

CANADA / JUDGMENT

Truro (Town) v. Toronto General Insurance Co.

[1974] SCR 1129

COURT

Supreme Court of Canada

DECIDED

27 August 1973

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Truro (Town) v. Toronto General Insurance Co.

Collection

Supreme Court Judgments

Date

1973-08-27

Report

[1974] SCR 1129

Judges

Martland, Ronald; Ritchie, Roland Almon; Spence, Wishart Flett; Laskin, Bora; Dickson, Robert George Brian

On appeal from

Nova Scotia

Subjects

Guarantee and suretyship

Decision Content

Supreme Court of Canada

Truro (Town) v. Toronto General Insurance Co., [1974] S.C.R. 1129

Date: 1973-08-27

Town of Truro (Plaintiff) Appellant;

and

Toronto General Insurance Company (Defendant) Respondent.

1973: May 2; 1973: August 27.

Present: Martland, Ritchie, Spence, Laskin and Dickson JJ.

ON APPEAL FROM THE SUPREME COURT OF NOVA SCOTIA, APPEAL DIVISION

Principal and surety—Building contract—Labour and material payment bond—Surety refusing to pay claim for work done by subcontractor—Alleged material change in prime contract without surety's consent—Submission rejected—Surety liable.

On July 21, 1969, the plaintiff town entered into an agreement (the prime contract) with K for the construction of an educational studies centre. Under the terms of this contract K provided, and the defendant insurance company (the surety) issued, a performance bond and a labour and material payment bond. The performance bond was intended to guarantee the performance by K of its obligations under the prime contract. The labour and material payment bond was intended to guarantee the performance by K of its obligations under subcontracts which it might enter into with those supplying labour or materials to the project. The town was named as trustee for all potential claimants. On August 4, 1969, K entered into a subcontract with A for the electrical section of the work.

By October 1970 work on the centre was substantially completed but by then K was in serious financial difficulty and on October 28, 1970, abandoned the work. A claim was made against the surety under the labour and material payment bond for work done by A. The surety refused to pay the claim. It averred that the town had assigned, transferred and conveyed "or in some other manner passed over" all of its rights in the prime contract to a new organization known as the "Colchester-East Hants Amalgamated School Board" in the early months of 1970 without notice to or consent of the surety; this was a fundamental change in the contract of surety and in the bond and the surety therefore ceased to be a surety.

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The trial judge found for the plaintiff. The appeal Court unanimously allowed the appeal and dismissed the action against the surety. The town then appealed to this Court.

Held: The appeal should be allowed.

The Court below erred in finding that the town had assigned its obligations under the prime contract to the school board. That contract permitted assignment by either party, but only with the written consent of the other and K refused consent except on terms unacceptable to the town. The agreements which the town entered into with three other municipal bodies did not, nor did they purport to, effect such an assignment. The town could not unilaterally alter undertakings which it had given to K. The town, by agreement with others, could not divest itself of its obligation to K to pay the contract price upon completion of the work.

The submission that regard must be had also to the prime contract because the prime contract was by reference made a part of the bond and the surety was discharged if there had been any material change in the prime contract was not supported by the plain words of the bond. But even if the construction for which the surety contended was the proper construction to be placed upon the bond and a material change in the prime contract would discharge the surety, the surety was none the less liable. The only obligation of the town under the prime contract was to pay the contractor the contract price and nothing done by the town affected that obligation. The assumption by the school board of control of the work in no way modified the obligation of the town to pay the contract price. The obligation assumed by the surety was to see to it that K paid all subcontractors, including A, the money to which they were entitled for work on the centre.

Moschi v. Lep Air Services Ltd., [1972] 2 W.L.R. 1175, referred to.

APPEAL from a judgment of the Supreme Court of Nova Scotia, Appeal Division[1], allowing an appeal from a judgment of Cowan

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C.J.T.D. Appeal allowed.

A.L. Caldwell, Q.C., T.P. Soderro and L.A. Kitz, Q.C., for the plaintiff, appellant.

G.B. Robertson, Q.C., for the defendant, respondent.

The judgment of the Court was delivered by

DICKSON J.—The Town of Truro entered into an agreement (the prime contract) with Kenney Construction Company Limited (Kenney) on July 21, 1969, for the construction of a school project to be known as the “Educational Studies Centre, Truro, N.S.” The contract price was \$2,690,000. Under the terms of the prime contract Kenney provided, and Toronto General Insurance Company (the surety) issued, a performance bond and a labour and material payment bond each in the amount of \$1,345,000. The performance bond was intended to guarantee the performance by 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. On August 4, 1969, Kenney entered into a subcontract with Arthur & Conn Ltd. for the electrical section of the work, at a price of \$319,086.

Work on the educational centre commenced. By October 1970 the work was substantially completed but by then Kenney was in serious financial difficulty and on October 28, 1970, abandoned the work. A claim was made against the surety under the labour and material payment bond for work done by Arthur & Conn. The surety refused to pay the claim. The statement of defence averred that the town had assigned, transferred and conveyed “or in some other manner passed over” all of its rights in the prime contract to a new organization known as the “Colchester-East Hants Amalgamated School Board” in the early months of 1970 without notice to or consent of the surety; this

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was a fundamental change in the contract of surety and in the bond and the surety therefore ceased to be a surety.

For some years before 1970 the Town of Truro was a “separate school section” under the Towns Act of Nova Scotia, R.S.N.S. 1967, c. 309. Control and management of the public schools of the town were vested in a Board of School Commissioners, a separate corporate entity, but title to school lands, buildings and other property was vested in the town.

In 1968 the Education Act of Nova Scotia, R.S.N.S. 1967, c. 81, was amended by the addition of a new s. 54A which made provision for the amalgamation of school boards where it appeared that educational services could be more efficiently and economically provided through amalgamation. Subsections (2) to (5) of s. 54A read as follows:

- (2) Where it appears to the Governor in Council that educational services could be more efficiently and economically provided throughout a geographic area of the Province if all the school boards in the area were... amalgamated into one amalgamated school board, the Governor in Council may designate the area as an Amalgamation Area.
- (3) Where an area is designated as an Amalgamation Area, the councils of the municipal units located or partly located in the Area may enter into a joint agreement providing for all matters related to the amalgamation of the school boards or incidental or consequent upon the amalgamation other than the transfer of property or the rights, obligations and duties of the school boards.
- (4) When the joint agreement has been duly executed by the councils of the municipal units in the Amalgamation Area, it shall be filed with the Clerk of the Executive Council.
- (5) Upon the filing of the joint agreement, the Governor in Council may, by order, declare that on a day named in the order all the property, rights, obligations and duties of all school boards in the Amalgamation Area are vested in relation to the Area in the

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amalgamated school board, the name of which shall be determined by the Governor in Council.

In 1969 a new subs. 12A was added to s. 54A reading:

(12A) The council of each municipal unit in the Amalgamation Area and the Minister may make and enter one or more agreements either before or after an order is made under subsection (5) respecting matters related to the amalgamation or incidental to or consequent upon the amalgamation, including the vesting of property in the amalgamated school board or the rights, obligations and duties of the amalgamated school board or, subject to the Education Assistance Act, the financing of the amalgamated school board and, when approved by the Governor in Council, such an agreement shall have the force of law.

Pursuant to this legislation, the Governor in Council of Nova Scotia by Order in Council dated March 18, 1970, designated the Town of Truro, the Town of Stewiacke, the Municipality of the County of Colchester and the Municipality of the District of East Hants as an Amalgamation Area. On March 23, 1970, these four municipal bodies executed an agreement amalgamating a number of school boards, including the “Board of School Commissioners, Town of Truro” into one amalgamated school board for the Amalgamation Area. Section 4(a) of the agreement reads:

- (4) CONTRACTS. (a) All contracts and agreements whereby rights or duties or benefits and obligations are imposed or conferred and to which a school board is a party shall be assumed by the Amalgamated School Board on the amalgamation date and the rights and benefits shall devolve to and the duties and obligations shall be performed by the Amalgamated School Board.

On March 28, 1970, the four bodies and the Minister of Education for the Province of Nova Scotia entered into a property and finance agreement, the relevant sections of which read:

1 (e) “Amalgamation Date” means the day referred to in the Order of the Lieutenant Governor in Council made under subsection (5) of Section 54A

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of the Education Act as amended, in relation to the Amalgamation Area.

1 (j) “school property” includes land and interest in land, buildings, school furnishings, equipment and other personal property that is or may be used in relation to a school system;

2 School Property. All school property owned or held by Truro, Stewiacke, Colchester County and the District of East Hants shall be vested pursuant to section 54A of the Education Act in the Amalgamated School Board on the amalgamation date subject to any lien, mortgage or charge in respect of unmatured debt that exists on the amalgamation date.

On April 3, 1970, the Governor in Council ordered that:

...on the 1st day of January A.D. 1970, all the property, rights, obligations and duties for all school boards in the Amalgamation Area as designated by Order in Council dated the 18th day of March A.D. 1970, are vested in relation to the Area in the Amalgamated School Board, named the Colchester-East Hants Amalgamated School Board.

It was patently one of the objects of the legislation and agreements that property used for school purposes within the Town of Truro should vest in the amalgamated school board but in my opinion the agreements and legislation did not effect that object. Subsection (5) of s. 54A of the Education Act provides for a vesting of the “property, rights, obligations and duties of all school boards” but does not include property owned by a town although used for school purposes. The amalgamation agreement provides for the amalgamated school board assuming all contracts and agreements “to which a school board is a party” but does not extend to contracts to which the school board is not a party, such as the prime contract between the Town of Truro and Kenney. Section 2 of the Property and Finance Agreement reflects agreement to vest school property

owned or held by Truro, “pursuant to s. 54A of the Education Act,” in the amalgamated school board on the amalgamation date, but s. 54A is limited to vesting the property, rights, obligations and duties of “school boards” and the vesting Order

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in Council of April 3, 1970, suffers from the same limitation.

The agreements and supporting legislation did not vest in the amalgamated school board, school property within the Town of Truro; more particularly they did not vest either the educational centre property or the prime contract affecting that property.

The town would appear to have been unsure of its legal position for on October 29, 1970, after the difficulties that gave rise to the present action became apparent, it executed a confirmatory deed in favour of the amalgamated school board. The deed was not delivered, however, until August 1971, well after the commencement of this action.

Although the legislation and agreements may not have effected a change of ownership in law, the officials of the Town of Truro treated the legislation and agreements as if they had effected such a change. The Town Clerk of Truro notified all insurance companies of the interest of the amalgamated school board and coverage was arranged in the names of the Town of Truro and the amalgamated school board as their respective interests might appear. No notice was given to the surety with respect to the bond. On April 15, 1970, the town assigned to the amalgamated school board its interest in a contract with Leslie R. Fairn & Associates covering architectural services for the educational centre, and Leslie R. Fairn & Associates consented to the assignment. An assignment from the Town of Truro to the amalgamated school board of the prime contract was forwarded to Kenney with a form of consent attached. In a letter dated May 22, 1970, Kenney expressed willingness to execute the assignment if the town gave assurance that the amalgamated school board had made all the necessary arrangements to pay progress estimates promptly as processed. The Town Council did not feel it could properly give any such assurance and did not reply to the letter.

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On April 13, 1970, the town advised the amalgamated school board by letter that the town had under construction a new school for which bank borrowing had been approved in the amount of \$1,700,000, that over \$1,400,000 had been spent and within a short period additional financing would be required. The board was requested to make arrangements immediately for such additional financing. On April 14, 1970, the town made a progress payment of \$145,197 to Kenney and, because the board was not yet in a position to do so, a further progress payment of \$149,744.50 on May 15, 1970. This latter payment prompted a letter from the town to the board, the final paragraph of which reads:

Town Council also requested you be advised that the Town borrowing authority will not enable any further advances of this nature. Arrangements for payment of the May accounts must come from other sources, as the Town borrowing power is now exhausted.

Thereafter the board made a progress payment during each of the five months preceding Kenney's abandonment of the work. By that time the town had paid \$1,348,695 toward the project, for which it was later reimbursed by the board, and the board had paid \$900,830. In late October 1970 the surety learned of the financial difficulties of Kenney and, for the first time, became aware that the board had assumed responsibility for the educational centre some months previously. The surety declined liability on the bond.

Cowan C.J.T.D. found for the plaintiff. He awarded \$96,615.22 and costs. The Supreme Court of Nova Scotia, Appeal Division, unanimously allowed the appeal and dismissed the action against the surety with costs.

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There are three grounds of appeal to this Court. It is submitted that the Supreme Court of Nova Scotia, Appeal Division, was in error in (i) finding that there was an assignment by the Town of Truro to the amalgamated school board of the prime contract between the town and Kenney; (ii) holding that the events that occurred between March 1970 and October 1970 constituted variations of that contract; (iii) holding that in the circumstances of this case, no distinction can be drawn between the position of a compensated surety and that of a non-compensated surety.

The following abstract from the judgment of McKinnon C.J.N.S. for the Court reflects the position taken by the Appeal Division on the issues raised in the first two grounds of appeal:

While it is true that the change in the contract did not alter Kenney's obligations to pay the subcontractors for labour and materials, which payments the bond guaranteed, the obligations and the bond were based on the contractual undertaking that the Town of Truro would make the payments and the Town would be obligee. The Town of Truro unilaterally altered these undertakings. It assigned its obligations under the contract to the Amalgamated School Board. The Amalgamated School Board became the "owner" and, according to the transfer from the Town, was to pay for the work. The Town by its letter to the Board, dated May 13, 1970, treated the contract as varied. The Town also executed a confirmation deed to the Board. It also informed the School Board that it would not pay any further progress estimates (May 13, 1970). The Town further informed fire insurance companies of the change of interest from the Town to the School Board and advised them to amend their fire insurance policies accordingly. The School Board assumed responsibility under these changes and variations and made payment to Kenney Construction Company, which payments were accepted by that company. This was all done without the consent or knowledge of the appellant insurance company.

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It seems to be quite apparent that the above instances constitute variations of the main building contract which was by reference made a part of the Labour and Material Payment Bond itself.

With great respect, I am unable to agree with the learned Chief Justice that the Town of Truro assigned its obligations under the prime contract to the amalgamated school board. That contract permitted assignment by either party, but only with the written consent of the other and Kenney refused consent except on terms unacceptable to the town. The assignment form remained unexecuted. The agreements which the town entered into with the other three municipal bodies did not, nor did they purport to, effect such an assignment. The town could not unilaterally alter undertakings which it had given to Kenney. The town, by agreement with others, could not divest itself of its obligation to Kenney to pay the contract price upon completion of the work. The rule is well stated in Williston on Contracts, 1960 ed., vol. 3, s. 411:

The duties under a contract are not assignable inter vivos in a true sense under any circumstance; that is, one who owes money or is bound to any performance whatever, cannot by any act of his own, or by any act in agreement with any other person, except his creditor, divest himself of the duty and substitute the duty of another.

I am of the opinion that the first ground of appeal is well founded. I am also of the opinion that the second ground of appeal is equally well founded. Ordinarily a surety is no longer bound if there has been a change or alteration in a contract, performance of which has been guaranteed by him, unless it is plain that he has consented or that the change is inconsequential or beneficial to him. What is the contract, performance of which has been guaranteed by the surety in the present case? The pertinent part of the bond is:

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\$1,345,000.00

BOND No. 2X3014

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 KENNEY CONSTRUCTION COMPANY LIMITED

hereinafter called the Principal, and the Surety designated above, are, subject to the conditions hereinafter contained, held and firmly bound unto

TOWN OF TRURO

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 ONE MILLION, THREE HUNDRED FORTY-FIVE THOUSAND 00/100 Dollars (\$1,345,000.00) 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.

SIGNED AND SEALED this 21ST. day of JULY 1969.

WHEREAS the Principal has entered into a written contract with the Obligee dated the 21ST. day of JULY 1969, for

CONSTRUCTION OF EDUCATION STUDY CENTER,

TRURO, NOVA SCOTIA

which contract is by reference made a part hereof, and is hereinafter referred to as the Contract.

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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:

(There follow five conditions which need not be here repeated.)

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 purposes 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

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contract. In *Doe et al. v. Canadian Surety Co.*[2], 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.

I would take the matter one step further and say that even if the construction for which the surety contends is the proper construction to be placed upon the bond and a material change in the prime contract would discharge the surety, the surety must none the less remain liable. Counsel submits there has been a material change or alteration in the prime contract. To determine the validity of this submission, one must examine the contract. It is the Canadian Standard Form of Agreement between owner and contractor. It is brief and simple. The contractor, Kenney, undertakes to provide all the materials and perform all the work shown on the drawings and described in the specifications and complete substantially all the work by the date stated. The owner, the Town of Truro, agrees to pay the contractor the contract price. That is the entire obligation of the town under the prime contract. Nothing done by the Town of Truro affected that obligation. Whether or not the amalgamated school board obtained *de jure* as well as *de facto* title in early 1970 is a question extraneous to the prime contract. That contract does not contain a covenant on the part of the town not to convey. Indeed the land of the educational centre is not even described in the contract. The only obligation of Truro is to pay, and conveyance of land has no impact on that covenant. The assumption by the amalgamated school board of control of the work in no way modified the obligation of the town to pay the contract price. It was no concern of

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Kenney whether the money came from the Town of Truro or from the amalgamated school board. A surety would, of course, be concerned, as the evidence of Mr. Arthur B. Johnson, branch manager of the surety shows, if there is a change of obligee under a labour and material payment bond and the new obligee does not have the financial resources to pay the subcontractor. But that is not what occurred here. The town remained liable. The actions taken in no way impoverished the town or rendered it less able to meet its financial commitments; the whole purpose of school amalgamation legislation was to enable educational services to be more economically provided.

When the surety, for a premium, issued the labour and material payment bond, it assumed an obligation. That obligation is characterized in *Moschi v. Lep Air Services Ltd.*[3], by Lord Diplock, p. 1183:

It follows from the legal nature of the obligation of the guarantor to which a contract of guarantee gives rise that it is... an obligation to see to it that another person... does something...

and by Lord Simon of Glaisdale, p. 1191: “...to ensure performance of the principal promisor’s obligation”. The obligation assumed by the surety was to see to it that Kenney paid all subcontractors, including Arthur & Conn Ltd., the money to which they were entitled for work on the educational centre. The means by which the surety professed to discharge that obligation were described by Mr. Johnson:

...at three month intervals from the date of the contract we have a progress payment form that we send to the architect and it asks four or five simple questions such as “what percentage of the contract has been completed?” and “the dollar amount of money paid to the contractor?” and things like that.

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An architect is not an accountant and he is not bound to furnish a surety company with financial data. It is the duty of a surety under a labour and material payment bond, by proper and adequate means, to keep itself reasonably informed of the current state of accounts between the contractor, whose performance is guaranteed, and subcontractors. The duty is not discharged by quarterly inquiry of an architect. If the duty is properly carried out, one could expect the surety to know of the financial predicament of the contractor whom it has bonded before, not after, the abandonment of the construction contract.

I am of the opinion this appeal must succeed and I find it unnecessary to deal with the third point of appeal. I would accordingly allow the appeal, set aside the judgment of the Supreme Court of Nova Scotia, Appeal Division, and restore the judgment of the trial judge with costs here and in the Appeal Division; the amount of the judgment to be as stated by the trial judge, less any amount Arthur & Conn Ltd. may have received on account of its claim since trial.

Appeal allowed with costs.

Solicitor for the plaintiff, appellant: A.L. Caldwell, Halifax.

Solicitor for the defendant, respondent: G.B. Robertson, Halifax.

[1] (1972), 4 N.S.R. (2d) 459, 30 D.L.R. (3d) 242.

[2] [1937] S.C.R. 1.

[3] [1972] 2 W.L.R. 1175.

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