3. The assertion that extensions of time "cannot prejudice" a surety.

These conclusions must be considered in light of the unique factual circumstances of the case, and not as broadly applicable principles of surety law. For these reasons, the precedential value of the decision in *Graphic Packaging* should be considered with caution.

Both Talisman and 247 have filed notices of appeal of the motion decision. We will update this commentary after the release of the Court of Appeal decision. For more information, please reach out to any of the key contacts below.

Footnote

[1] 2025 CanLII 134390 (ON SC)

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