

Toronto
1969
Apr. 10-11

THE EMPLOYERS LIABILITY ASSUR-
ANCE CORPORATION LIMITED }

APPELLANT;

AND

Ottawa
Apr. 28

HER MAJESTY THE QUEEN RESPONDENT.

Crown—Contract for construction of houses—Surety bond for payment of labour and material—Default by principal debtor—Crown not entitled to retain moneys appropriated to contract for excise tax owed by principal debtor—Rights of surety—Whether interest payable—Excise Court Act, secs. 47, 48—Excise Tax Act, R.S.C. 1952, c. 100, s. 50(8a).

In March 1965 the Crown entered into a contract with Dalite Corp. for the construction of 220 houses at a price of \$594,459. As required by the contract Dalite Corp. furnished bonds (1) for the performance of the contract and (2) for payment of the labour and materials supplied. Supplant was surety of both bonds. In June Dalite Corp., which had received \$356,250 on the contract, became bankrupt and abandoned the contract. Supplant, which as surety of the bond was then required by the Crown to complete the contract, paid \$282,354 for labour and materials and the Crown paid to others a further \$87,613 to complete construction of the houses. There remained \$150,595 of the moneys appropriated for the contract. Of that sum the Crown retained \$15,740 under s. 50(8a) of the *Excise Tax Act*, R.S.C. 1952, c. 100 for excise tax due by Dalite Corp. to the Crown in an unrelated matter and paid the balance of \$134,855 to supplant. Supplant by this petition of right claimed payment of the \$15,740 plus interest thereon at 5 per cent per annum.

Held, suppliant was entitled to the \$15,740 plus interest thereon from the commencement of the action.

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- 1. The moneys appropriated for the Dalite contract stand on the same footing as securities in the hands of a creditor received from a principal debtor to which a surety is entitled in equity after making good a guarantee to such creditor. *In re Sherry* (1884) 25 Ch.D. 692 per Selborne, L.C. at p 702; *Halsbury* 3rd Ed. Vol. 18, p. 469, referred to.
- 2. Sections 47 and 48 of the *Exchequer Court Act* are not a bar to suppliant's demand for interest since its principal claim is based not on contract as contemplated by those sections but on equitable principles of the law of surety, creditor and principal debtor. *Dimensional Investments Ltd. v. The Queen* [1966] Ex. C.R. 761; [1968] S C R. 93, distinguished.
- 3. Section 50(8a) of the *Excise Tax Act* is not applicable in the circumstances since at no time was any amount payable by the Crown to Dalite Corp.

PETITION of right.

C. A. Keith for suppliant.

George W. Ainslie, Q.C. and R. W. Law for respondent.

GIBSON J.:—By its petition of right the suppliant claims from the respondent the sum of \$15,740.10 together with interest at 5 per cent per annum. The suppliant is the surety of two bonds supplied in respect to a contract between the respondent and a corporation by the name of Dalite Corporation (Canada) Limited.

The circumstances giving rise to this claim were as follows:

On March 23, 1965, the respondent Her Majesty acting by the Minister of Northern Affairs and National Resources and the said Dalite Corporation (Canada) Limited (hereinafter referred to as "Dalite") entered into a contract (hereinafter referred to as "the Dalite contract") under which Dalite undertook to construct and supply to the respondent:

- (a) 30 Low Cost Houses—Angirraq Standard Plan Number 424—F.O.B. Hay River;
- (b) 170 Low Cost Houses—Angirraq Standard Plan Number 424—F.O.B. Montreal;
- (c) 20 Low Cost Houses—3 Bedroom Standard Plan Number 396—F.O.B. Montreal;

for a total contract price of \$590,800 subsequently increased by authorized change orders to \$594,459.

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In relation to the Dalite contract, Dalite furnished two bonds issued by the suppliant and numbered 221827 (a performance of contract bond) and 221828 (a labour and material bond) respectively.

By June 28, 1965, the respondent had paid to Dalite \$356,250 for work done and material supplied, all according to the terms of the Dalite contract.

On June 28, 1965, a petition in bankruptcy was filed by or on behalf of Commodore Sales Acceptance Limited against Dalite, and the respondent, as entitled under the terms of the contract, took the Dalite contract out of the hands of Dalite. (Subsequently, the respondent in writing to the trustee in bankruptcy confirmed that it had already done so.)

By that time also, Dalite had abandoned this contract.

On July 6, 1965, by letter, the respondent called on the suppliant surety to perform the Dalite contract pursuant to the terms of the two bonds.

Subsequent thereto, certain persons who pursuant to contracts with Dalite had supplied labour or material for the work to be performed under the Dalite contract made claims for the payment of their unpaid accounts in respect thereof and pursuant to the said demand to perform on the bonds the suppliant paid accounts of labour and materialmen in the sum of \$282,354.93. All of these accounts had been incurred prior to the bankruptcy of Dalite and were paid by the suppliant with the approval of the respondent who demanded and received sworn evidence of such payment. These accounts comprised all the accounts which the suppliant had obligated itself to pay under Bond 221828 (the labour and material bond).

As of August 31, 1965, the said 200 Angirraq houses had been fabricated except for minor deficiencies and were en route to their ultimate destinations. The respondent paid the sum of \$1,940 to have the minor deficiencies rectified with the approval of the suppliant.

Then the suppliant negotiated with a corporation by the name of Welsh Lumber Co. Limited (hereinafter referred to as Welsh) for the completion of the work to be performed under the Dalite contract and consequent upon those negotiations on or about January 26, 1966, the

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respondent and Welsh entered into a contract under which Welsh undertook to construct 20 low cost houses being the work required to complete the Dalite contract for a total price of \$85,673.45. The said low cost houses were constructed and delivered by Welsh to the respondent and the respondent paid the said amount of \$85,673.45 to Welsh.

It so happened that Dalite was indebted to the respondent in the amount of \$15,740.10 under the provisions of the *Excise Tax Act*. This indebtedness was wholly unrelated to the contracts which were the subject of the suppliant's bonds. On or about July 26, 1965, August 25, 1965, and January 6, 1966, the Minister of National Revenue by letter pursuant to section 50 (8a)¹ of the *Excise Tax Act* required the respondent to retain by way of deduction or set-off the amounts of \$2,158.24, \$15,000 and \$15,740.10 respectively out of any amount that may be or become payable to Dalite.

The respondent paid to the suppliant the sum of \$134,855.45 as partial reimbursement of the suppliant in respect of the payments made by the suppliant referred to above.

A summary of the monies appropriated to Dalite contract and disbursed or held by or on behalf of the respondent is as follows:

(a) to Dalite	\$356,250.00
(b) to pay for minor deficiencies	1,940.00
(c) to Welsh	85,673.45
(d) held under section 50 (8a) of the <i>Excise Tax Act</i>	15,740.10
(e) to the suppliant	134,855.45

Contract price	\$594,459.00

It is common ground between the parties pursuant to and by reason of the terms of the Dalite contract, that as of July 1965, when the Dalite contract was taken out of

¹ Where a person is indebted to Her Majesty under this Act the Minister may require the retention by way of deduction or set-off of such amount as the Minister may specify out of any amount that may be or become payable to such person by Her Majesty.

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Dalite's hands that nothing was owing by the respondent to Dalite and that the respondent then had title to all the work, material, work in process of the Dalite contract.

It is also common ground between the parties that these two bonds were contracts of suretyship and not contracts of insurance. Surety bond number 221827 in the amount of \$296,600 is a co-called performance bond. Surety bond number 221828 in the like sum of \$296,600 is a so-called labour and material payment bond. The principal debtor in each of these bonds is the contractor Dalite Corporation (Canada) Limited. The suppliant is the surety and the obligee and creditor is the respondent (in right of Canada represented by the Minister of Northern Affairs and Natural Resources). In the second or labour and material payment bond, the surety is bound in the said sum to the respondent as obligee and creditor "for the use and benefit of claimants as hereinbelow defined". The definition of "claimant" referred to is:

...one having a direct contract with the Principal for labour, material, or both, used or reasonably required for use in the performance of the contract, labour and material being construed to include that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental of equipment (but excluding rental of equipment where the rent pursuant to an agreement is to be applied towards the purchase price thereof) directly applicable to the Contract;

These bonds were furnished by the surety and accepted by the respondent as obligee and creditor of the said Dalite contract pursuant to Article IV of the contract between the respondent and the principal debtor and contractor Dalite. The specific language employed was:

The Contractor has furnished and Her Majesty accepts a Performance Bond, i.e.,
 Employees Liability Assurance Corp. Ltd.
 \$296,600.00—April 15th 1965.

(Insert details—name of Company, amount, date, etc.)
 and a Labour and Material Payment Bond, i.e.,
 Employees Liability Assurance Corp. Ltd.
 \$296,600.00—April 15th 1965.

(Insert details—name of Company, amount, date, etc.)

With respect to the delivery of the materials and execution of the work by the Contractor, which bond or bonds shall operate according to their tenor. The Contractor shall post on the site of the work a notice that a Labour and Material Payment Bond is in force together with the name and address of the surety thereunder, definition of those persons protected hereunder and an outline of the procedure for submitting a claim thereunder.

The language employed by the respondent when formally by letter dated July 6, 1965, calling on and requiring the suppliant surety to complete the contract pursuant to its obligation under the bonds was:

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...In view of the fact that the above contract is not yet completed, would you ensure that the necessary action is taken to provide for the delivery of the 220 prefabricated houses. The bulk of these houses have been delivered to Montreal. However, there are a number in the process of being prefabricated and a number that the materials have been ordered for but no actual construction has commenced on.

We would appreciate being advised as to your plans for the performance of the balance of the work under the contract.

At that time out of the Dalite contract price of \$594,459 appropriated, the respondent had not paid out \$238,209.

The suppliant surety and the respondent in carrying out and completing this contract and fulfilling the terms of the bonds according to their tenor, (including the labour and material bond) expended \$369,968.38. Of this amount, the respondent, as stated, expended \$1,940 for minor deficiencies, \$85,673.45 for the Welsh contract for a total of \$86,613.45; and the surety paid \$282,354.93 which as also stated, constituted payments to certain persons who, pursuant to contracts with Dalite and the respondent had supplied labour and material for the work to be performed under the Dalite contract. As a result, the overall deficiency in this Dalite contract was \$131,759.38.

Subtracting the said sum of \$86,613.45 from the balance of the moneys appropriated for the Dalite contract and then on hand when the Dalite contract was taken out of Dalite's hands namely, \$238,209, leaves the sum of \$150,595.55. Of this sum the respondent paid the surety only \$134,855.45. The balance of \$15,740.10 allegedly was held or was paid by the Department of Northern Affairs to the Department of National Revenue, both of the respondent, purportedly under the authority of section 50 (8a) (*supra*) of the *Excise Tax Act*.

Counsel for the suppliant submitted that (1) in all of the circumstances the provisions of said section 50 (8a) of the *Excise Tax Act* could not be applied in order to require any payment to the Department of National Revenue out of the funds appropriated for the Dalite contract and remaining for the completion of this contract, and that therefore, if there was a payment, it was an unauthorized

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and an unlawful one under the said statute; and alternatively, (2) it is a matter of general law relating to principal debtor, creditor and surety that when a surety is called upon to honour its obligation under a contract by a creditor, all funds appropriated to such contract must be held solely for the purpose of such contract and for the surety in priority to all other unrelated claims; and (3) that in all the circumstances, the surety is entitled to receive interest on the amount held illegally in this case, as a matter of general law and not as a right under any contract.

Counsel for the respondent submitted that (1) when the work was taken out of the hands of Dalite, the bonds became absolute and there became payable as liquidated damages the sums of \$296,000 and \$13,645.07 (sections 47 and 48² of the *Exchequer Court Act*; *Dimensional Investments Ltd. v. The Queen*³); (2) the contractual right between the suppliant and Dalite was that of guarantee and not of insurance (*vide: Trade Indemnity v. Worthington Harbour*⁴; *Whalen v. Union Indemnity*⁵); (3) the suppliant, upon paying the claimants, became entitled to (a) be subrogated to all the rights possessed by the claimants in respect of the debt default or miscarriage to which the guarantee exists; and (b) seek indemnification from Dalite, but is not entitled to be subrogated to any rights which the principal debtor had against the respondent, a third party (*vide: Halsbury's Laws of England*⁶; *Household Finance v. Foster*⁷; *Anson v. Anson*⁸; *In Re a*

² 47. In adjudicating upon any claim arising out of any contract in writing the Court shall decide in accordance with the stipulations in such contract, and shall not allow

(a) compensation to any claimant on the ground that he expended a larger sum of money in the performance of his contract than the amount stipulated for them, or

(b) interest on any sum of money that the court considers to be due to the claimant, in the absence of any contract in writing stipulating for payment of such interest or of a statute providing in such a case for the payment of interest by the Crown.

48. No clause in any such contract in which a drawback or penalty is stipulated for on account of the non-performance of any condition thereof, or on account of any neglect to complete any public work or to fulfil any covenant in the contract, shall be considered as comminatory, but it shall be construed as importing an assessment by mutual consent of the damages caused by such non-performance or neglect.

³ [1966] Ex. C.R. 761; aff'd [1968] S.C.R. 93.

⁴ [1937] A.C. 1.

⁵ (1931) 41 O.W.N. 208.

⁶ 3rd Ed., Vol. 18 p. 468, para. 863 and vol. 14, p. 618, para. 1143.

⁷ [1949] O.R. 123, 131.

⁸ [1953] 1 W.L.R. 573, 576-79.

*Debtor*⁹ *Brooks Wharf & Bull Wharf Ltd. v. Goodman Brothers*¹⁰; *Snell's Principles of Equity*¹¹); (4) the claimants never had any claim against the respondent—There was no privity of contract, thus the suppliant who stands in the shoes of the claimants, can stand in no better position than the claimants and has no right to recover from the respondent (*vide: Hudson's Building Contracts*¹²; *The Millwall*¹³; *Pearson v. The King*¹⁴; *Hampton v. Glamorgan County Council*¹⁵; *Standing v. London Gas Co.*¹⁶); (5) the right of indemnification which the suppliant has against Dalite does not give it any rights under the contract between the respondent and Dalite. There is no privity of contract which would allow the suppliant to sue under the contract (*Tweddle v. Atkinson*¹⁷; *Dunlop Pneumatic Tyre Co. v. Selfridge*¹⁸; *Scruttons Ltd. v. Midland Silicones Ltd.*¹⁹; *Vandepitte v. Preferred Accident Insurance*²⁰); (6) furthermore, on the work being taken out of the hands of Dalite, all its rights to claim any amounts from the respondent ceased. The contract was

...a contract to do the whole work stipulated for in consideration of a fixed sum, a portion of which under its terms was not to be paid until a period subsequent to not only the performance but to the acceptance of the work to be done under it. Manifestly performance is a condition precedent to the right of the plaintiff to enforce payment of the balance of the contract price (per Lester, J.A. in *Sherlock v. Powell*²¹);

see also: *Sumpter v. Hedges*²²; *Munro v. Butt*²³; *Elliott v. Hewitt*²⁴; *Cheshire, Law of Contracts*²⁵; *Burton v. Hookwith*²⁶) and (7) it is well established that a defaulting contractor is not entitled to the benefit of the saving on his contract price where the works have been completed by others at a lower figure to the employer (*vide: Dussault v. The King*²⁷).

In coming to a conclusion in this matter, it is not in dispute between counsel for the parties that, at any relevant

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⁹ [1937] 1 All E.R. 1.

¹¹ 25th Ed. pp. 452-54.

¹³ (1905) P. 155, 163.

¹⁵ [1917] A.C. 13.

¹⁷ 121 E.R. 762.

¹⁹ [1962] 1 All E.R. 1.

²⁰ [1932] S.C.R. 22; aff'd. [1933] A.C. 70.

²¹ (1900) 26 O.A.R. 407.

²³ (1858) 8 E. & B 738.

²⁵ 6th Ed. 458.

²⁷ (1917) 16 Ex. C.R. 228; aff'd. (1917) 58 S.C.R. 1.

¹⁰ [1937] 1 K.B. 534.

¹² 9th Ed. p. 579.

¹⁴ (1916) 16 Ex. C.R. 225.

¹⁶ (1861) 21 U.C. Q.B. 209.

¹⁸ [1915] A.C. 847.

²² [1898] 1 Q.B. 673

²⁴ (1854) 11 U.C. Q.B. 292.

²⁶ (1919) 45 O.L.R. 348.

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time, pursuant to section 50 (8a) of the *Excise Tax Act*, there was no "amount that may be or become payable to such person ("Dalite") by Her Majesty". As a result, the right of the respondent to deny payment to the suppliant of the said sum of \$15,740.10 in issue in this action, cannot be founded on the respondent's pleading that "The Minister of National Revenue pursuant to section 50 (8a) of the *Excise Tax Act* required Her Majesty to retain by way of deduction or set-off the total amounts of \$2,158.24, \$15,000.00, and \$15,740.10 respectively out of any amount that may be or become payable to Dalite".

Instead, the conclusion must be reached by determining what the suppliant surety undertook in this case, and what its rights are in the circumstances.

The two bonds which were required by the respondent of the contractor "Dalite" to be given and which were given, one for the performance of the contract and the other for the benefit of labour and materialmen, are two distinct and separate legal obligations; but neither bond changed the common law status of the respondent (creditor under the bonds) as it related to the contractor's (principal debtor under the bonds) employees or materialmen. The respondent had no duty to see that such labour and materialmen were paid.

The real purpose of the respondent in requiring the labour and material bond was the policy of the respondent in seeing fit to protect labour and materialmen engaged by the contractor "Dalite" in the performance of this public contract of the respondent for the doing of a public work. This policy as implemented by the requirement and delivery of this latter bond gave such labour and materialmen a guarantee for payment additional to that of the contractor "Dalite".

But neither bond was in fact necessary for the actual accomplishment of this particular undertaking; and as stated, the requirement of the second bond, or of splitting the guarantee into two bonds, and the giving of the latter bond was purely an act of the respondent as a protective measure for the betterment of that part of the public who were to supply the labour and material for this public contract so that the public generally would be assured that all elements contributory to the completion of this public contract were paid for and so that no complaint could be

lodged against the respondent that the means had not been afforded to protect for payment the labour and material connected therewith.

Notwithstanding the fact that one bond is conditioned for the performance of the whole of the subject contract and the other is conditioned for the payment of labour and materialmen, both these bonds (executed and filed pursuant to the provisions of the subject contract, and in compliance therewith) and the subject Dalite contract must be construed together, in order to determine the extent of the liability of the suppliant surety under these bonds.

Putting it another way, the obligations of the bonds are to be read in the light of the subject Dalite contract that they were given to secure, and as a consequence, the extent of the undertaking entered into by the surety, is to be measured by the terms of the contractor's ("Dalite") (the principal debtor under the bonds) agreement with the respondent (the creditor under the bonds).

When the subject Dalite contract and these bonds are read together the intentions of both of the parties to the subject Dalite contract, as well as all the parties to the bond (i.e. principal debtor, creditor and surety) are clear. If the contractor failed to perform the subject contract, the surety was liable to perform it pursuant to one bond. Pursuant to the other bond, if the contractor failed to pay the labour and materialmen who supplied labour and material in the performance of this subject Dalite contract, then the surety was liable to the extent of this bond to pay such labour and materialmen.

But the surety engaged only to make good the deficiencies to the respective limits of these bonds. And when the surety was called upon to perform by the respondent (creditor under the bonds) and after it did perform under its guarantee, the surety was entitled to require the respondent (creditor) to hold and have used the balance of the moneys appropriated for this subject Dalite contract, namely, the sum of \$150,595.55, solely for the purpose of this subject Dalite contract. Such moneys stand on the same footing as securities in the hands of a creditor received from a principal debtor to which a surety is entitled after making good or paying a guarantee to such creditor. (See *dicta* of Lord Selborne L.C. in *In re Sherry*²⁸).

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²⁸ (1884) 25 Ch. D. 692 at 702

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The right of the suppliant surety to have the balance due under the subject contract employed in the said manner, prevents the respondent (creditor) appropriating any part of such balance to the payment of any other debt or liability unrelated to the subject contract, as the respondent by its pleading stated it did. This right of the surety does not rest upon contract, but upon "general principles of equity similar to those governing the marshalling of funds when one creditor of the same debtor may resort to either of two funds and another creditor to one only". (See *Halsbury's Laws of England*²⁹).

On July 6, 1965, the respondent (by the said letter to the suppliant surety) elected to call on the suppliant surety to perform the subject Dalite contract pursuant to the guarantees in the bonds of surety and the suppliant surety did so perform. The respondent could have elected to treat the subject Dalite contract as at an end. If it had elected this latter course, of course, the surety would have been released. The respondent in this case has attempted to get the benefit of both such elections without some of the liabilities.

As to the claim for interest on \$15,740, in my view, sections 47 and 48 of the *Exchequer Court Act* are no bar. The surety's claim against the respondent is not based upon contract which these sections contemplate, but on equitable principles of the law of surety, creditor and principal debtor.

In addition, section 48 refers to a contract "in which a drawback or penalty is stipulated for on account of non-performance of any condition . . .". Therefore, it must refer to a contract between the respondent and a third person. That was the situation in the *Dimensional Investments (supra)* case. That is not so here. But even if the suppliant was bringing an action based on this Dalite contract, then in any event the suppliant has not been in default and therefore section 48 does not apply to it.

The suppliant is entitled to judgment against the respondent for \$15,740.10 with interest at 5 per cent from the commencement of this action.

²⁹ 3rd Ed., Vol. 18, p. 469.