GRENADA

IN THE COURT OF APPEAL

CIVIL APPEAL NO.3 OF 2005

BETWEEN:

NEW INDIA ASSURANCE COMPANY (TRINIDAD) LTD.

Appellant

and

LIBERTY CLUB LTD

Respondents

Before:

The Hon. Michael Gordon, QC	Justice of Appeal
The Hon. Denys Barrow, SC	Justice of Appeal
The Hon. Hugh A. Rawlins	Justice of Appeal

Appearances:

Mr. Karl Hudson-Phillips, QC and Ms. Rosalyn Wilkinson for the Appellant
Mr. Leslie F. Haynes, QC and Mr. James A. L. Bristol for the Respondent

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2006: February 22;
May 8.

JUDGMENT

[1] BARROW, J.A.: The issue that arises for decision on this appeal is whether the appellant, who gave a bond ("the guarantee") in favour of the respondent, which guaranteed the performance of a contractor under a building contract, was liable to the respondent upon the default of the contractor, or whether the appellant had validly avoided liability on the ground that the respondent and the contractor altered the contract.

[2] In the High Court proceedings the respondent claimed the amount guaranteed, US$964,500.00, consequent upon the default of the contractor, ABA Inversiones, (ABA) in performing the contract. The contract was dated 18th January 1991 and

called for the contractor to build a 100-room hotel facility for the respondent for the sum of U.S. $6,430,000.00, subject to additions and deductions. The guarantee was dated 8th February 1991.

[3] As part of the overall arrangement the respondent advanced US$643,000.00 ("the advance payment") to the contractor and the contractor secured the repayment of that sum by obtaining a separate bond ("the advance payment bond") in favour of the respondent, also issued by the appellant. The contract provided that the advance payment should be repaid, after the value of the construction works had passed a certain point, by specified instalments. The contract also provided that the respondent should retain from payments falling due to the contractor a certain percentage of payments ("the retainage") to secure the remedying of any defects that might arise during the defects liability period, following the completion of the contract.

[4] ABA, the contractor, is a Venezuelan company and difficulties arising from conditions in Venezuela dogged its efforts. Its inability to access United States dollars in Venezuela due to the instability of the Venezuelan currency, at that time, soon had it in trouble. There is no dispute that as a result of the contractor's difficulties it was open to the respondent at an early point to terminate the contract but the respondent took the decision to render financial assistance to the contractor. The judge found that the contract was modified to permit changes in interest rate, changes in liquidated damages, changes in retainage and by rescheduling the repayment of the advance payment.[1] In relation to the respondent's submission that the respondent had overpaid the contractor the judge also found "that there must have been at some point what amounted to a payment not in accordance with the Contract."[2]

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[1] See paragraph [89] of the judgment in Grenada Civil Case No. GDAHCV 1995/0146 between Liberty Club Limited and New India Assurance Company (Trinidad & Tobago) Limited, delivered 13 April 2005 (the judgment).
[2] Paragraph [92] of the judgment.

[5] The judge considered the effect of the changes made. He determined that the changes that were made did not enable the respondent to be discharged from the guarantee on the ground of prejudice. He therefore upheld the respondent's claim and ordered the appellant to pay the sum guaranteed and interest at the rate of 11.5% from the date of the filing of the claim to the date of trial and thereafter at the rate of 6% per annum until the date of payment. The judge also awarded prescribed costs to the respondent. It will be necessary, at a later stage, to consider fully the facts found by the judge and the challenges to them but it is convenient to first consider the dispute as to the legal effect on the guarantee of making amendments to the contract.

The legal effect on the guarantee of amending the contract

[6] Counsel on both sides were agreed that the fundamental statement of the law concerning the effect on a guarantee of the alteration of a contract that is guaranteed is contained in the following passage from the judgment of Cotton L.J. in Holme v Brunskill:[3]

> "The true rule, in my opinion is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court, will not, in an action against the surety, go into an inquiry as to the effect of the alteration, or allow the question, whether the surety is discharged or not, to be determined by the finding of a jury as to the materiality of the alteration or on the question of whether it is to the prejudice of the surety, but will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and that if has not so consented he will be discharged."

[3] (1878) 3 QBD 495 at 505

[7] Hudson's Building And Engineering Contracts[4] paraphrases the rule in the following language:

> "The broad principle which emerged from the nineteenth-century case law, notably from the leading Court of Appeal case in England of Holme v Brunskill, was that no subsequent alteration of the debtor's obligations agreed to by the creditor would bind a guarantor of those obligations without his prior consent, unless it was either wholly trivial and insubstantial, or, if not, self-evidently could not in any conceivable circumstances prejudice the surety:"

[8] From the rule in Holme Mr. Hudson-Phillips Q.C., leading counsel for the appellant, built the central pillar of the submission for the appellant. Mr. Hudson-Phillips accepted that all contracts have provision for variation of works and changes but, he submitted, any change in a contract which could prejudice the guarantor will render the guarantee void unless the guarantee expressly provides that it does not. There has to be an express provision, counsel submitted. The case for the appellant was therefore that any alteration, whether permissible by the terms of the contract or not, which was capable of operating to the prejudice of the guarantor, enabled the guarantor to decide to avoid the guarantee or not according to its choice.

[9] As an example of language that expressly provided that changes shall *not* entitle the guarantor to avoid the guarantee, counsel pointed to paragraph 2 of the advance payment bond that the appellant had issued in favour of the respondent. That bond provided:

> "2. The Guarantor shall not be discharged or released from the Guarantee by any arrangement made between the Contractor and the Employer without the assent of the Guarantor or by any alteration in the obligations undertaken by the Contractor or by any forbearance or forgiveness whether as to payment time performance or otherwise in respect of any matter or thing concerning the Contract. Provided however, if any part of the Advance Payment is recovered as aforesaid the amount of this guarantee shall be reduced accordingly by an amount equivalent to the amount so recovered."

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[4] Volume 2, 11th ed., (1995).

[10] Mr. Hudson-Phillips observed that the guarantee did not contain any such clause and the two documents were executed on the same day. The parties were fully aware, counsel observed, of the principle that a guarantee may be avoided if the contract guaranteed was amended or varied without the consent, prior or otherwise, of the guarantor – except where such changes were so minor as not to be capable of prejudicing the guarantor. Counsel therefore submitted that the absence of a similar clause from the guarantee meant there was no exclusion of the rule in Holme that alteration leads to avoidance.

Effect of reference to amendments in the guarantee

[11] The respondent's counter to the appellant's argument - that no alteration of the contract, except minor ones, was permitted by the guarantee - was the submission by Mr. Haynes Q.C., leading counsel for the respondent, that the language of the guarantee itself contained the consent of the guarantor for changes to the contract to be made. Counsel pointed to the recital and the operative clause in the guarantee that stated:

> "WHEREAS the contractor has entered into a Written Agreement with the Employer dated the 18th day of January, 1991 for Construction of the Liberty Club Hotel in accordance with the documents, plans, specifications and amendments thereto, which to the extent herein provided for, are the (sic) reference made part thereof and are hereinafter referred to as the contract.
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> "NOW, THEREFORE, the Condition of this Obligation is such that, if the Contractor shall promptly and faithfully perform the said Contract (including any amendments thereto) then this obligation shall be null and void; otherwise it shall remain in full force and effect. …" (emphasis added).

[12] From these provisions Mr. Haynes advanced a submission for the respondent that was the exact opposite of the one advanced for the appellant. The respondent's submission was that there was no reason to construe the words "any amendments" so as to limit amendments to those allowed by the building contract. Counsel argued that if these words had not been included in the guarantee the guarantor would nonetheless be bound by amendments that were effected in

accordance with the provisions for making amendments contained in the contract. Therefore, counsel submitted, the words "any amendments thereto", contained in the guarantee, were intended to refer to amendments outside the contract. Further, it was submitted, the reference to amendments *thereto* is much wider than if the reference had been to amendments *therein*. The latter would have restricted amendments to those made in accordance with the methodology provided by the building contract; the use of *thereto* makes it much wider, counsel submitted. In effect, the respondent submitted that the guarantor had agreed to any amendment, whether or not permitted by the contract.

[13] In support of his submission Mr. Haynes relied on the case of Trade Indemnity Company Ltd. v Workington Harbour and Dock Board[5] in which the bond that was sued upon contained a provision that the guarantor would not be released by any agreement between the contractors and the owners 'for any alteration". Counsel relied upon the fact that Lord Atkin accepted that the words should be given a very wide meaning. Counsel also relied on a passage from Hudson's Building And Engineering Contracts[6] that reads:

> "17.049 Where a variation clause is present, no alteration of the contract itself, as opposed to the work under it, is involved, and it is submitted that, even in the absence of an express power in the bond, and provided that the principal construction contract documentation has been sufficiently identified or cited by reference or otherwise in the bond, it will not be possible, at the very least in the case of commercial due performance bonds, for the security to obtain a release by reason of the exercise of the variation power, unless some express limit on the power to vary has been imposed by the bond."

[14] In reliance on the passage from Hudson's Mr. Haynes submitted that where, as in the instant case, the guarantee does not expressly limit the power to vary the contract, the guarantor is not discharged by a variation. He therefore contended that, because the guarantee did not include an express limit on the right of the respondent to vary the contract, the guarantor was bound by the contract as varied. In his written submissions Mr. Haynes acknowledged a limit to this

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[5] [1937] A.C. 1

[6] Volume 2, 11th ed., (1995), at 17.049.

proposition – that it did not authorize variations that were fundamental or went to the root of the contract.

What amendments are permitted?

[15] The rival submissions set out the ground of dispute. The appellant says that no alteration in the obligation guaranteed was permitted except such as was unsubstantial or was, without inquiry, clearly such as not to be capable of causing prejudice to the guarantor. The respondent says that any alteration in the obligation guaranteed was permitted except such as was fundamental or went to the root of the contract. When the opposing submissions are arrayed the battle is to decide where to draw the line that demarcates which amendments will discharge a guarantor and which will not.

[16] The case for the respondent is that the provision for amendment contained in the guarantee permits greater amendment to the contract than the rule in Holme permits. The respondent says, in other words, that this provision permits amendments that are substantial as long as they fall short of being fundamental. As a matter of principle there is nothing in the authorities that have been cited that supports the proposition that this is the standard effect of a provision for variation or amendment. A proper reading of the passage at 17.049 in Hudson's on which the respondent relied shows that it is confined to the effect of a variation clause on variations in the work, as distinct from the contract. The submission in that passage is that a surety is not discharged, if the guarantee does not contain an express limit on the power to vary, by a variation in the *work*. The passage contains no suggestion that the guarantor remains undischarged by a variation or amendment of the *contract* unless the guarantee expressly limits what may be done by way of amendment to the contract. It is not difficult to see why there is no such suggestion; it would run directly contrary to the rule in Holme that any amendment that is capable of causing prejudice to a guarantor discharges him unless he has consented to it.

[17] The interpretation of the provision for amendment that is contained in the guarantee also does not support the respondent's contention that it permits amendments that are substantial as long as they are not fundamental. This was the decision of the trial judge, with which I agree. The judge expressed his reasons for that decision by adopting the following submission of Mr. Hudson-Phillips:

> "The Defendant guaranteed the prompt payment and faithful performance of the Construction Contract (including any amendments thereto). It is the contention of the Defendant that this latter phrase adds nothing to the liability of the Defendant. Without it, the Defendant would be liable for any amendments, modifications, variations or changes carried out in accordance with the terms of the contract. As indicated supra, Article 1.1.2 specifically states that "the Contract may be amended or modified only by a Modification as defined in Sub-paragraph 1.1.1"
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> "In entering into the Performance Bond, the Defendant agreed to be bound by the Construction contract including the term in Article 1.1.1 for its modification in a specific manner. The Defendant was therefore bound by any amendments within the definition of "modifications" as defined.
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> "This means that the words "any amendments" appearing in the Performance Bond, must be construed not generally but strictly in accordance with or by reference to the Construction Contract. As indicated in paragraph 15 supra, the Defendant as guarantor will not be bound by a change which is not effected in the manner indicated. To construe a performance Bond to mean that the Defendant, as guarantor, is bound by any and all amendments agreed between the Claimants and the Contractor would lead to absurdity. Neither the Contract nor Performance Bond could be construed so as to mean, for example, that the Owner and the Contractor could amend the Contract so as to build a rocket to go to the moon rather than a hotel."

[18] The facts that the contract between the respondent and the contractor provided for amendment and that the guarantee contemplated that there would be amendments to the contract do not equate to consent to the amendments. If, as Mr. Haynes rightly conceded, the reference in the guarantee to "any amendments" cannot be taken as consent to an amendment that went to the root of the contract, why should that reference be taken as consent to other amendments? It was competent for the respondent and the contractor to amend the contract without the consent of the guarantor, so there is no reason why by referring to amendments to the contract the guarantor should be taken thereby to consent to them. It was also

competent for the respondent and the contractor to amend the contract after first seeking and obtaining the consent of the guarantor so again there is no reason why by referring to amendments the guarantor should be taken thereby to consent to them. The reference in the guarantee to "any amendments" to the contract was evidently intended to ensure that the guarantee would continue to attach to the contract even if it was amended and would not need to be re-issued each time the contract was amended. That reference did not amount to blanket consent to all amendments. As Mr. Hudson-Phillips aptly demonstrated, if blanket consent was what the parties intended they needed to have provided for it in the same way that they provided in the advance payment bond.[7]

The nature of the amendments that were made

[19] In my view the provision in the contract for its amendment and the reference in the guarantee to amendments to the contract did not displace the rule in Holme as to which amendments would or would not bind a guarantor without his prior consent. This conclusion leads to an examination of the amendments to see if they were obviously unsubstantial or incapable of causing prejudice to the guarantor. In conducting that exercise it is important to keep clearly in mind the passage cited earlier from the speech of Cotton L.J. in Holme[8]:

> "… If it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court will not, in an action against the surety, go into an inquiry as to the effect of the alteration, or allow the question, whether the surety is discharged or not, to be determined by the finding of a jury as to the materiality of the alteration or on the question whether it is to the prejudice of the surety, but will hold in such a case that the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and that if he has not so consented he will be discharged."

[7] See paragraph 9, above

[8] Supra

[20] There has been no dilution of that principle in the more than a century and a quarter since it was stated, as is shown by the following observation from the case of Oval (717) Ltd v Aegon Insurance Co (UK) Ltd:[9]

> "It is a well established principle that *any* variation in the terms of the underlying agreement which *could prejudice* the position of a guarantor will, unless his consent is sought and given or unless the contract expressly provides to the contrary, discharge him from *all* liability. The authorities establish that it is immaterial that the variation has not in fact prejudiced the guarantor or that the likelihood of its so doing is remote. Provided the variation *could prejudice* the guarantor, the nature of the risk undertaken has been altered and he is the person entitled to decide if the guarantee is to be continued notwithstanding that change. This principle has been consistently and strictly applied by the English courts." (Original emphases).

Hudson's Building And Engineering Contracts summarizes the legal history behind that rule:

> "Both in England and the United States there have been frequent judicial references to the existence of a general rule requiring contracts of guarantee to be interpreted in all cases of doubt in favour of the surety. … there can be no doubt of the privileged status of guarantors in the past as "favourites of the law", having regard in particular to the readiness of the Courts in all jurisdictions to discharge sureties altogether from their obligations in situations where no real, or at best only minimal or theoretical, prejudice can have in reality occurred; … Whatever its true basis, the rule has been widely recognised …"[10]

[21] For present purposes it is unnecessary to do more than acknowledge the argument by the learned authors[11] of that work that the time has come for the English courts to adopt the less rigid approach to the discharge of sureties that characterises American jurisprudence. It is not an argument that was made before us and it would be entirely whimsical, in these circumstances, to opt for such an approach. For present purposes it is the rule in Holme v Brunskill that must be applied. That rule is that once it is shown that the amendments to the contract

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[9] (1997) 54 ConLR 73 at 83
[10] At 17.019.
[11] ibid

could prejudice[12] the guarantor, he is entitled to a discharge; it does not matter that only theoretical[13] and not real prejudice is shown.

The changes that were made

[22] The appellant submitted that the respondent took the following steps contrary to the contract in an attempt to assist or support the contractor:

1. Agreed to provide to the contractor whatever financial assistance was necessary and made payments for and on behalf of the contractor not in accordance with the method of certified payment authorised by the contract;
2. Changed the method of payment laid down by Article 9 of the contract from a payment certificate system to a voucher system;
3. Failed to withhold retainage as required by the contract; and
4. Failed to deduct instalments to account of the advance payment.

Payments in advance of entitlement

[23] Steps 1) and 2) can be considered together. The judge agreed with the opinion of the respondent's expert, Mr. McManus, that the change in the method of payment, to the Voucher system, was just another method of doing the same thing as the Schedule of Values system since the contract made plain that this latter method was to be "used only as a basis for the Contractor's application for payment."[14] Mr. Haynes has repeated that proposition as part of his argument on appeal. He argued that the change was within the methodology of change permitted within the contract but, more than that, he argued that the contract did not prescribe any system of payment so that a change in the method of payment could not have been an amendment to the contract.

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[12] Oval (717), above.
[13] See the passage from Hudson's, at paragraph 20, above.
[14] At paragraph [102] of the judgment.

[24] The case of Stewart v M'Kean[15] supports the proposition that, where it was left to the discretion of the parties to a contract how to perform an obligation guaranteed, it was open to the parties to adopt any reasonable mode of doing so and, provided it was reasonable, the exercise of discretion would not discharge the guarantor. To similar effect is the case of Alberta Opportunity Co. v Zen[16] which establishes that where the guarantee did not attach to the specific terms of an agreement between parties but simply to the performance of the central obligation the guarantor was not discharged by a variation in one of the terms of the agreement of which he was completely unaware.

[25] The submissions from the appellant did not engage the respondent on the issue whether the change in the method of payment, in itself, was capable of causing prejudice because the appellant focused its submissions on the purpose behind the decision of the respondent and the contractor to change the system of payment and on the measures they took to achieve that purpose. The appellant submitted, as stated above, that to provide financial assistance to the contractor, the respondent paid to the contractor under the voucher system moneys in advance of its entitlement. It was with the payments rather than with the system of payment that the appellant was concerned.

[26] The judge found that "there must have been at some point what amounted to a payment not in accordance with the Contract" but the judge went on to state:

> "However in the final analysis having done a full reconciliation it is evident that there was no overpayment based on the contract sum. Indeed the modification was to ensure that the books balanced eventually, but the changes made from the Schedule of Values system to the Voucher system ensured that the Contractor was paid what he asked for at certain intervals, before any assessment of the value of the work could be done."[17]

[27] In its counter notice the respondent challenges the judge's finding that there was any payment to the contractor before assessment of the work was done. In

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[15] (1855) Exch. 610.
[16] (1984) 6 D.L.R. (4th) 620 at [93]
[17] At paragraph [93].

considering that challenge it is interesting to note that the respondent's expert, Mr. McManus, in responding to the appellant's pleading that there had been overpayments, did not dispute the fact that there had been the payments that the appellant describes as overpayments. Instead, this witness expressly acknowledged that the contract "…envisions that certain items may be paid outside of a schedule of values … That being the case, it is envisioned within AIA that there will [be] payments (so-called "overpayments") made to the Contractor in excess of the Schedule of Values amount. The Owner is protected for these so called "overpayments" by Article 9.6.1 which permits the Owner to stop payments when it is viewed that the job can not be completed for the unpaid balance of the contract sum."[18] Mr. McManus' view was that any payments made pursuant to the party's agreement, in this case in accordance with the voucher system, once it is an amount approved by a certificate under that system, could not be an overpayment.[19]

[28] The opposing submission for the appellant was that once that system was introduced, for the express purpose of providing financial assistance to the contractor, which the respondent identified in its letter of 29th April 1992,[20] it was used to make all sorts of payments to the contractor other than for work done. Examples of these cited by Mr. Hudson-Phillips included a letter from the respondent to the contractor dated 27th December 1992[21] stating that the respondent had paid in excess of EC$250,000.00 "to meet local site costs in particular wages, benefit and material" as well as holiday pay. The vouchers themselves showed that the respondent were paying for things such as payroll, food, housing for Venezuelan personnel, petty cash, and electricity.[22] The vouchers also revealed payments of straight cash advances in amounts such as $40,000.00, $50,000.00 and $60,000.00.[23]

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[18] At paragraph 14.3 of his witness statement, p. 225 of the record.
[19] At paragraph 14.6 of his witness statement, at p. 225 of the record.
[20] At p. 616 of the record.
[21] At p. 653 of the record.
[22] At p. 673 of the record
[23] At p. 674 of the record.

[29] Article 9 of the contract makes clear that the applications for payment and the certificates for payment were intended to be for work done. It is for this reason that it was provided that the issuance of a certificate for payment would constitute a representation by the Architect to the Owner that the work had progressed to the point indicated, that the quality of the work was in accordance with the contract, and that the contractor was entitled to payment in the amount certified.[24]

[30] The voucher system payments were the subject of detailed analysis by the appellant's expert witness, Mr. Snape. He stated in his witness statement that the monetary advances made by the respondent to the contractor had started as early as March 1992 and continued until termination in April 1993. By then, he stated, the advances were said to have totalled US$496,282.00.[25]

[31] In his witness statement Mr. Leon Taylor, the managing director of the respondent and himself an expert in civil engineering, stated that there were no overpayments. He gave a reasoned presentation in support of the position that "the "voucher system" of applications for payment did not permit advance payments to be made. It only allowed for payments against the Work."[26] He went on to explain that under this system the contractor submitted a voucher defining and requesting payment for materials and services to be incorporated into the Work. It was the burden of his evidence that tight and very effective control was kept of all payments to the contractor so that the contractor never got paid more than it would have gotten under the voucher system.

[32] It may be an arguable proposition that the payment for food for workmen or for accommodation for Venezuelan employees related in an immediate way to the performance of the work. It may be similarly arguable that there was a misdescription in the heading that appeared on the vouchers: "Advance Payment

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[24] See article 9.4.2 at p. 584 of the record.
[25] At paragraph 32 of his witness statement, at p. 246 of the record.
[26] At paragraph 33 of his witness statement, at p. 188 of the record

Advice Voucher". However, the judge made an express finding that there were instances of payment before any assessment of the value of the work could be done and the evidence of the vouchers themselves bear him out.

Failure to recover the advance payment

[33] There is no factual dispute in relation to steps 3 and 4 – that the respondent varied the contract by not recovering the advance payments and not deducting retainage in accordance with the contract. The judge found that a change order was issued to modify the contract to effect these changes.[27] The position of the respondent was, therefore, that these were permitted modifications and they bound the appellant. The position of the appellant was that these were further instances of overpayment.

[34] The appellant's expert witness, Mr. Snape, also spoke to the failure to withhold instalments to recoup advance payments and, passingly, to the failure to deduct retainage from payments due to the contractor. He stated that "the whole of the advance payment should have been recovered from ABA by the issue of progress payment no: 12 in December 1991, at the latest."[28] He concluded, "The re-scheduling of the advance payment deferred the date for the repayment of the contractually agreed advance payment and … has resulted in ABA being overpaid." [29] In relation to retainage he thought that the increase to 10% from a maximum accumulated retainage of 5% placed a heavier burden upon the contractor.

[35] Mr. Snape asserted that the "failure to ensure that the advance payment was recovered from ABA has severely prejudiced New India's position under the bond."[30] He also expressed the opinion that the overpayment to the contractor "has severely prejudiced New India's position under the guarantee as, because of

[27] See paragraph [89] of the judgment.
[28] At paragraph 20 of his witness statement, at p. 242 of the record.
[29] At paragraph 41 of his witness statement, at p. 248 of the record.
[30] Ibid, at paragraph 24.

the overpayment, New India will have lost the strong inducement that would have otherwise operated on ABA's mind to finish the works in due time."[31] Mr. Snape's concluding observation was that these changes prejudiced the appellant to the extent that if the respondent had not agreed to make these changes and advances the respondent would not have suffered the loss or any part of the loss which it is said to have suffered and would thus not have had to claim from the appellant under the guarantee.[32]

[36] The judge quoted[33] the following passage from Hudson's as to the effect of overpayment:

> "For good commercial reasons it is very common in a construction contract for owners, faced with a contractor in apparent difficulties, or in a controversial situation where the merits of a dispute may be uncertain, to agree to relax the contract provisions relating to interim payment when the overriding commercial interest is to secure early completion. This may take the form of allowing payment in full, notwithstanding work known or expected to be defective, advancing more money than is properly due over valuation to assist a contractor in difficulties; or paying in advance of the due date for instalments.
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> "While it has been seen that inadvertent overpayment will not release a surety, and there is no duty of care owed to the surety in this regard by the creditor, payment concessions of these kinds by a creditor with eyes open, even though in expectation of avoiding the contractor's failure and securing completion, and so superficially seeming to benefit the surety, have been held by the Courts to release the surety in toto on numerous occasions."[34]

Effect of overpayment

[37] As appears in the extract from the judgment, at paragraph 26 above, the judge made a determination that, upon a full reconciliation subsequent to the termination of the contractor, there was no overpayment based on the contract sum. The judge returned to this point when he stated that on termination there were

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[31] Ibid, at paragraph 27.
[32] Ibid, at paragraph 46.
[33] At paragraph [72] of the judgment
[34] At page 1535.

substantial funds remaining, which could have contributed to the completion of the contract. He found[35] that as against the value of the works that the contractor performed, $5,618,384.87, the contractor was paid $5,176,338.00, and therefore less than what they worked for. With respect, this misses the point: it does not matter that the contractor ultimately ended up being paid less money than the value of the work they performed. What matters is that the contractor would apparently have received even less had the advance payment been deducted and had the financial assistance not been rendered. In short, the material times at which to consider whether there were overpayments were the times when the deductions[36] to recover the advance payments were not made but ought to have been made, and when the financial assistance was rendered.

[38] It is clear that the respondent made the overpayments, as the appellant used that term. It is immaterial that the contract between the respondent and the contractor permitted the overpayments to be made. The appellant did not consent to them. The cases recognize that the likely effect of overpayment is to remove financial pressure upon a contractor to complete. This was the point made in Calvert v London Dock Co.[37] It is the point that Mr. Snape took. It was a point to which the judge expressly adverted.[38]

[39] However, the judge decided that:

> "...there is no evidence that the modifications and the efforts of the Claimant removed the incentive to complete the Contract."[39]

In so deciding the judge erred because the cases are clear that the appellant did not need to provide any evidence that the overpayment had that effect. The judge similarly erred when he stated further:

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[35] At paragraph [104] of the judgment.
[36] The point was made for the respondent that the contract did not provide for withholding or deducting moneys that were due from the contractor from payments due to the contractor for work performed but, in my view, the method by which the respondent chose or ought to have chosen to collect instalments cannot matter.
[37] (1838) 2 Keen 638.
[38] See paragraph 34, above
[39] At paragraph [101] of the judgment.

> "This variation of method of payment was not such a breach as would prejudice the guarantor. Indeed there is no evidence that it affected the quality of the work."[40]

In the same vein the judge decided:

> "However again there is no evidence that this [the overpayment] could be perceived as being prejudicial to the Defendant. I come to this conclusion because at the base of the issue of overpayment is that it removes the Contractor's incentive to finish the job and receive the final payments due"[41]

The judge also stated:

> "I think that the perception that overpayment could have caused the Contractor to lose interest in completing the Contract does not fit the facts of this case."[42]

It is clear, from these further statements, that the judge was making a determination as to the effect of the changes. In fact he did so in a direct way in the following passage:

> "These were the modifications or changes. But on the whole of the evidence I cannot see how they could have prejudiced the Defendant.
> "[106] I think that the Defendant is guilty of linear thinking which assumes that once a generic cause of problems has been identified then in the specific circumstances of this case, that must be the cause of the Contractor's default. In this case one is not the cause of the other."

The court must not inquire into the effect of changes

[40] The rule in Holme is pellucid that it is not for the court to make a determination as to prejudice: "if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court will not, in an action against the surety, go into an inquiry as to the effect of the alteration".[43] As it is put in Hudson's, the surety will be discharged unless the change is "either wholly trivial

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[40] Ibid, paragraph [102]
[41] ibid, paragraph [103]
[42] ibid, [104]
[43] see paragraph 6 , above

and insubstantial, or, if not, self-evidently could not in any conceivable circumstances prejudice the surety:"[44]

[41] The changes in the instant case were patently substantial. It does not matter whether the changes caused the contractor's default or served to remove the pressure on them to complete; it was sufficient that the changes could conceivably have had that effect. Once that was the case, as it must have been, the guarantor was entitled to avoid the guarantee. It is immaterial that there was no evidence that the changes had the prejudicial effect; the effect of the changes was not a matter that it was competent for the court to determine. No doubt this was why the appellant did not adduce any evidence on the matter. Hence, there was no significance to the judge's finding that there was no evidence as to the effect of the changes.

No blind acceptance of prejudice

[42] Mr. Haynes submitted that the court must not blindly accept the guarantor's assertion of possible prejudice and the reasoning of the Supreme Court of New South Wales in Corumo Holdings Pty Ltd. v C Itoh Ltd[45] supports that approach. In that case a guarantee to a limit of $32m was given in relation to an obligation to pay money in a land development transaction. By a variation, to which the guarantor was not a party, the time for paying the money was extended. The party that was obliged to pay the money having defaulted, a claim was made on the guarantor and it denied liability on the basis that its obligations were avoided by the variation.

[43] The court stated that the rule that courts are not permitted to inquire into the effect of an alteration as a matter of fact, should not be taken at face value. A court must still perform the evaluative function inherent in the decision whether or not an alteration was "unsubstantial" and "not prejudicial" to the surety. In that case the

[44] see paragraph 7, above
[45] (1991) 24 NSWLR 370

majority was of the view that no detailed factual inquiry was required. It was plain that the guarantor was liable for the maximum amount it had guaranteed at the time that the variation was made and the effect of the extension of time could only have been beneficial to the guarantor by deferring the time when it was called upon to pay. The court therefore held that the variation was insubstantial and was beneficial to the guarantor.

[44] To a similar effect is the other case on this point cited by Mr. Haynes. In Alberta Opportunity Co. v Zen[46] the British Columbia Court of Appeal considered the effect of a guarantee of the repayment of a loan for $250,000 when the lender withheld from its disbursement to the borrower the sum of $105,000 that the borrower had previously owed and the borrower acquiesced in this arrangement. The court decided that this arrangement was a variation of the terms of the loan agreement but it was clearly insubstantial. It could have made no difference to the guarantor because the result would have been precisely the same if, instead of withholding payment the lender had paid the full amount of the loan and the borrower had simultaneously repaid what it previously owed. As this case states, a variation is substantial if it increases the risk to which the guarantor was exposed.[47]

Conclusion

[45] It has not been shown how the principle stated by these two cases assists the respondent. The facts in those cases, with respect, properly led to the decision in those cases. The same may be said of the case of Johnson Brothers (Dyers) Ltd. v Davison[48] where a guarantor of payment of the rent due under a lease, which was expressly stated to be assignable, was held liable notwithstanding the assignment of the lease, because the assignment of the lease was not a substantial alteration. None of these cases concerned overpayment of money

[46] (1984) 6 D.L.R. (4th) 620
[47] At paragraph [87]
[48] [1935] Sol. J. 306

under a building contract. It is too well established to be controversial that overpayment is capable of removing the pressure on a contractor to complete. There is nothing on the facts of the instant case to make it self-evident that the effect of the overpayments was clearly insubstantial or was beneficial to the guarantor or incapable, even without inquiry, of causing prejudice to the guarantor.

[46] It follows that I would allow the appeal. I would set aside the judgment in the court below and direct that judgment be entered for the defendant dismissing the plaintiff's claim. I would award prescribed costs to the appellant both here and in the court below.

Denys Barrow, SC
Justice of Appeal

[47] GORDON, J.A.: I have taken a different approach to my brother Barrow. There is no quarrel between us as to the effect and continuing authority of Holme v Brunskill[49]. Where we part company in our reasoning is in the interpretation of the language of the guarantee and, by incorporation, the contract. It is my view that Holme v Brunskill is irrelevant to the resolution of this case. I rely on the factual summary as set out in the judgment of my brother Barrow, though there will be repetition of certain parts for ease of flow of thought.

[48] With permission, I adopt the statement of the dispute set out at paragraph 15 of this judgment.

[49] The crucial language in the guarantee is to be found both in the recitals and in the operative words and is to the effect that the guarantor, the appellant, guarantees the performance of the "Written Agreement with the employer [the respondent] dated 18th day of January, 1991 for construction of the Liberty Club Hotel in accordance with the documents, plans, specifications and amendments

[49] Op cited

thereto..." (emphasis added) referred to thereafter as "the contract". In the body of the guarantee the appellant guarantees the performance of "the said contract (including any amendments thereto) (emphasis added)."

[50] The contract between the respondent and the contractor signed on the 18th day of January, 1991 was a "Standard form of Agreement between Owner and contractor" issued by the American Institute of Architects. Article 1 of the agreement reads as follows:

> "The Contract Documents consist of this Agreement, the Conditions of the Contract (General, Supplementary and other Conditions), the Drawings, the Specifications, all Addenda issued prior to and all Modifications issued after execution of this Agreement."

Article 1.1.1 of the General Conditions of the Contract repeats exactly the above form of words and continues:

> "A Modification is (1) a written amendment to the Contract signed by both parties, (2) a Change Order, (3) a written interpretation issued by the Architect pursuant to Sub-paragraph 2.3.11, or (4) a written order for a minor change in the Work issued by the Architect pursuant to Paragraph 12.4.

[51] In my view, the correct starting point is the proper interpretation of the construction agreement, and in particular the definition of the term "modification". Once this is done the term "amendments" which appears in the guarantee can then be examined for equivalence and the factual circumstances can be examined in that context.

[52] There is a further definition contained in the General Conditions at Article 12.1.1 of relevance to this case, and that is "Change Order"

> "A Change Order is a written order to the Contractor signed to show the recommendation of the Construction Manager, the approval of the Architect and the authorisation of the Owner issued after execution of the Contract authorising a change in the Work or an adjustment in the Contract Sum or the Contract Time. The Contract Sum and Contract Time may be changed only by a Change Order. A Change Order signed by the Contractor indicates the Contractor's agreement therewith, including the adjustment in the Contract Sum or the Contract Time"

[53] As good a place to commence interpretation as any is the statement by Lord Hope of Craigshead in The Melanesian Mission Trust Board v Australian Mutual Provident Society[50]:

> "The approach which must be taken to the construction of a clause in a formal document of this kind is well settled. The intention of the parties is to be discovered from the words used in the document. Where ordinary words have been used they must be taken to have been used according to the ordinary meaning of these words. If their meaning is clear and unambiguous, effect must be given to them because that is what the parties are taken to have agreed to by their contract. Various rules may be invoked to assist interpretation in the event that there is an ambiguity. But it is not the function of the court, when construing a document, to search for an ambiguity. Nor should the rules which exist to resolve ambiguities be invoked in order to create an ambiguity which, according to the ordinary meaning of the words, is not there. So the starting point is to examine the words used in order to see whether they are clear and unambiguous. It is of course legitimate to look at the document as a whole and to examine the context in which these words have been used, as the context may affect the meaning of the words. But unless the context shows that the ordinary meaning cannot be given to them or that there is an ambiguity, the ordinary meaning of the words which have been used in the document must prevail.

[54] To paraphrase Article 1.1.1 of the General Conditions of the Contract, the contract included all modifications issued after execution of the contract. There is little in the language of Article 1.1.1 that presents any difficulty in interpretation. It anticipates that in the course of a building contract there will be changes, changes to the description of the work, to the method of payment and to the myriad other matters that anyone who has a passing acquaintance with a building project recognises as almost inevitable and it says, quite simply, where such changes come about, then there is a mechanism for incorporating them in the contract between the owner and the contractor.

[55] The question which then arises is whether that simplicity of interpretation flows through to the guarantee. To put it another way, is the term "amendments" in the guarantee equivalent to "modification" in the contract. I am strongly of the view that

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[50] Privy Council Appeal No. 58 of 1996

the guarantee, underwriting, as it does, the obligations of the contractor pursuant to an identified contract, can only be interpreted as if the guarantee and the contract for construction are read together as one. Thus, when in the guarantee reference is made to amendments to the construction contract, it can only mean amendments made in consonance with the construction contract. I therefore hold that the term "amendments" as used in the guarantee is synonymous with the term "Modification" as defined in the General Conditions

[56] In Triodos Bank NV v Dobbs[51] the Court of Appeal in England had for consideration the issue of interpretation a clause in a guarantee permitting variations. The particular clause read as follows:

> "2.4 The Bank may at any time and as it thinks fit and without reference to the Guarantor:
> 2.4.1 grant time for repayment or grant any other indulgence or agree to any amendment, variation, waiver or release in respect of an obligation of the Company under the Loan Agreement;

As Longmore LJ said at paragraph 9 of the judgment:

> "As a mater of principle there is no reason why the right of the Bank under clause 2.4.1 to agree amendments or variations to the loan agreement without reference to the guarantor should be confined to amendments or variations which are expressly contemplated by the agreement; the clause must mean that anything rightly termed a variation or amendment is a matter which can be agreed without reference to the guarantor. The question is then whether what is said to be an amendment or variation is correctly so called."

[57] The learned Law Lord was well aware of the general law regarding the discharge of guarantors and had this to the forefront of his mind. At paragraph 14 he stated:

> "It is, of course, the law that a material variation in the contract between the creditor and the principal debtor will discharge the guarantor, unless the variation is one to which he assented or which is provided for in the contract of guarantee."

[58] Learned Queen's Counsel for the appellant makes the bald statement in his written argument "The Performance Bond does not contain a clause excluding the

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[51] [2005] All ER (D) 364 (May)

Common Law rule in Holme v Brunskill". With the greatest of respect to learned Counsel, that is precisely what it does contain. I am clearly of the view that the guarantee contract provided for amendment in the contract between the creditor (the respondent) and the principal debtor, the contractor, whether such amendments were substantial or not. In other words, the guarantor assented in advance.

[59] As a final word on this issue I refer to the case of Perry v National Provincial Bank of England[52] wherein Cozens-hardy M.R said the following:

> "This is a curious case arising out of the law of principal and surety. It is important to distinguish clearly between the rights of a surety under an ordinary contract of suretyship not containing any special provisions and the rights of a surety where the instrument creating the suretyship contains certain special clauses. It is elementary law that in a simple case of principal and surety the surety is discharged if the creditor gives time to the principal or does certain other acts; and, a fortiori, if the creditor releases the principal debtor, of course the surety is released too. There are a certain number of acts which will not release the surety if when the act in question is done, there is a reservation of rights against the surety. A common instance of this is giving time. When you find in the instrument of suretyship itself a provision that the surety shall be liable notwithstanding certain acts being done by the creditor which would otherwise release him, these doctrines have no application at all. It is not then a simple contract of suretyship. It is true that in one sense it is a contract of suretyship, but it is a contract of suretyship containing special clauses which deliberately exclude certain rights which the surety would otherwise have had."

Findings of fact

[60] At paragraph 89 of the judgment of the Court below, the learned trial judge said: "I hold that the claimant proved in accordance with Article 1.1.1 that the contract was modified to permit the changes in interest rate, rescheduling of the Advance Payment, change in liquidated damages and change in retainage by LT 18 pursuant to Article 1.1.1." LT 18, which appears at page 707 of bundle 2 of the Record, is a "Change Order"

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[52] [1910] 1 Ch. 464

[61] At paragraph 94 the trial judge found that there had been no modification of the contract from the Schedule of Values system to the Voucher system. Clearly this was his conclusion based on the evidence of Mr Joseph A McManus Jr. who was declared an expert witness and who said that the Schedule of Values as referred to in the contract was a basis for payment of the contractor, not the only basis.

[62] In conclusion, therefore, I find, as did the trial judge, that the modifications to the contract of which complaint was made by the appellant, were properly made pursuant to the terms of the contract and that the variation in the manner of calculation of payment was not a modification under the contract.

[63] Having indicated above (paragraph 55) that in my view "modification" in the contract and "amendment" in the guarantee have been made synonymous by their connection to the same transaction it follows that I do not agree that the terms of the guarantee were breached by the respondent. I would dismiss the appeal with costs to the respondent.

Michael Gordon, QC
Justice of Appeal

[64] RAWLINS, J.A.: I have had the advantage of reading the judgments of my brothers Barrow, J.A. and Gordon, J.A. I concur with the judgment and decision of Gordon, J.A. The result is that the appeal is dismissed. The appellants should pay the costs of the respondent on this appeal on the prescribed costs basis.

Hugh A. Rawlins
Justice of Appeal