C.A. No. 106504

NOVA SCOTIA COURT OF APPEAL
Cite as: Halifax Insurance Company v. Trenton Works Lavalin Inc., 1995 NSCA 17
Hallett, Chipman and Pugsley, JJ.A.

BETWEEN:

THE HALIFAX INSURANCE COMPANY, a body corporate Appellant - and - TRENTON WORKS LAVALIN INC., a body corporate Respondent - and - PANALPINA INC., a body corporate Intervenor	)	George W. MacDonald, Q.C. and J. David Connolly for the appellant Peter D. Darling for the respondent Mark E. MacDonald for the intervenor Appeal Heard: January 27, 1995 Judgment Delivered: February 21, 1995

AND BETWEEN:

TRENTON WORKS LAVALIN INC., a body corporate Appellant on Cross-Appeal - and - THE HALIFAX INSURANCE COMPANY, a body corporate and PANALPINA INC., a body corporate Respondents on Cross Appeal	)

THE COURT: Appeal allowed and cross appeal dismissed per reasons for judgment of Hallett, J.A.; Chipman and Pugsley, JJ.A. concurring.

HALLETT, J.A.:

This is an appeal from a decision finding the appellant, Halifax Insurance, liable to the respondent, Trenton Works, pursuant to the provisions of a performance bond. Trenton Works is

the successor to the rights and obligations of Hawker Siddeley Canada Inc. pursuant to a contract made between that company and Zambia Railways Limited of the Republic of Zambia. Hawker Siddeley manufactures railway cars. It entered into the contract with Zambia Railways to sell 285 railway cars *ex quay* Port of Dar es Salaam, Tanzania.

Trenton Works contracted with the intervenor, Panalpina Inc. to transport the 285 rail cars by ship from Halifax. The freight charge per rail car was $9,000 U.S. and was prepayable. The terms of the contract contain a General Paramount Clause which provided:

"General Paramount Clause

The Hague Rules contained in the International Convention for the Unification of certain rules relating to Bills of Lading, dated Brussels the 25th August 1924 as enacted in the country of shipment shall apply to this contract. When no such enactment is in place in the country of shipment the corresponding legislation of the country of destination shall apply but in respect of shipments to which no such enactments are compulsorily applicable the terms of said Convention shall apply.

Trades where Hague-Visby Rules apply
Trades where the International Brussels Convention 1924 as amended by the Protocol signed at Brussels on February 23, 1968 - The Hague-Visby Rules - apply compulsorily, the provisions of the respective legislation shall be considered incorporated in this Bill of Lading. The Carrier takes all reservations possible under such applicable legislation relating to the period before loading and after discharging and while the goods are in the charge of another Carrier and to deck cargo and live animals."

Canada adopted the Hague Rules incorporating them into the **Carriage of Goods by Water Act**, R.S.C. 1985 c. C-27. This **Act** applies to all ocean contracts of carriage for shipments originating in Canada.

The Hague Rules limit a carrier's liability to $500 per unit pursuant to Article IV, Rule 5 which states:

> " Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with goods in an amount exceeding $500 per package or unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading."

The contract between Trenton Works and Panalpina also contained special terms including the following:

> " FF) As a guarantee of the full performance of all its obligations under the contract, the carrier shall present to the merchant a performance bond in the form agreed. Cost of said performance bond to be the merchant's account."

I would infer that Trenton Works wanted a performance bond because the very substantial freight charge was prepayable. Pursuant to its obligation under the special terms of the contract with Trenton Works, Panalpina obtained the performance bond from Halifax Insurance. The bond was in the amount of $2,927,574. Pursuant to the terms of the bond Panalpina, as principal, and Halifax Insurance, as surety, jointly and severally bound themselves unto Trenton Works as obligee in the amount of the bond. The bond recites that the principal, Panalpina, had entered into a written contract with Trenton Works to provide transportation for 285 rail cars to Dar es Salaam, Tanzania. The bond provides that the contract is made part of the bond and is referred to in the bond as the Contract. The operative part of the bond provides:

> " NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that if the Principal shall promptly and faithfully perform the Contract then this obligation shall be null and void; otherwise it shall remain in full force and effect.
>
> Whenever the Principal shall be, and declared by the Obligee to be, in default under the Contract, the Obligee having performed the Obligee's obligations thereunder, the Surety may promptly remedy the default, or shall promptly
>
> (1) complete the Contract in accordance with its terms and conditions or
>
> (2) obtain a bid or bids for submission to the Obligee for completing the Contract in accordance with its terms and conditions, and upon determination by the Obligee and the Surety of the lowest responsible bidder, arrange for a contract between such bidder and the Obligee and make available as work progresses (even though there should be a default, or a succession of defaults, under the contract or contracts of completion, arranged under this paragraph) sufficient funds to pay the cost of completion less the balance of the Contract price; but not exceeding, including other costs and damages for which the Surety may be liable hereunder, the amount set forth in the first paragraph hereof. The term "balance of the Contract price," as used in this paragraph, shall mean the total

> amount payable by the Obligee to the Principal under the Contract, less the amount properly paid by the Obligee to the Principal."
>
> Any suit under this Bond must be instituted before the expiration of two (2) years from the date on which final payment under the Contract falls due.
>
> The Surety shall not be liable for a greater sum than the specified penalty of this Bond.
>
> No right of action shall accrue on this bond, to or for the use of, any person or corporation other than the Obligee named herein, or the heirs, executors, administrators or successors of the Obligee."

The bond was signed by Panalpina and Halifax Insurance.

Under the contract with Zambia Railway, Hawker Siddeley was required to insure the rail cars for their replacement value against all risks of transportation, theft, damage, etc. until the rail cars were placed at the disposal of Zambia Railways in accordance with the contract. Trenton Works applied for a policy of marine cargo insurance from Pacific Employers Insurance Company to cover the shipment of the rail cars from Halifax to Zambia. The cover note issued by Tower Hill Insurance Brokers Limited to Trenton Works showed the value of the shipment of 285 rail cars at $22,527,359 Canadian.

Panalpina nominated the vessel Silver Gulf to transport 75 of the rail cars. While loading one of the cars the cable on the ship's crane broke; the rail car was dropped and extensively damaged. A subsequent examination of the cable showed it had deteriorated due to metal fatigue and wear. The damaged car was returned to Trenton Works and found to be a constructive total loss having a value of $74,240 after salvage. Zambia Railways agreed to accept the number of cars contracted for less one. Therefore, there was no need to manufacture a replacement which would have required a retooling at Trenton Works' plant.

Trenton Works eventually filed a proof of loss with its marine cargo insurer, Pacific Employers Insurance Company, and was paid in full for the loss. Pacific Employers then

commenced two subrogated actions in the name of Trenton Works against Panalpina, Halifax Insurance and others. Eventually the actions were consolidated and the claim against two defendants was discontinued. The action proceeded to trial on an agreed statement of facts with Trenton Works as plaintiff and Halifax Insurance and Panalpina as the defendants. The learned trial judge found that Panalpina breached its contract of carriage and was liable for the damage to the rail car. He further found that, in accordance with Article IV, Rule 5 of the Hague Rules, Panalpina's liability was limited to $500. However, the learned trial judge found that Halifax Insurance's liability was not limited by the provisions of the Hague Rule and found Halifax Insurance liable for the full amount ($74,240) of the loss to Trenton Works. He ordered that the 9% agreed rate of pre-judgment interest would be applied to the outstanding amount from the date of payment to Trenton Works by Pacific Employers Insurance to the date of judgment.

Halifax Insurance appeals on the ground that its liability should have been limited to the liability of its principal Panalpina. Trenton Works has filed a cross-appeal claiming that Panalpina should have been held liable for the entire amount of Trenton Works loss and that pre-judgment interest should be payable from the time of the loss and not from the date when payment was received by Trenton Works from its insurers.

By order of this Court Panalpina was added as an intervenor.

There are two issues raised on the appeal: (i) was the bond issued by Halifax Insurance, a contract of guarantee/suretyship or was it a contract of insurance/indemnity; and (ii) if the bond was a contract of guarantee/suretyship is Halifax Insurance entitled to the benefit of the provisions of the contract of carriage limiting Panalpina's liability for damage to $500 per unit?

Counsel for Trenton Works takes some issue with the framing of the issues by counsel for Halifax Insurance. He is of the opinion that the only issue is whether the per package limitation set out in Article IV Rule 5 of the Hague Rules limits Halifax Insurance's liability under the performance bond. He does not consider it useful to determine if the bond is a contract of suretyship

or indemnity. With respect I disagree although I agree that it is the terms of the bond that are of paramountcy in interpreting its effect.

Panalpina essentially agrees with the statement of issues as set out in the factum of Halifax Insurance. Panalpina was added as an intervenor in these proceedings as it has interest in the subject matter as by virtue of its obligation at law to indemnify Halifax Insurance for amounts paid under the performance bond in issue.

The Trial Judge's Decision

After reviewing the facts, the terms of the contract between Trenton Works and Panalpina and the relevant Hague Rules, the learned trial judge found that Panalpina's liability was limited to $500. He stated:

> " I find that the intention of the parties was that the phrase "package or unit" meant one railway car. Therefore, the $500 limitation applies to each railroad car.
>
> It follows that the liability of Panalpina for the damaged cattle car is limited to $500."

The learned trial judge then considered the extent of Halifax Insurance's liability under the performance bond. After reviewing statements from several authorities and, in particular, statements from the opinions expressed in **Moschi v. Lepp Air Service Ltd.**, [1973] A.C. 331 (H.L.) he stated:

> " In short, the general effect of a performance bond is the indemnification by the surety of the loss suffered by the creditor or obligee."

He then considered the submission by counsel for Halifax Insurance that "the obligee's right of indemnification by the surety is subject to any defences which the surety might have derived by operation of law from the principal."

The learned trial judge then reached his conclusion:

" Clause FF of Addendum 2, Special Terms, of the liner booking note required Panalpina to obtain a performance bond "as a guarantee of the full performance of all it[']s obligations under the contract". The condition of the obligation of the performance bond issued by Halifax Insurance required Panalpina as principal to promptly and faithfully perform the contract which, in the recital, was stated to be "to provide transportation for 285 rail cars to Dar es Salaam, Tanzania".

While there is a difference between the wording of Clause FF of the liner booking note and the wording of the obligation set out in the performance bond, it is clear that the performance bond must have been requested and issued to fulfil the requirement of Clause FF of the liner booking note, and accepted in fulfilment of that requirement. Therefore, I find that Halifax Insurance intended to issue the performance bond in order to guarantee the full performance of the obligations of Panalpina under its contract to provide transportation for 285 rail cars.

Those obligations were not fulfilled. Even though Zambia Railways subsequently was willing to accept the delivery of one less railway car in full performance of its contract, I find that the obligation of Halifax Insurance under the performance bond was not reduced thereby. I also find that the obligation of Halifax Insurance was not reduced by the inclusion by operation of law in the contract of carriage of a $500 per package limitation of liability. I also find no evidence that a limitation of liability was in the contemplation of the parties at the time of the issue of the performance bond in fulfilment of Panalpina's obligations under Clause FF of the liner booking note, which was to guarantee the performance of Panalpina's obligations under the contract of carriage. Finally, I also find no evidence of an intention that Halifax Insurance as surety would have the benefit of any defence able to be raised by operation of law."

The Law

The essential features of a surety obligation are delineated in **Scott and Reynolds on Surety Bonds** (1993) at p. 2-5 as follows:

" The criteria necessary at common law to establish that an obligation is one of suretyship are as follows:

(1) There must be a tripartite relationship involving the principal, the surety, and the obligee;

(2) The surety's obligation must be collateral or accessory to the obligation of the principal;

(3) The surety's obligation to the obligee must be the same as the obligation of the principal; and

(4) The surety must be unconnected to the transaction except as surety, having no "interest" therein."

In **The Law of Guarantee**, McGuinness (1986) sets out the distinction between a contract of guarantee and a contract of indemnity at p. 37:

" The true distinction between guarantees and simple indemnity obligations may be summarized as follows: Where another person remains liable to the creditor and the promisor is not otherwise liable to the creditor than under the agreement, the agreement is one of guarantee rather than indemnity. Where, however, the obligation is an independent undertaking to make good a loss, the obligation is one of indemnity rather than guarantee."

Scott and Reynolds on Surety Bonds explains the distinction between contracts of indemnity and contracts of surety at p. 2-13 as follows:

" An insured contracts with an insurer to indemnify in the event of certain risks occurring; only two parties are required for the relationship to exist. In the event of a provable loss occurring within the type of risk insured against, the insured will recover. A principal, on the other hand, contracts with a surety to indemnify a third party, the obligee, in the event the principal fails at his task, whether it be the repayment of money or the construction of a building, and the surety effectively assumes the obligation of the principal in the event of such a failure. Insurance is thus a much broader form of relationship, which, for the purposes of establishing entitlement to compensation, looks only to the nature of the risk insured against, and ignores the legal responsibility of the person causing the loss. This contrasts with surety, for a surety will only become liable if the principal is also liable."

In a contract of indemnity the liability of the insurer is primary (**Canadian General Insurance Co. v. Dube Ready-Mix Ltd., et al**, (1984), 52 N.B.R. (2d) 66 (C.A.). Counsel for

Halifax Insurance and Panalpina assert that the learned trial judge erred in finding the performance bond was in the nature of a contract of indemnity.

Disposition of Appeal Ground 1

It is clear from the words of the performance bond that the obligations of Halifax Insurance only arise on Panalpina's default under the contract between Trenton Works and Panalpina. It did not agree to indemnify Trenton Works from any loss arising out of damage to or loss of the railway cars. It agreed only to take certain steps if Panalpina defaulted under the carriage contract. Its obligation is secondary to that of Panalpina which had the primary obligation to perform the contract of carriage with Trenton Works. Therefore the obligation of Halifax Insurance under the performance bond is in the nature of a guarantee rather than an indemnity.

Issue 2 - Is the appellant entitled to the benefit of a defence based on the limitation of liability provision in the Contract between Panalpina and Trenton Works?

Counsel for the appellant and the intervenor take the traditional position that the liability of Halifax Insurance is no greater than that of the principal Panalpina under the terms of its contract with Trenton Works. In **The Law of Guarantee**, McGuinness at p. 148 states this basic principle as follows:

> " It is a corollary of the secondary nature of the liability of a surety that he is not in general liable to a creditor for any amount above that for which the principal is liable."

This basic principle was affirmed by the Supreme Court of Canada in **Communities Economic Development Fund v. Maxwell et al** (1991), 85 D.L.R. (4th) 88 in discussing the nature of a contract of guarantee stated:

> " The exact nature of the obligation owed by the guarantor to the lender depends on the construction of the contract of guarantee, but the liability of the guarantor is usually made coterminous with that of the principal debtor."

A corollary of this principle is that a guarantor is entitled to raise all the defences able to be raised by its principal. (**The Law of Guarantee**, McGuinness at pp. 198 and 359) The appellant and the intervenor assert that the learned trial judge erred in finding to the contrary.

Counsel for Trenton Works argues that the learned trial judge was correct in finding that Halifax Insurance was obliged to pay damages to Trenton Works in the amount of $74,240. He relies in the main on the decision of the House of Lords in **Moschi**, supra. It is therefore necessary to review that decision in some detail. **Moschi** involved facts fundamentally different than the facts in the case we have under consideration. The headnote contains all the pertinent facts and the conclusion of the three levels of court that dealt with the decision. The headnote states:

> " The respondent creditors were forwarding agents for a company (the debtor) whose managing director (the guarantor) held all but one of its shares. By a written contract the creditors agreed to relinquish their lien over the debtor's goods in consideration of the debtor agreeing to pay the creditors £40,000, which was then owed to the creditors for services rendered, by six weekly instalments of £6,000 plus a final weekly instalment of £4,000. It was also agreed that steps would be taken to ascertain the exact amount of the debt to the creditors. The contract contained a guarantee by the guarantor of the performance by the debtor of its obligations to pay the £40,000 by instalments. The debtor defaulted on its obligations from the outset and after three weeks had paid only some £10,069 out of a total of £18,000 which had become due. The creditors treated those breaches by the debtor of its obligations as a wrongful repudiation of the contract and accepted that wrongful repudiation.
>
> In an action by the creditors against the debtor for damages and against the guarantor for the full amount of the weekly instalments of £40,000 less what had been paid, £10,069, with interest, the official referee held that the guarantor was liable for the amount of the instalments due and payable at the date of the acceptance of repudiation, which he held was £24,000 less what had been paid, £10,069, and awarded the creditors the difference between those two sums of £13,931 which together with interest amounted to £15,811.
>
> The guarantor appealed on the grounds that his liability was discharged by the creditors' acceptance of the debtor's repudiation of the contract, alternatively, that it amounted to a material variation of the contract thus extinguishing his liability; the creditors cross-appealed on the ground that the guarantor's liability extended to the instalments due and payable after the date of the acceptance of the

> repudiation. The Court of Appeal dismissed the appeal and allowed the cross-appeal.
>
> On the guarantor's appeal: -
>
> *Held*, dismissing the appeal, (1) that since the creditors' acceptance of the debtor's wrongful repudiation of the contract was a right given to the creditors by the law of contract, the exercise of that right did not discharge the guarantor from liability under the guarantee nor was it a material variation of the contract which extinguished the guarantor's liability.
>
> *Chatterton v. Maclean* [1951] 1 All E.R. 761 approved.
>
> (2) That, accordingly, when the creditors accepted the debtor's fundamental breach of the terms of the contract, including those guaranteed, as a repudiation of the contract, they were entitled to sue the guarantor in damages for the total sum guaranteed (except in so far as already satisfied by payment made by the company), and that the measure of damages was that net sum.
>
> *Per curiam*. When a contract is brought to an end by repudiation accepted by the other party all the obligations in the contract come to an end and they are replaced by operation of law by an obligation to pay damages. The damages are assessed by reference to the old obligations but the old obligations no longer exist as obligations. Were it otherwise there would be in existence simultaneously two obligations, one to perform the contract and the other to pay damages. But that could not be right. The only legal nexus remaining is the obligation to pay damages."

In short, in **Moschi** the debtor defaulted in payment of the installments it had promised to pay to its creditors. The creditors accepted that as a repudiation of the contract and sued the debtor for damages and the guarantor for the balance owing on the guarantee. The creditors, by considering that the debtor had repudiated the contract, did not relieve the debtor of its obligations. The creditors enforced their rights under the contract by suing the debtor for damages. The creditors' action against both the debtor and the guarantor were upheld as one would expect. In the course of rendering judgment, Their Lordships made certain statements on which counsel for Trenton Works relies in support of his argument that Halifax Insurance is liable for the sum of $74,240. I will set out the statements he relies on and I will comment on them. I would also note that several of these

statements were quoted by the learned trial judge in the course of rendering his decision. Lord Reid stated at p. 345:

> " On the other hand, the guarantor's obligation might be of a different kind. He might undertake that the principal debtor will carry out his contract. Then if at any time and for any reason the principal debtor acts or fails to act as required by his contract, he not only breaks his own contract but he also puts the guarantor in breach of his contract of guarantee. Then the creditor can sue the guarantor, not for the unpaid instalment but for damages. His contract being that the principal debtor would carry out the principal contract, the damages payable by the guarantor must then be the loss suffered by the creditor due to the principal debtor having failed to do what the guarantor undertook that he would do.
>
> In my view, the appellant's contract is of the latter type. He "personally guaranteed the performance" by the company "of its obligation to make the payments at the rate of £6,000 per week." The rest of the clause does not alter that obligation. So he was in breach of his contract as soon as the company fell into arrears with its payment of the instalments. The guarantor, the appellant, then became liable to the creditor, the respondents, in damages. Those damages were the loss suffered by the creditor by reason of the company's breach. It is not and could not be suggested that by accepting the company's repudiation the creditor in any way increased his loss. The creditor lost more than the maximum which the appellant guaranteed and it appears to me that the whole loss was caused by the debtor having failed to carry out his contract. That being so, the appellant became liable to pay as damages for his breach of contract of guarantee the whole loss up to the maximum of £40,000."

Lord Diplock's statement at p. 351:

> " The guarantor's obligation under his contract of guarantee does not, as the Court of Appeal appear to suggest, depend upon the debtor's primary obligation continuing to exist after the contract had been rescinded. Nor is it affected by whether the debtor's secondary obligation which was substituted for it by operation of law is classified as an obligation to pay damages or as an obligation to pay the debt. It was the debtor's failure to perform his primary obligation to pay the instalments in circumstances which put an end to it that constituted a failure by the guarantor to perform his own primary obligation to the creditor to see that the instalments were paid by the debtor, and substituted for it a secondary obligation of the guarantor to pay to the creditor a sum of money for the loss he thereby sustained. It is the guarantor's own secondary obligation, not that of the debtor, that the creditor is enforcing in his claim for damages for

breach of his contract of guarantee."

Lord Simon of Glaisdale's statement at p. 356 to p. 357:

" (4) The respondents' proposition is supported by the high authority of Rowlatt, *The Law of Principal and Surety*, 3rd ed. (1936), p. 144. The learned author was discussing the rule that on default of the principal promisor causing damage to the promisee the surety is, apart from special stipulation, immediately liable to the full extent of his obligation, without being entitled to require either notice of the default, or previous recourse against the principal, or simultaneous recourse against co-sureties. "The reason for the rule," wrote Rowlatt, "is that it is the surety's duty to see that the principal pays or performs his duty as the case may be . . . ." No other reason for the rule was proposed in argument before your Lordships, nor was the rule itself questioned; which suggests that Rowlatt's proposed reason is the correct one, which his own high standing would in any case vouch."

Based on these statements counsel for Trenton Works asserts that liability of Halifax Insurance under the bond is to be assessed on the basis that there had been a breach of the underlying contract of carriage by failing to perform the contract to deliver all the rail cars and therefore there has been a breach of the performance bond which guaranteed performance. He argues that pursuant to the terms of the bond, Trenton Works is entitled to recover from Halifax Insurance the damages it has suffered as a result of that breach, namely, $74,240.

Counsel for Panalpina also draws comfort from **Moschi**. He refers to the following statement from Lord Diplock's opinion:

" It follows from the legal nature of the obligation of the guarantor to which a contract of guarantee gives rise that it is not an obligation himself to pay a sum of money to the creditor, but an obligation to see to it that another person, the debtor, does something; and that the creditor's remedy for the guarantor's failure to perform it lies in damages for breach of contract only. That this was so, even where the debtor's own obligation that was the subject of the guarantee was to pay a sum of money, is clear from the fact that formerly the form of action against the guarantor which was available to the creditor was in special assumpsit and not in indebitatus assumpsit: *Mines v. Sculthorpe* (1809) 2 Camp. 215.

The legal consequence of this is that whenever the debtor has

> failed voluntarily to perform an obligation which is the subject of the guarantee the creditor can recover from the guarantor as damages for breach of his contract of guarantee whatever sum the creditor could have recovered from the debtor himself as a consequence of that failure. The debtor's liability to the creditor is also the measure of the guarantor's."

The statements from the opinions of Their Lordships in the **Moschi** must be taken in the context of the case they had under consideration. The issue before them was whether the creditors by accepting the debtor's repudiation of the contract thereby increased their loss which would be the case if the guarantor's argument had been accepted. The facts in that case were straight forward; the debtor had an obligation to pay money and the managing director of the debtor company had guaranteed the payment of the money. It was a simple contract with a predictable outcome once the court focused on how ludicrous it would be to accept the proposition put forward by the guarantor. There is nothing in any of the judgments in **Moschi** that would indicate that the House of Lords was turning away from the basic principle of law that a guarantor will not be liable for an amount greater than an amount that could be found to be owing by the principal debtor. This is abundantly clear from the passage quoted from the judgment of Lord Diplock which I have previously set out.

With respect to the quotation from Lord Reid's judgment it is clear that the guarantor's liability did not exceed that of the principal debtor. Lord Reid's statements must be considered with that pertinent fact in mind. In the case we have under consideration, if the interpretation advanced by the trial judge were to prevail, the liability of the surety would exceed that of the principal.

With respect to the statement from Lord Simon of Glaisdale's judgment I would note that the learned justice simply makes the point that the surety is liable to the full extent of his obligation. He is quoting from **Rowlatt, The Law of Principle and Surety** and the general proposition that it is the surety's duty to see that the principal pays or performs his duty as the case may be. That is simply a statement of the general principle that sureties must stand in the shoes of the principal to the extent of the principal's obligations under the underlying contract. This statement is consistent

with the concept that the surety is not liable to an extent greater than that of the principal.

Counsel for Trenton Works also places considerable reliance on a decision of Culliton J.A. in **The Preload Company Limited v. City of Regina** (1958), 13 D.L.R. (2d) 305 to support his argument that Halifax Insurance is liable for the loss sustained by Trenton Works. The liability of the surety in that case was not the principal issue before the court. The passage from Culliton J.A.'s decision upon which counsel relies is set forth at p. 337:

> " While the bond does not expressly provide that the Surety will be liable for damages resulting from breaches of contract by the Company, that liability arises as a matter of law. The measure of liability is clearly stated in De Colyar's on Guarantees, 3rd ed., p. 233, as follows: "For *the measure* of the surety's liability is the loss sustained by the creditor through the default of the principal debtor."
>
> Being unable to agree with the submission of the Surety, I must conclude that the Surety is liable for the damages sustained by the City as a result of the breaches of contract by the Company up to and including the amount of the bond."

As a general statement, what Justice Culliton had to say is correct but where the contract contains a limitation of liability as in the case we have under consideration the overriding principle that the surety is not liable to a greater extent than the principal cannot be ignored. In the **Preload** case there was no limitation on liability. The case is not on point.

The form of performance bond used in this case was that customarily used in connection with construction contracts and was not ideally suited for use with respect to the performance of a contract of carriage. Counsel for the parties were unable to find any case involving carriage of goods in which a performance bond was put in place in addition to marine cargo insurance.

The law with respect to the right of a surety to rely on any defence that would be open to the principal is stated in Goldsmith, **Canadian Building Contracts**, 4th edition, (1988) at p. 9-3 as follows:

> " The question whether the contractor is in fact in default, and the extent of the default, must be determined in accordance with the building contract, and any defence that would have been open to the contractor if a claim had been made directly against him by the owner is open to the surety."

With respect, I do not agree with the trial judge's finding that there was no evidence that the limitation of liability was not in the contemplation of the parties at the time of the issuance of the performance bond nor do I agree with his finding that there was "no evidence of an intention that Halifax Insurance as surety would have the benefit of any defence able to be raised by operation of law".

In my opinion the evidence is present in the terms of the performance bond itself and the law applicable to the obligations of sureties. The terms of the contract between Hawker Siddeley and Panalpina were incorporated into and expressly made part of the performance bond. The bond provides that whenever the principal (Panalpina) is declared to be in default under the contract the surety may "promptly remedy the default or (i) complete the contract; or (ii) obtain bids for submission to Trenton Works for the completion of the contract and make available sufficient funds to pay the cost of completion. These are the critical provisions of the bond. Halifax Insurance could elect to remedy a default made by Panalpina.

Panalpina's liability was limited to $500 per car. The limitation of liability was an essential term of the contract of carriage. On the facts of this case Panalpina's only default under the terms of the contract would be a failure to pay $500. Trenton Works could not declare Panalpina to be in default under the contract if Panalpina paid the $500 which it was always willing to do. Panalpina's default under the terms of the contract cannot be the failure to deliver 75 cars to Zambia Railways but only a failure to pay $500 for the damaged rail car as was Panalpina's right under the contract. The limitation of liability provision of the contract cannot be disregarded as such provisions delineate the extent of Panalpina's obligations under the contract with respect to loss or damage to a rail car.

Halifax Insurance has always been willing to pay $500 to remedy Panalpina's default, if any. The wording of the performance bond does not require Halifax Insurance to do anything more than remedy the default of Panalpina.

In my opinion this disposes of the second ground of appeal. The learned trial judge misinterpreted the words of the performance bond in finding Halifax Insurance liable to indemnify Trenton Works for the damage to the rail car. The words of the bond do not evidence an intention that the limitation provision in the contract did not apply to the surety.

Counsel approached the case somewhat differently; therefore, I will make some additional comments to support the conclusion that I have reached.

The law with respect to sureties is clear. As a general rule the obligation of a surety is no greater than that of the principal pursuant to the terms of the contractual obligations of the principal that are guaranteed by the surety. As a corollary of that principal the surety has the benefit of any defence available to the principal. This would include any limitations on liability. The parties to the performance bond, Halifax Insurance, Trenton Works and Panalpina, are commercial entities presumed to know the law and the effect of the contracts they enter. Apart from the nature of the Bond as determined from the words it is inconceivable that Panalpina would have intended to expand on its liability by signing the performance bond. But that would be the effect if the learned trial judge's interpretation were to stand as Panalpina is jointly and severally liable with Halifax Insurance under the bond. Furthermore, under the law Halifax Insurance as surety can, if the trial judge's decision were to stand, make a claim to recover the sum of $74,240 from Panalpina. With respect to the intention of Halifax Insurance upon issuing the performance bond it would not, in the absence of evidence to the contrary, have intended to do more than be liable for Panalpina's defaults pursuant to the underlying contract between Trenton Works and Panalpina. Nor would it have intended that it not have the benefit of the established law respecting the liability of sureties. There is nothing in the wording of the performance bond that would indicate that Halifax Insurance

intended to give up these recognized rights at law.

As for Trenton Works its intention, like that of Halifax Insurance and Panalpina, is to be ascertained from the terms of the bond and the law. In my opinion the learned trial judge erred in his apparent search for an intention of the parties outside the terms of the performance bond. If the learned trial judge was considering the provisions of Clause FF of the special terms in the contract between Trenton Works and Panalpina which required Panalpina to obtain a bond to guarantee full performance of the contract to support his interpretation of the bond it is my opinion that he erred in that Clause FF merely evidenced an intention to obtain a bond that provide a remedy to Trenton Works if Panalpina failed to live up to its obligations under the contract. The terms of the bond as issued must prevail as evidencing the intention of the parties to the bond.

Counsel for Trenton Works argues that the court must distinguish between performance of the contract and remedies for breach of the contract. He argues that Halifax Insurance guaranteed performance and insofar as Panalpina did not perform the contract Halifax Insurance is liable for the breach. In my opinion Halifax Insurance did not guarantee performance in the sense suggested by Trenton Works' counsel. I would agree that if there was a guarantee of performance in the broad sense suggested by appellant's counsel then applying the reasoning in **Moschi** could lead to a finding that Halifax Insurance's obligation was one of primary liability. However, the performance bond is not so worded. The liability of Halifax Insurance is clearly a secondary obligation. Halifax Insurance did not ensure performance of the contract in the sense of it making itself primarily liable to indemnify Trenton Works for damages in the event the rail cars were lost or damaged in transit. In looking at the performance bond to determine what was the intention of the parties the trial judge ought to have kept in mind that the parties to the performance bond would be aware of the law respecting the obligation of sureties, in particular, that the liability of the surety is co-extensive with that of the principal pursuant to the underlying contract.

There is nothing in the wording of this bond which includes the contract between Trenton

Works and Panalpina that would indicate the parties agreed to something that would extend the liability of Halifax Insurance beyond that provided by the law of suretyship. In my opinion the performance bond would have to contain clear language that such was the intention of the parties, in particular, that the limitation on liability in the contract did not apply to the surety. There are no words to this effect in the performance bond.

In summary, under the terms of the performance bond Halifax Insurance could elect in the event that Panalpina was declared to be in default under the contract to remedy the default. The contract provided a limitation on liability. Therefore, Panalpina could remedy the default by payment of $500 and so can Halifax Insurance. Without a clear expression of intention that such a limitation was not available to the surety as provided by law no such limitation should be inferred. No such intention can be found in the words of the performance bond as written. The performance bond must take precedence over the wording of Clause FF in the Special Conditions of the contract as it was issued and accepted as complying with that requirement. While I agree with counsel for Trenton Works that one can distinguish between performance of a contract and the remedies available under a contract I do not agree that the provisions of the contract which limit the liability of Panalpina do not also limit the liability of Halifax Insurance as surety under the terms of the performance bond in issue. Trenton Works' remedy against Halifax Insurance is a claim for damages but the measure of the damages as expressed by Lord Diplock in **Moschi** is the same as that of the principal. The words of the performance bond are not such as to deprive Halifax Insurance of the right to remedy the default by payment of $500. The words of the performance bond are not such as to put Halifax Insurance in the position that it is required to indemnify Trenton Works for any loss. The intention of the parties as determined from a review of the terms of the performance bond as a whole require Halifax Insurance to respond as a surety. Therefore, it is entitled to raise the defences available to the principal.

Accordingly I would allow the appeal by Halifax Insurance from the trial judge's finding

that it would be liable to Trenton Works for $74,240. Halifax Insurance ought to be liable for the sum of $500 plus pre-judgment interest.

I would also dismiss the cross appeal of Trenton Works that Panalpina ought to have been found jointly and severally liable with Halifax Insurance for the sum of $74,240.

In view of these findings it is not necessary to deal with the issue raised on cross-appeal that the trial judge erred in the exercise of his discretion respecting pre-judgment interest as the judgment for $74,240 has been set aside.

Neither Halifax Insurance nor Panalpina have ever denied that they are jointly and severally liable to Trenton Works for the sum of $500. This is relevant on the issue of costs.

It should be noted that at trial Halifax Insurance and Panalpina were represented by the same counsel. It was not until after trial that the ramifications of the trial judge's finding that Halifax Insurance was liable for $74,240 became apparent. It was not brought to the attention of the trial judge that Halifax Insurance could recover this sum from Panalpina. This consideration would have been relevant in his assessment of the intention of the parties to the performance bond.

I should also mention that the right of Pacific Employers Insurance to bring the subrogated action was not raised on this appeal. The learned trial judge found that the provision of the bond that no right of action accrued for the use of any person other than Trenton Works or "the heirs, executors, administrators or successors" of Trenton Works had no application. He considered Pacific Employers Insurance to be a "successor" within the meaning of that word as set out in the relevant clause of the Bond. I do not express any opinion on this finding as it was not raised on the appeal.

I would set aside the order of the learned trial judge dated the 31st day of May, 1994 and substitute an order that the Halifax Insurance and Panalpina are jointly and severally liable to Trenton Works in the amount of $500 plus pre-judgment interest thereon from the date the cause of action arose to the date of the order that would issue on this judgment. The interest rate would be

at 9% as agreed by the parties.

I would also order that (i) Halifax Insurance be repaid any costs paid pursuant to the Order of May 31st, 1994; (ii) Halifax Insurance and Panalpina have the costs of the trial in the amount of $7,344.25 plus disbursements to be taxed which they shall share equally as they were represented by the same counsel; and (iii) each of Halifax Insurance and Panalpina shall have costs on the appeal of $2,500 plus disbursements.

Hallett, J.A.

Concurred in:

Chipman, J.A.

Pugsley, J.A.

C.A. No. 106504

NOVA SCOTIA COURT OF APPEAL

BETWEEN:

THE HALIFAX INSURANCE COMPANY,
a body corporate

Appellant

- and -

TRENTON WORKS LAVALIN INC.,
a body corporate

Respondent

- and -

PANALPINA INC., a body corporate

Intervenor

REASONS FOR JUDGMENT BY:

HALLETT, J.A.

AND BETWEEEN:

TRENTON WORKS LAVALIN INC.,

Appellant on Cross-Appeal

- and -

THE HALIFAX INSURANCE COMPANY,
a body corporate and PANALPINA INC.,
a body corporate

Respondents on Cross Appeal