S.C.A. No. 02645

IN THE SUPREME COURT OF NOVA SCOTIA

APPEAL DIVISION

Cite as: Alta Surety Company v. Harris Steel Ltd., 1993 NSCA 147

Matthews, Chipman and Roscoe, JJ.A.

BETWEEN:

ALTA SURETY COMPANY Appellant - and - HARRIS STEEL LIMITED, DARTMOUTH READY-MIX LIMITED and SIGMA CONSTRUCTION LIMITED Limited Respondents	)	Geoffrey A. Saunders and R.J. Ross Stinson for the Appellant Michael J. Wood for the Respondent, Sigma Construction Limited David P.S. Farrar and T. Arthur Barry for the Respondent, Dartmouth Ready-Mix David G. Coles for the Respondent, Harris Steel Limited Appeal Heard: November 25, 1992 Judgment Delivered: January 4, 1993

THE COURT: Appeal dismissed with costs against the appellant to each of the respondents in the amount of 40% of that allowed for the trial, per reasons for judgment of Roscoe, J.A.; Matthews and Chipman, JJ.A. concurring.

ROSCOE, J.A.:

The appellant, Alta Surety Company (Alta), appeals from a decision of Mr. Justice Tidman of the Trial Division allowing the claims of the three respondents against Alta under a labour and material payment bond issued in respect of the construction of a hotel at the Halifax International Airport.

The owner of the land upon which the hotel was to be built was the federal Minister of Transport. The lands had been leased under the terms of a 41 year lease to Keddy Motor Inns Limited (KMI). The general contractor involved in the project was Gem Construction Specialist Limited (Gem). Two of the respondents, Harris Steel Limited (Harris) and Dartmouth Ready-Mix Limited (Dartmouth), were subcontractors of Gem. The third respondent, Sigma Construction Limited (Sigma), was the assignee of the assets and liabilities of a third subcontractor, Shore Masonry Systems Limited (Shore).

By the terms of the lease with the Minister of Transport, KMI was to construct and operate a hotel at the Halifax International Airport. Another term of the lease provided that KMI would supply a surety bond in an amount not less than 50% of the total contract price for construction of the hotel guaranteeing the performance of the construction contract and payment of suppliers of labour and materials.

KMI and Gem entered into an oral contract for the construction of the hotel for approximately $12,000,000.00. Before construction could begin, it was necessary for Gem to obtain a Facilities Alteration Permit from Transport Canada. Transport Canada required the bonding referred to in the lease to be put in place prior to issuing the permit. Gem applied for the bonding to Alta through its agent, V.J. Stanhope Insurance Limited. On June 1, 1990 Alta issued a performance bond naming Gem as the principal, Alta as the surety, and the Minister of Transport and KMI as obligees. On the same day a labour and material payment bond was issued which named Gem as the principal and Alta as the surety, but the blank on the form where the name of the obligee was to be filled in was inadvertently left blank. The amount of the labour and material payment bond was $6,000,000.00 and it indicated it was in reference to the development of a hotel at the Halifax International Airport.

Construction of the hotel began in July, 1990 but ceased in December, 1990 as a result of difficulty in arranging financing for the project. By that time Gem had billed approximately $4.5 million for work on the hotel, but had received only $958,000.00 on account of the progress billings. A portion of the funds received by Gem was paid by Mr. Donald Keddy personally and another portion was received from his solicitors' trust account. As a result of the failure of KMI to pay Gem, Gem did not pay its subcontractors. Gem was placed in receivership in June 1991.

After work on the project stopped, Shore assigned all of its assets and liabilities to a related company, Sigma, and surrendered its certificate of incorporation. Dartmouth, Harris and Sigma sued Alta for payment of their accounts, the amounts of which are not in issue, totalling approximately $1.4 million. The actions of the three respondents were consolidated and other actions involving the same project have been stayed pending the outcome of these claims.

At the time of the trial Alta conceded that materials and labour were provided by Harris, Dartmouth and Shore to the Airport Hotel project. It also conceded that the three subcontractors met with the conditions in the labour and material payment bond regarding notice of their claims. Alta, however, denied the validity of the bond on the basis that Gem did not enter into a contract with KMI but with another Keddy company, Keddy's International Airport Hotel Inc. (KI), and further, that the subcontractors could only claim on the bond through their trustee, KMI, and because of the misconduct of KMI as their trustee they were prevented from claiming against the surety. With respect to the Sigma claim, Alta defended on the basis that the contract between Gem and Shore prevented the assignment of the contract by Shore.

The trial judge found:

1) that the contract for the construction of the hotel was between KMI and Gem;

2) even if he was wrong on the first point, Alta had not been misled or prejudiced in any way;

3) that the failure of KMI to pay Gem under the terms of the construction contract did not release Alta from its obligation to pay the subcontractors;

4) that the subcontractors did not breach any obligation of good faith which it owed to Alta;

5) that Shore had effectively assigned its rights under the labour and material bond to Sigma; and

6) that Alta was therefore liable to pay the claims of Dartmouth, Harris and Sigma.

The issues on appeal are:

1) Did the learned trial judge err when he concluded that the failure of KMI to pay Gem under the terms of the construction contract did not release Alta from its obligation to pay the respondents under the terms of the labour and material payment bond?

2) Did the learned trial judge err in concluding that nothing turned on the fact that there was no obligee named in the bond and that the construction relationship between Keddy and Gem is not the deciding factor in determining the validity of the bond?

3) Did the learned trial judge err when he concluded that clause 13 of the contract between Gem and Shore did not preclude Sigma from claiming against Alta under the terms of the labour and material payment bond?

FIRST ISSUE

The appellant submits that the main purpose of the payment bond is to protect the owner from claims by subcontractors, but that the owner

is not entitled to that protection when the owner itself breaches the terms of the agreement. This point is summarized in the appellant's factum as follows:

> "Alta is simply the surety or guarantor of Gem's obligation to pay the claimants and as such can only be liable to KMI for the same if Gem is similarly liable. The contractual rights and obligations amongst the parties remain the same as that in the usual tripartite relationship among surety (Alta), principal (Gem) and creditor (obligee). The principal, Gem, agreed with the obligee to construct the hotel and to pay for all labour and material used in performing that obligation. The surety guaranteed the performance of the latter obligation and the obligee agreed to pay the principal. Gem did not pay for the labour and material as a direct result of the obligee's failure to pay it and therefore the obligee was the cause of the principal's default. The law is clear that in these circumstances the surety is discharged."

On this point, the trial judge said:

> " What defendant's counsel [Alta] have failed to recognize, however, is that first of all the acts of an obligee carried out in its capacity as trustee for the suppliers must be separated from its acts carried out in a personal capacity. The conduct of KMI in failing to pay was conduct separate and apart from that in its role as trustee for the claimants. Secondly, and more importantly, in order to defeat a claim under a surety bond, the claimant in its relationship with the obligee/trustee must be guilty of some wrongdoing prejudicial to the bonding company. In this case any prejudice to the defendant caused through the conduct of KMI was not in any way contributed to by the conduct of the plaintiffs or any of them. Since there has been no misconduct on the part of the plaintiffs in their relationship with the obligee/trustee the ficticious [sic] relationship through which they claim has not been contaminated and thus they are not disentitled to claim under the bond.
>
> Consequently I would find that the failure of KMI to pay Gem under the terms of the construction contract does not release the defendant from its obligation to pay the claimants under the terms of the labour and materials payment bond."

The relevant portions of the payment bond are:

> " **Labour and Material Payment Bond**
> (Trustee Form)

No: 868-294-1 (Approved by CAA)

Note:
This Bond is issued simultaneously with another Bond in favour of the Obligee conditioned for the full and faithful performance of the Contract.

KNOW ALL MEN BY THESE PRESENTS THAT

Gem Construction Specialist Ltd.

as Principal, hereinafter called the Principal, and *ALTA SURETY COMPANY* a corporation created and existing under the laws of Canada and duly authorized to transact the business of Suretyship in Canada as Surety, hereinafter called the Surety are, subject to the conditions hereinafter contained, held and firmly bound unto

as Trustee, hereinafter called the Obligee, for the use and benefit of the Claimants, their and each of their heirs, executors, administrators, successors and assigns, in the amount of

Six million----------dollars *($6,000,000.00)*

of lawful money of Canada for the payment of which sum well and truly to be made the Principal and the Surety bind themselves, their heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.
WHEREAS, the Principal has entered into a written contract with the Obligee, dated the

1st day of *June* 19*90*, for

Construction Hotel Development, Halifax International Airport

which contract, specifications and Drawings are by reference made a part hereof, and is hereinafter referred to as the Contract.
NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that, if the Principal shall make payment to all Claimants for all labour and material used or reasonably required for use in the performance of the Contract, then this obligation shall be null and void; otherwise it shall remain in full force and effect, subject, however, to the following conditions: . . ."

The condition of the performance bond is stated as:

"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."

In determining this issue it is necessary to decide what Alta has guaranteed by the payment bond. The appellant submits that it has guaranteed to KMI as the obligee, Gem's obligation to pay the subcontractors. It is submitted that the primary intention of the bond is the protection of the owner, which it says is KMI. Alta says that the payment bond is conditional upon KMI performing its obligation under the construction contract to pay Gem.

The appellant cites **Bank of Montreal v. Wilder et al.** (1986), 37 D.L.R. 290 (S.C.C.) and **Royal Bank of Canada v. Goff** (1991), 82 D.L.R. (4th) 745 (O.C.A.) in support of this argument. In the **Wilder** case, the Supreme Court of Canada held that a breach of contract by the creditor which materially and adversely affected the guarantor, discharged the guarantor. In **Goff**, the Ontario Court of Appeal held that when a bank improperly dishonoured a cheque, it breached its contract with the debtor, impairing the security of the guarantor. The guarantor was therefore discharged from its obligations.

In arguing that the **Wilder** and **Goff** cases apply to this fact situation, Alta submits that KMI, as the trustee for the claimants, is the creditor of Gem and since the creditor has breached the contract with the debtor (Gem), the surety is discharged.

The first problem with the appellant's argument is that it is not the obligations of KMI that have been guaranteed. What has been guaranteed is the performance of Gem under its subcontracts. This is clear from the decision of the Supreme Court of Canada in **Town of Truro v. Toronto General Insurance Company** (1973), 6 N.S.R. (2d) 163 where the condition of the payment bond in issue contained the exact wording as the payment bond in this case.

In that case, the Town was the owner of the property and Kenney was the contractor. In reciting the facts, Dickson J. said at p. 165:

> "The Performance Bond was intended to guarantee the performance of Kenney of its obligations under the Prime Contract. The Labour and Material Payment Bond was intended to guarantee the performance by Kenney of its obligations under subcontracts which it might enter into with those supplying labour or materials to the project."

And further, at p. 172, after quoting from the payment bond:

> "The bond is conditioned for the due payment by Kenney of all Claimants for all labour and material used or reasonably required for use in the performance of the Prime Contract. The Town is named as Trustee for all potential Claimants and referred to as the Obligee. **The contracts, performance of which is guaranteed by the Surety, are the subcontracts entered into by Kenney with labourers and materialmen.** A 'Claimant', for the purpose of the bond, is defined as one having a direct contract with Kenney for labour, material or both, used or reasonably required for use in the performance of the Prime Contract. In the present instance Arthur & Conn Ltd. is such a claimant. **The contract, performance of which is guaranteed, is the subcontract between Kenney and Arthur & Conn Ltd. dated August 4, 1969. The Town is not a party to that contract. Nothing done by the Town made any change in or alteration to that contract.** It is submitted on behalf of the Surety, however, that regard must be had also to the Prime Contract, because the Prime Contract is by reference made a part of the bond and the Surety is discharged if there has been any material change in the Prime Contract. For myself, I do not think that can be so. The plain words of the bond do not support the submission. The 'NOTE' at the top of the bond makes evident that 'another bond' is conditioned for the due performance of the Prime Contract. In **Doe et al. v. Canadian Surety Co**., [1937] S.C.R. 1, and in each of the other cases cited to this Court, the acts of the Obligee relate to the contract, performance of which is guaranteed by the Surety. The Court has not been referred to any case, and I can find none, in which a material change in Contract A, to which the Obligee is a party, discharged a guarantee in respect of Contract B, to which the Obligee is not a party." [emphasis added]

The second flaw in the appellant's argument is the submission that KMI is the creditor of Gem and that therefore cases such as **Wilder** (**supra**) and **Goff** (**supra**) apply to this type of suretyship. KMI is not a creditor of Gem. KMI is named as the trustee on behalf of the claimants. 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.

In **Citadel General Insurance Co. v. Johns-Manville**, [1983] 1 S.C.R. 513; 1 C.C.L.I. 55, the Supreme Court of Canada dealt with the issue of notice by the claimants under a payment bond and whether the claimants had to file mechanics' liens before suing the surety. MacIntyre J. said at p. 65:

> " The respondent points out, correctly in my view, that there is no requirement in the bond itself that a claimant must have recourse to other remedies before claiming on the bond. The appellant must therefore rely on the well-established principle that a creditor who holds security for the payment of a debt must protect it and be in a position upon payment of the debt by the surety to assign and deliver such security to the surety: . . ."

On the facts in that case it is clear that the "creditor" referred to by MacIntyre J. was the subcontractor and the security he referred to was the lien claim.

The respondents herein refer to many American authorities to support their position. The appellant submits however that American cases should not be relied upon because the U.S. payment bonds do not establish a trust. A trust is not required because in the United States a third party beneficiary can sue to enforce a contract to which he is not a party. It is clear, however, from a perusal of the American authorities, that in all other respects American construction bonds are very similar to those used in Canada. In the **Johns-Manville** case, **supra**, and in **Helm et al. v. Simcoe and Erie General Insurance Co.** (1979), 108 D.L.R. (3d) 8 (Alta.C.A.), the courts relied on American authorities. I agree that, unless contrary to Canadian jurisprudence, the American authorities are very helpful and should be referred to for guidance when appropriate.

The American position is that a default by the obligee does not affect the suppliers' rights to recovery on the bond. In **American Jurisprudence**, 2nd Edition, Vol. 17, 1990 at p. 768, it states:

> "Since the right of labourers, materialmen and the like are independent of the rights of an obligee on a contractor's bond, their right to recover against a surety on such a bond generally cannot be defeated by any act or omission of the obligee named in the bond, not authorized or participated in by the labourers or materialmen, even though the conduct or default is such as would release the surety from liability to the obligee. The rule applies in general where changes are made in terms of the contract. The surety may be released thereby on its obligation to the obligee, but its liability to materialmen and labourers ordinarily is not affected." [emphasis added]

In this case the claimants did nothing to interfere with the performance of the contract by Gem. I agree with the American position that the default by the obligee does not affect the rights of the claimants.

The third flaw in the appellant's argument on the first issue is that the bond does not contain a condition that relieves Alta of its guarantee if the reason the principal has defaulted is due to the default of the obligee, that is KMI. A condition to that effect is contained in the performance bond:

> " Wherever 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 . . .."

The underlined words have the effect of discharging the surety if the obligee is in default. Those words could have been used in the payment bond but were not. The court will not imply such a condition.

In conclusion, on this issue, I find no error by the trial judge in finding that the failure of KMI to pay Gem did not release Alta from its obligation to pay the claimants under the payment bond.

SECOND ISSUE

The appellant submits that the labour and material payment bond is void because the name of the obligee has not been filled in on the printed form. The appellant further submits that Gem's contract was not with KMI or, if it was originally with KMI, there was a substitution of KI and, therefore, KMI was discharged from liability under the contract.

The learned trial judge found as a fact that the insertion of the name of the obligee in the payment bond was inadvertently left blank by the appellant's agent. The evidence clearly supports that finding. The evidence also clearly established that the intent of the parties was that the obligees on the payment bond would be the same obligees as on the performance bond. The first paragraph of the payment bond is:

> " This Bond is issued simultaneously with another Bond in favour of the Obligee conditioned for the full and faithful performance of the Contract."

The surety cannot rely on the mistake of its own agent or a mere technical defect in the bond to defend the claims of the subcontractors when the intention of the parties is clear.

The learned trial judge also found as a fact that the contract referred to in the bond was between Gem and KMI. There is certainly support for this finding in the evidence as reviewed by the trial judge in the following passage:

> " Although it was the intention of the Keddy people to eventually carry on the airport project under a different corporate entity the evidence adduced does not satisfy me that the construction contract referred to in the bond was not between the parties as stated or intended to be stated therein, namely Gem and KMI. Mr. MacNutt [the principal of Gem] discussed the terms of the contract with Mr. Keddy. There is no evidence that MacNutt was told he was dealing with KI. KI was not in existance [sic] at the time discussions commenced but it was well known that Mr. Keddy was the owner and operator of Keddy Motor Inns and that he was constructing a hotel facility at the airport. The ground lease showed KMI as the lessee of the land upon which construction took place."

Even if there had been a change in the contract by the substitution of KI for KMI, clause 5 in the payment bond would apply:

> " Any material change in the contract between the Principal and the Obligee shall not prejudice the rights or interest of any Claimant under this Bond, who is not instrumental in bringing about or has not caused such change."

I find no error on the part of the trial judge in respect to the second issue and that ground of appeal must, therefore, fail.

THIRD ISSUE

The third issue involves the assignment by Shore to Sigma of its rights under the payment bond. The appellant argues that Sigma did not have "a direct contract with the principal" as required by the bond and, further, that the contract between Shore and Gem prohibited assignment by clause 13 which read:

> "Neither this contract nor the monies due hereunder shall be assignable without the consent of the contractor and any such assignment without such consent shall vest no right in the assignee against the contractor permission to sublet the whole or any part of the subcontract must be consented to in writing by the contractor."

It is agreed that Shore did not have the consent of Gem to the assignment to Sigma.

On this point the learned trial judge said:

> " The non-assignability clause here was not required for the purpose of controlling who did the work because Shore had completed the work prior to the assignment to Sigma. What is perhaps more significant is that the assignment was part of an in-house corporate tax restructuring, rather than a simple conveyance of a debt to a stranger.
>
> Liability for any claims that Gem may have against Shore under the terms of the contract have been assumed by Sigma. Sigma, by a Declaration of Trust, holds all of the assets of Shore to respond to any claims against Shore. The assignment has the effect of making available to Gem, in response to any claims it may have under the contract, all of the assets of Sigma as well as the assets of Shore. Sigma is, effectively, a successor to Shore rather than a bare assignee of its indebtedness."

And further, after referring to **Mahant Singh v. V Ba Yi** (1939), Appeal Cases 601, says:

"Mr. Wood [Sigma's counsel] submits that the situation here is the same, that is, although Sigma may be precluded by the assignment from suing Gem the debt has not been released or discharged. He submits that Alta is obligated, under its contract as surety, to pay Gem's outstanding indebtedness to its suppliers which includes the claim of the plaintiff Sigma.

He correctly points out that Shore has no agreement with Alta not to assign its debt from Gem. Not being a party to the contract containing the non-assignability clause, I would not permit the defendant to use the clause to avoid its responsibilities under the labour and materials payment bond."

The dates relevant to this issue are:

August 31, 1990:	Shore contract with Gem
December 20, 1990:	Work on hotel stopped
January 8 and 17, 1991:	Shore filed claims for lien against Gem and KMI and notified Alta of these claims
January 31, 1991:	Assignment from Shore to Sigma

There is nothing in the payment bond preventing the assignment of rights arising from it. In fact it states it is for the "benefit of the claimants, their and each of their heirs, executors, administrators, successors and assigns . . .." [my emphasis]

I agree with the submission of Sigma that once notice of Shore's claim on the bond was given to Alta, the cause of action against Alta crystallized and was therefore capable of assignment to Sigma. It is irrelevant that the contract with and claim against Gem was also assigned. Alta cannot rely on a clause in a contract to which it was not a party to defeat an otherwise valid claim on the bond.

I agree with the trial judge's conclusions on this point and find no reason to disturb his conclusion.

CONCLUSION

For these reasons I would dismiss the appeal with costs against the appellant to each of the respondents in the amount of 40% of that allowed for the trial.

The respondents submitted that, in addition, they should be allowed to tax as disbursements the costs of security given to Alta pending the appeal. The agreement entered into after the trial was that Alta would pay the amounts ordered, and if the appeal was allowed, the respondents would pay the sums back to Alta. To guarantee this arrangement the respondents purchased some type of performance bond. They now seek the costs of those bonds.

Civil Procedure Rule 63.10A provides:

> "63.10A Unless the court otherwise orders, a party entitled to costs or a proportion of that party's costs is entitled on the same basis to that party's disbursements determined by a taxing officer in accordance with the applicable provisions of the Tariffs."

Tariff "D", which provides for a list of allowable disbursements, includes:

> "(13) All other reasonable expenses necessarily incurred, when allowed by the taxing officer."

The costs of providing post-trial security in accordance with an agreement such as that entered into in this case, are not, in my view, "reasonable expenses necessarily incurred" for the conduct of the proceeding. Therefore, I would not direct the taxing master to allow these claims by the respondents.

J.A.

Concurred in:

Matthews, J.A.

Chipman, J.A.