Action No.0901-04199

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF CALGARY

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF FAIRMONT RESORT PROPERTIES LTD., LAKE OKANAGAN RESORT VACATION (2001) LTD., LAKE OKANAGAN RESORT (2001) LTD., AND LL DEVELOPMENTS LTD.

BENCH BRIEF OF FAIRMONT RESORT PROPERTIES LTD., LAKE OKANAGAN RESORT VACATION (2001) LTD., LAKE OKANAGAN RESORT (2001) LTD., AND LL DEVELOPMENTS LTD.

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and LL Developments Ltd.

I. BACKGROUND

1. On March 30, 2009, each of Fairmont Resort Properties Ltd. ("**Fairmont Resort**"), Lake Okanagan Resort Vacation (2001) Ltd. ("**LORV**"), Lake Okanagan Resort (2001) Ltd. and LL Developments Ltd. (collectively as "**Fairmont**") were granted creditor protection pursuant to the Companies' Creditors Arrangement Act (the "**CCAA**"). The circumstances giving rise to the CCAA proceedings are set out in the Affidavit of Gary Bentham.

Affidavit of Gary Bentham (sworn March 30, 2009)

Initial Order (March 30, 2009)

2. Since the granting of the Initial Order, Fairmont has obtained an Order extending the stay of proceedings to July 31, 2009. In its ongoing efforts to structure a plan of arrangement to its creditors, Fairmont has obtained Orders approving a Debtor-in-Possession facility (the "**DIP Facility**") with Century Services Inc. ("**Century**") to a maximum sum of $5,500,000.00 and approving and implementing the initiatives previously referred to as the Remainder, Conversion and Monetization Programs.

First Stay Extension Order (April 29, 2009)

Second Stay Extension Order (May 1, 2009)

Century Services DIP Facility Order (May 1, 2009)

Remainder, Conversion and Monetization Approval Order (June 10, 2009)

II. RESORT FUNDING LLC

3. Resort Funding LLC ("**Resort Funding**") is a secured creditor of both Fairmont Resort and its wholly owned subsidiary LORV. Resort Funding's status as a secured creditor arises as a result of the assignment of a credit facility from Equivest Capital, Inc. ("**Equivest**") in March, 2004. Equivest provided Fairmont Resort with a construction loan and a revolving line loan in June, 2003 (the "**Initial Facility**"). The Initial Facility was documented by a hypothecation loan agreement, a guarantee by LORV and a security agreement (collectively, the "**Security Documents**").

Paragraphs 2 - 6 of the Affidavit of Lisa Henson ("**Henson**") (sworn June 8, 2009) (the "**Henson Affidavit**")

Page 6, line 27 - page 7, line 22 of the cross-examination of Henson held on June 18, 2009 (the "**Henson cross-examination**")

4. As security for the Initial Facility, Fairmont Resort pledged certain collateral pursuant to the security documents as security which included documents entitled "Promissory Note and Installment Sales Contract" (the "**Notes/Installment Sale Contracts**") from purchasers of time-share units sold by Fairmont Resort (the "**Underlying Debtors**"). The Notes/Installment Sale Contracts contemplated monthly payments by the Underlying Debtors to Fairmont Resort and LORV. The Initial Facility contemplated that Fairmont Resort and LORV would, for the benefit of Equivest and subsequently Resort Funding, place payments received from the Underlying Debtors into a trust account. Equivest registered its security as against all present and after acquired personal property of Fairmont Resort and LORV in the Personal Property Registry of British Columbia in 2003.

Paragraphs 2 - 6 of the Henson Affidavit

5. The terms of the Initial Facility, in December, 2005, were amended by way of an amended and restated loan hypothecation agreement, to increase the available credit (the "**Amended Loan Agreement**").

Paragraph 7 of the Henson Affidavit

6. As of February 28, 2009, the value of the Notes/Installment Sale Contracts held as collateral by Resort Funding was $11,894,006.06 (CDN) and $275,037.62 (US).

Paragraph 14 of the Henson Affidavit

Page 11, lines 1 - 4 of the Henson cross-examination

7. As of April 30, 2009, according Resort Funding, there was approximately $8,300,000.00 Million (CAD) owing from Fairmont Resort and LORV to Resort Funding pursuant to the Amended Loan Agreement. At present, Resort Funding is owed approximately $7,800,000.00 (CAD) from Fairmont Resort and LORV.

Paragraph 4 of the Brief of Resort Funding (May 1, 2009)

Page 10, lines 1 - 3 of the Henson cross-examination

III. THE WITHIN APPLICATION

8. Resort Funding, in the course of this application, seeks Orders:

(a) declaring that the Notes/Installment Sale Contracts became the property of Resort Funding at the time of endorsement by Fairmont Resort and LORV and do not form part of the assets or estate of those entities and therefore are not subject to the Initial Order. In connection therewith, Resort Funding also seeks the return of payments made by Underlying

Debtors to Fairmont Resort and LORV in relation to the Notes/Installment Sale Contracts since the date of the Initial Order;

(b) declaring that its security interest in the Notes/Installment Sale Contracts is perfected and forms a first charge on the property of Fairmont Resort and LORV as it relates to the Notes/Installment Sale Contracts; and

(c) lifting the stay, as extended, granted pursuant to the Initial Order as it relates to Resort Funding.

Notice of Motion (filed June 9 ,2009)

9. The evidence put forward by Resort Funding in support of the within application is the Henson Affidavit. Henson was cross-examined, by way of video conference, on her Affidavit on June 18, 2009.

10. In response to the evidence contained in the Henson Affidavit, Fairmont has filed the Affidavit of Murray Moore ("**Moore**"), Chief Restructuring Officer of Fairmont (sworn June 17, 2009) (the "**Moore Affidavit**"). Moore was also cross-examined on his Affidavit on June 18, 2009. Other evidence relevant to the within application is contained in previous filed Affidavits, Reports and Orders.

IV. ISSUES

11. Fairmont submits that the following issues are determinative of the within application:

(a) are the Notes/Installment Sale Contracts property of Resort Funding?

(b) insofar as the Notes/Installment Sale Contracts are collateral to Resort Funding as a secured lender, does the law of *res judicata* apply as against Resort Funding in relation to that relief sought in the within application?

(c) is it just and convenient that Resort Funding's interest in the Notes/Installment Sale Contracts be affected by these CCAA proceedings?

12. In its motion, Resort Funding seeks a declaration that its security interest forms a first charge (as opposed to a second or subordinate charge). With respect, that issue is irrelevant to the Debtor-in-Possession motion and should be reserved for a later dated. Whether Resort Funding is a first, second, secured or unsecured creditor is not determinative not does it affect or restrict the Courts ability to grant a priority Debtor-in-Possession lending charge.

V. ANALYSIS

(i) Are the Notes/Installment Sale Contracts property of Resort Funding?

The Notes/Installment Sale Contracts are not promissory notes within the meaning of the Bills of Exchange Act

13. Fairmont respectfully submits that the Notes/Installment Sale Contracts are not "promissory notes" within the meaning of the *Bills of Exchange Act*, R.S.C. 1985, c. B-4 (the "***BEA***"). In order for the Notes/Installment Sale Contracts to fall under the *BEA*, they must meet the definition of a "promissory note". Section 176 of the *BEA* defines a promissory note in the following terms:

> **176.** (1) A promissory note is an unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.

In order to fit within the parameters of the *BEA*, the Notes/Installment Sale Contracts must be in writing, signed by the maker, unconditional in nature and evidencing a promise to pay a sum certain. It is not sufficient that a purported promissory note meets one of the criteria; it must meet all. For at least two reasons, the Notes/Installment Sale Contracts do not meet the applicable definition and are therefore not governed by the *BEA*. As such, Resort Funding's argument as to ownership of the Notes/Installment Sale Contracts fails.

TAB 1
Section 176 of the *Bills of Exchange Act*

14. The first deficiency lies in the fact that on a plain reading of the Notes/Installment Sale Contracts, and associated documents, it is patently obvious that the Underlying Debtors' obligation to pay is conditional in nature.

15. The Notes/Installment Sale Contracts expressly state that their purpose is to provide financing for the purchase of a vacation lease (the "**Lease**") from Fairmont Resort and LORV. The Notes/Installment Sale Contracts also state that if the account is more than 30 days in arrears the "rights of usage under the vacation lease will be suspended in favour of [Fairmont Resort and LORV]". The rights of usage are not set out in the Notes/Installment Sale Contracts, but are set out in the Leases. The Notes/Installment Sale Contracts further state that the "full value, rights and benefits to the vacation lease" are pledged to Fairmont Resort and LORV as security.

16. The Leases include a provision allowing the Underlying Debtors the right to rescind the purchase if Fairmont Resort and LORV fail to deliver a Certificate of Leasehold Interest within a specified period of time. The Leases contain the following term:

> **RIGHTS OF RESCISSION OF LESSEE**: In the event that a Lessee who has not financed his purchase (or has financed it where there is no requirement to pledge his Certificate of Leasehold Interest to a lender) does not receive a Certificate of Leasehold Interest from the Lessor evidencing his Lease within five (5) months from the date of payment of the Purchase Price and such Certificate of Leasehold Interest is not delivered to the Lessee within thirty (30) days of the Lessee providing written notice to the Lessor requesting delivery of the Certificate of Leasehold Interest, <u>then the Lessee shall be entitled to repudiate this Lease</u> by providing written notice to the Lessor and thereupon the Lessor will return to the Lessee all monies paid by the Lessee, together with all accrued interest thereon. Delivery by the Lessor of the Certificate of Leasehold interest to a lender constitutes delivery to a lessee.
>
> In addition to the aforesaid contractual right, <u>the Lessee may, in any event, rescind his agreement to purchase a time share interest</u> by serving written notice on the Lessor within seven (7) days after the later of:
>
> (a) the date this Lease was entered into; or
>
> (b) the date the Lessee receives a copy of the prospectus (the "Prospectus") dated September 1, 1990 (as may be amended from time to time), for Fairmont Vacation Villas at Riverside and Hillside.
>
> [Emphasis Added]

17. In the course of being cross-examined, Henson confirmed the conditional nature of the Leases:

> Q. Is Resort Funding aware that purchasers have certain rights of [sic] rescission under their vacation lease agreements?
>
> A. We are aware they have [sic] rescission rights.

Page 21, lines 1 - 3 of the Henson cross-examination

18. Given the close relationship between the Notes/Installment Sale Contracts and the Leases, it would be contrary to fundamental principles of contractual interpretation to consider the documents in isolation of each other. If the Notes/Installment Sale Contracts are read in conjunction with the terms of the Leases, the only reasonable inference to be drawn is that the Notes/Installment Sale Contracts are conditional in nature. On that basis alone, the

Notes/Installment Sale Contracts do not satisfy the definition of "promissory note" as set out in the *BEA* in that they lack certainty.

19. Lastly, on this issue of the conditional nature of the Notes/Installment Sale Contracts, in *Canadian Imperial Bank of Commerce* v. *Morgan*, the Court considered the issue of a contingent obligation in the context of a bank plan note. The Court held that the bank plan note was conditional irrespective of whether or not the contingency had been exercised. The Court specifically found:

> With respect, I would differ from R.P. Fraser J.'s conclusion and find <u>that it is the possibility that the note may be conditional that governs and not whether in this case the contingency arose.</u> The paragraphs on the reverse side of the Bankplan Note permit the borrower and the bank, with or without notice to the holder, who may not be the bank, to alter the terms set out on the face of the document. If this is the case, then the note is conditional and does not meet the requirements of s. 176(1).
>
> [Emphasis Added]

TAB 2
(1993), 143 A.R. 36 (Q.B.) at para. 16

20. A second deficiency in the Notes/Installment Sale Contracts, as it relates to the definitional requirements of a promissory note under the *BEA*, lies in the fact that the Notes/Installment Sale Contracts lack certainty in terms of the amount owing. In the course of being cross-examined on her Affidavit, Henson acknowledged that while individual Notes/Installment Sale Contracts identify the amount of the loan to the interest holder and the purchase price, it is not possible to ascertain the amount owing merely by examining the face of the document:

> Q. Now, looking at this note and installment sales contract, can you tell me how much this purchaser owes to the Fairmont Group?
>
> A. 10,300 was the loan. Purchase price was 11,445.
>
> Q. I understand that. I'm asking you, today, how much is owing under this promissory note and installment sales contract?
>
> A. No idea.
>
> ...
>
> Q. So its unlike a cheque for some certain - - the amounts change under these promissory notes and installment sales contracts from time to time?

A. If the customer makes payment, then the balance is reduced, if that's your question.

Q. Correct. So you need information beyond the face of this document, to know what the balance is?

A. Correct.

Page 13, lines 10 - 17 and page 14, lines 11 - 18 of the Henson cross-examination

21. The fact that the Notes/Installment Sale Contracts fail to meet the "certainty" criteria has additional adverse implications to Resort Funding's argument that the Notes/Installment Sale Contracts constitute promissory notes under the *BEA*. In particular, the conditional nature of the Notes/Installment Sale Contracts necessarily means that, as a transferee, Resort Funding is not a holder in due course as is required by the *BEA*. This concept is illustrated in the Manitoba Court of Appeal decision in *Edie* v. *Turkewich* ("***Edie***") wherein the Court found that where an endorsee has express knowledge that a promissory note is conditional, it is not a holder in due course and therefore does not meet the standard set out in section 176 of the *BEA*. The Court of Appeal specifically held:

> The Bills of Exchange Act, R.S.C., 1927, ch. 16, sec. 56, contains the following:
>
> A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions namely: --
>
> . . . . .
>
> (b) That he took the bill in good faith and for value, and at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.
>
> The plaintiff had notice that the company had no right to assign this contract until certain conditions had been performed by them. This put him on enquiry which, if it had been made, would have shown him that a fraud was being perpetrated.
>
> The notes given never became effective until the defendant had received, tested and accepted the machine as the contract provides.
>
> This brings the case squarely within the section quoted from the Bills of Exchange Act for the plaintiff had express notice that the title of the company was defective until the conditions upon which the notes were issued had been performed. He was put upon enquiry, and he made none.

> Sec. 176 of the Act defines a promissory note as an unconditional promise to pay. The document sued on is not a promissory note in the hands of the plaintiff who had express notice in writing that it was given on conditions which made it inoperative until those conditions had been performed. The company could not have sued on the note, and when they endorsed it to the plaintiff with full information as to the equities surrounding it, the endorsee acquired no greater rights than the payee.

TAB 3
(1940) CarswellMan 15 (Man. C.A.) at paras. 20 - 24

22. In addition to the decision in *Edie*, the Supreme Court of Canada, in *Range* v. *Belvedere Finance Corp.* ("***Range***"), found that where the endorsee takes possession of a promissory note and conditional sales contract together, the endorsee's right to sue on the note is subject to the terms of the conditional sales contract to the extent there is evidence that they should be read together and the note does not contain a clause stating that the endorsee is a holder in due course. Though application of the *Range* decision has been narrowed, it remains good law for the proposition that the Notes/Installment Sale Contracts and Leases must be read together failing which a commercially unreasonable interpretation of the note would result.

TAB 25
Range v. *Belvedere Finance Corp.*, [1969] S.C.R. 492, 5 D.L.R. (3d) 257

23. In the circumstances at issue, it is also of critical importance that the Notes/Installment Sale Contracts fail to contain a clause stating that the endorsee is a holder in due course. On that basis, it is necessary to imply the terms of the rescission clause into the Notes/Installment Sale Contracts in order for the Notes/Installment Sale Contracts to be interpreted in a commercially reasonable manner. If the right of rescission is exercised, the Underlying Debtor will have no obligation to pay.

24. To be effective, the express language contained in the Notes/Installment Sale Contracts must be read together with the terms of the Leases. It logically follows that because the Leases contain a rescission clause, the Notes/Installment Sale Contracts are conditional in nature. In addition, as acknowledged by Henson, the Notes/Installment Sale Contracts fail to satisfy the certainty criteria in that the Notes/Installment Sale Contracts fail to identify a sum certain owing. In either case, the Notes/Installment Sale Contracts fail to meet the statutory requirements of a promissory note. Certainly, if the underlying Lease was rescinded, no payment could be pursued under the Notes/Installment Sale Contracts.

Fairmont Resort and LORV have retained a "property" interest in the Notes/Installment Sale Contracts

25. In the event that this Honourable Court determines that the Notes/Installment Sale Contracts are promissory notes within the meaning of the *BEA*, Fairmont respectfully submits that they are not the property of Resort Funding and that Fairmont Resort and LORV retain a proprietary interest in the Notes/Installment Sale Contracts.

26. The Amended Loan Agreement and the Security Documents contemplate Resort Funding as a secured creditor of Fairmont Resort and LORV. The Notes/Installment Sale Contracts and payments made thereon, among other things, serve as collateral for the Amended Loan Agreement.

27. Section 55 of the *BEA* sets out the test for a holder in due course:

> **55.** (1) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely,
>
> (*a*) that he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact; and
>
> (*b*) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

TAB 4
Section 55 of the *Bills of Exchange Act*

28. Section 73 of the *BEA* then goes on to identify the powers of a holder in due course as it relates to a bill:

> **73.** The rights and powers of the holder of a bill are as follows:
>
> (*a*) he may sue on the bill in his own name;
>
> (*b*) where he is a holder in due course, he holds the bill free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill;
>
> (*c*) where his title is defective, if he negotiates the bill to a holder in due course, that holder obtains a good and complete title to the bill; and
>
> (*d*) where his title is defective, if he obtains payment of the bill, the person who pays him in due course gets a valid discharge for the bill.

TAB 5
Section 73 of the *Bills of Exchange Act*

29. On a simple analysis of sections 55 and 73 of the *BEA*, it is evident that a holder in due course must also be a holder for value. A holder in due course is, according to section 73(b) of the *BEA*, "free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill."

30. Resort Funding takes the position that the Notes/Installment Sale Contracts, having been collaterally endorsed to them by Fairmont Resort and LORV, are no longer the property of Fairmont Resort and LORV because such endorsement constitutes a transfer pursuant to the provisions of the *BEA*. Resort Funding argues that the *BEA*, at sections 52 and 55, deems them a holder in due course of the Notes/Installment Sale Contracts due to the endorsement in their favour as well as possession. Resort Funding relies on *King* v. *On-Stream Natural Gas Management Inc.* ("***King***") and *Range* to support its position.

RESORT FUNDING BRIEF - TAB 13
[1993] B.C.W.L.D. 1808

31. The law is far from clear with respect to whether a holder of a note as security who meets the definition in s. 55 of the BEA is a holder in due course. The jurisprudence cited by Resort Funding is not particularly instructive. In particular, *Range* dealt specifically with the use of promissory notes in conjunction with conditional sales contracts and is therefore distinguishable from the facts currently at issue. In addition, neither *King* nor *Range* discusses the relationship between the concept of "holder in due course" and a party's ownership interest in the notes. These decisions merely consider the concept of holder in due course in terms of a party's right to bring an action on the notes as against other parties. Of greater significance however, is the fact that neither *Range* nor *King* deals with the specific issue before this Honourable Court, namely whether the Notes/Installment Sale Contracts remain part of the property of Fairmont Resort and LORV in these CCAA proceedings.

32. Even if Resort Funding holds the Notes/Installment Sale Contracts in due course, the Notes/Installment Sale Contracts remain part of the of Fairmont Resort and LORV estate. This point is illustrated by the *Range* decision which cites *Bonenfant* v. *Canadian Bank of Commerce* ("***Bonenfant***") for the proposition that a secured creditor is a holder in due course of a promissory note. In *Bonenfant*, the Quebec Court of Appeal held that when a secured creditor seeks to recover on a promissory note, it does so as the agent for the debtor. The Court of Appeal went on to find that taking a note as collateral security for a debt is to be distinguished from a sale or discount of the note in which the endorsee becomes the outright owner. When a note is pledged, the pledgor (i.e., Fairmont Resort and LORV) remains the outright owner of the note, subject to a lien. On that basis, it follows that the pledgor retains a property interest in the promissory note and that a conveyance of all rights and obligations does not

transpire merely by endorsement of a promissory note intended to act as collateral.

TAB 6
Bonenfant v. *Canadian Bank of Commerce* 1929 CarswellQue 57 (C.A.) at para. 21
(upheld [1930] S.C.R. 386

33. The actual position of Resort Funding in relation to the Notes/Installment Sale Contracts is that of a lien holder. That lien is the right to retain possession of the Notes/Installment Sale Contracts, belonging to Fairmont Resort and LORV, until such time as the Amended Loan Agreement has been repaid in full. Resort Funding acquires that lien by virtue of the Notes/Installment Sale Contracts having been deposited as collateral security for the debt owing. The *BEA* is clear that a lien holder over a bill is a holder for value to the extent of the lien amount. In particular, section 53(2) of the *BEA* states:

> 2) Where the holder of a bill has a lien on it, arising either from contract or by implication of law, he is deemed to be a holder for value to the extent of the sum for which he has a lien.

TAB 7
Bank of Montreal v. *Weisdepp*, [1917] 2 W.W.R. 615 (B.C.C.A.) at 616

TAB 8
Section 53(2) of the *Bills of Exchange Act*

34. By definition, a lien is a charge on property that is owned by the debtor. While Resort Funding certainly acquired rights with respect to the Notes/Installment Sale Contracts, the mere act of pledging the Notes/Installment Sale Contracts did not amount to a transfer or absolute conveyance of Fairmont Resort and LORV's ownership interest. It is acknowledged that while Resort Funding has a lien over the Notes/Installment Sale Contracts, they remain part of the estate of Fairmont Resort and LORV. Resort Funding, like any secured or unsecured creditor, is subject to the CCAA proceedings.

Commercial absurdity

35. A commercial absurdity would result if this Honourable Court were to find that the Notes/Installment Sale Contracts did not form a part of Fairmont Resort and LORV's estate. In particular, a determination that Fairmont Resort and LORV have no property interest in the Notes/Installment Sale Contracts would mean that each are unsecured creditors of Resort Funding in relation to amounts collected under the Notes/Installment Sale Contracts. Given the substantial difference in the debt obligation of Fairmont Resort and LORV to Resort Funding and the value of the Notes/Installment Sale Contracts, this result is highly prejudicial to Fairmont Resort and LORV, including its creditors in the CCAA

proceedings, and does not accord with the commercially reasonable expectations of the parties.

36. If Fairmont Resort and LORV were found to be unsecured creditors in relation to the Notes/Installment Sale Contracts, their risk in relation to their debt obligations to Resort Funding nearly doubles, from the value of the debt obligation at $8,000,000.00 to the value of the Notes/Installment Sale Contracts at $13,000,000.00. Resort Funding acknowledges having at least one secured creditor, namely, Merrill Lynch Mortgage Capital Inc. ("***Merrill Lynch***") for loans related to all projects and not just the Fairmont projects.

37. The Supreme Court, in *Canada Life Assurance Co.* v. *Canadian Imperial Bank of Commerce*, specifically found that the *BEA* should not be interpreted to produce absurd or unjust results. The Court held that as the *BEA* was intended to simplify and clarify commerce in negotiable instruments and its interpretation should favour the facilitation of commerce.

TAB 9
[1979] 2 SCR 669, 8 B.L.R. 55 at para. 9

38. This approach to the *BEA* was more recently affirmed by the Supreme Court in *Boma Manufacturing Ltd.* v. *Canadian Imperial Bank of Commerce* wherein LaForest J. held:

> Where a court is faced with the situation where there is more than one possible construction of the statutory provision before it, and the result of one construction would lead to manifest absurdity or injustice (see E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 47, and *Grey v. Pearson* (1857), 6 H.L.C. 60), it is well established that a court will adopt the construction that does not lead to that result, even though the words used would strongly favour the alternative construction; see, for example, *Caledonian Railway Co. v. North British Railway Co.* (1881), 6 App. Cas. 114 (H.L.).

TAB 10
[1996] 3 SCR 727, 82 B.C.A.C. 161 at para. 109

39. The *BEA* must not only be interpreted to avoid commercial absurdity, so must the contracts pledging the Notes as collateral (the "Security Documents"). The existing body of jurisprudence is clear that the duty of the court is to avoid commercial absurdity in the interpretation of commercial contracts. In particular, in *3869130 Canada Inc.* v. *I.C.B. Distribution Inc.*, the Court held that commercial contracts are to be interpreted in a manner that avoids rendering any of the contractual terms ineffective and "in a fashion that accords with sound

commercial principles and good business sense, and that avoids a commercial absurdity."

TAB 11
[2008] O.J. No. 1947 at para. 31

Contradiction with Subsequent Behaviour

40. In the course of its argument, Resort Funding takes the position that endorsement of the Notes/Installment Sale Contracts to Resort Funding constitutes a transfer and relinquishment of the entirety of Fairmont Resort and LORV's property interest in the Notes/Installment Sale Contracts. This position was confirmed by Henson in the course of cross-examinations:

> Q. So your position at Resort Funding is that the Fairmont Group has delivered its interest in the notes to Resort Funding, such that it's no longer the Fairmont Group's property?
>
> A. Yes.

Page 16, lines 11 - 15 of the Henson cross-examination

41. That assertion however, is contradicted by Resort Funding's subsequent behaviour. Resort Funding admits to having "endorsed and delivered the Notes, including all payments made thereon, as security to its lender Merrill Lynch Mortgage Capital Inc. The Notes are currently held by US Bank Corporate Trust Services in St. Paul, Minnesota as custodian." On the logic being advanced, Resort Funding lost its interest in the Notes/Installment Sale Contracts upon them being pledged to Merrill Lynch.

Page 13, lines 22 - 26 of the Henson cross-examination

42. Resort Funding dealt with the Notes/Installment Sale Contracts in precisely the same manner as Fairmont Resort and LORV in that they endorsed and delivered them to their lender pursuant to a security agreement. A substantial injustice would be occasioned by Fairmont Resort and LORV, and their CCAA creditors, if Resort Funding was successful in having the same course of action result in vastly different legal consequences.

43. The frailty of Resort Funding's assertion of ownership of the Notes/Installment Sale Contracts is further revealed when the result is examined having regard to Resort Funding's subsequent transfer of the Notes/Installment Sale Contracts to Merrill Lynch. Not only would Fairmont Resort and LORV be in an unsecured position vis-à-vis Resort Funding in relation to the Notes/Installment Sale Contracts, Resort Funding would be in an unsecured position vis-à-vis Merrill Lynch in relation to the Notes/Installment Sale Contracts. Neither Fairmont

Resort/LORV nor Resort Funding would have any priority as to these debt obligations and would be subordinated to Merrill Lynch's secured creditors.

44. The absurdity of Resort Funding's position was exposed in the course of the Henson cross-examination:

> Q. But haven't you just told me that Resort Funding has similarly passed them on to Merrill Lynch? So under that logic, wouldn't it no longer be Resort Funding's property, but Merrill Lynch's?
>
> MR. ROBINSON: I'm not sure that my client cares to comment on the logic of the situation. She's described the relationship, described it frankly in her affidavit. I'm not sure she's prepared to answer questions about where logic leads you from that relationship.

Page 16, lines 16 - 24 of the Henson Affidavit

45. It is beyond dispute that the value of payments under the Notes/Installment Sale Contracts collaterally assigned, endorsed and delivered to Resort Funding are in excess of the indebtedness owing from Fairmont and LORV to Resort Funding. The recipient of the subsequent collateral assignment, endorsement and delivery, Merrill Lynch, is the lender to Resort Funding on numerous projects unrelated to Fairmont. If Resort Funding's theory of passage of title is correct, then Merrill Lynch, with no contract or relationship to Fairmont, holds absolutely in excess of $12,000,000.00 of Notes/Installment Sale Contracts as collateral for less than $8,000,000.00 of indebtedness.

(ii) If the Notes/Installment Sale Contracts are collateral security, is the relief sought by Resort Funding *res judicata* as it relates to its position as a secured creditor?

46. In the course of the DIP Facility application, Resort Funding, through its former counsel, opposed the relief sought by Fairmont on the basis that, as a secured creditor, its secured position should not be primed by a priority charge to Century. In particular, Resort Funding argued that granting a priority charge to Century in the amount of the proposed DIP Facility would be overly prejudicial to Resort Funding's position as a secured creditor.

47. In granting Fairmont's application for approval of the DIP Facility, the Court held:

> I am satisfied by the evidence before me that the possibility of an orderly restructuring that would create an upside value for all the stakeholders of the Fairmont group outweighs the potential prejudice to resort funding and I will see here, recognizing that we are in the early stages of this CCAA proceeding.

Exhibit "C" to the Moore Affidavit

48. The reasoning of this Honourable Court in granting the DIP Facility is consistent with the current jurisprudence. In *Re: Hunters Trailer & Marine Ltd.*, Chief Justice Wachowich specifically considered the circumstances under which a Court should grant Debtor-in-Possession financing which subordinates pre-existing security interests. In finding that the Court's inherent jurisdiction is not limited to purely "exceptional circumstances", his Lordship held:

> If super-priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively would be denied a debtor company in many cases.

TAB 12
[2001] A.J. No. 857 (Q.B.) at para. 32

49. For Resort Funding to now take the position that, as a secured creditor, its position should not be primed represents a collateral attack on the decision of this Honourable Court in granting the DIP Facility. Any argument advanced by Resort Funding in the course of the within application that its secured position should not be primed is *res judicata* based on the law of issue estoppel.

50. The current state of the law in respect of the doctrine of *res judicata* is clear. In *Ernst & Young Inc.* v. *Central Guaranty Trust Co.*, the Alberta Court of Appeal succinctly summarized the law in the following terms:

> ***A. Res Judicata***
>
> The doctrine of res judicata has two branches: issue estoppel and cause of action estoppel. Issue estoppel precludes litigation of an issue previously decided in another court proceeding, and cause of action estoppel precludes the litigation of a cause of which was adjudged in a previous court proceeding: Donald J. Lange, *The Doctrine of Res Judicata in Canada*, 2d ed. (Ontario: LexisNexis Canada Inc., 2004) at 1 [*Res Judicata*]. We need not consider the applicability of cause of action estoppel because issue estoppel precludes Central Guaranty from attacking the validity of the trusts in this litigation.
>
> *(i) Issue Estoppel*
>
> For issue estoppel to be successfully invoked, the issue must be the same as the one decided in the prior judicial decision, the prior judicial decision must have been final, and the parties to both proceedings must be the same, or their privies: *Toronto (City) v. C.U.P.E., Local 79*, [2003] 3 S.C.R. 77, 2003 SCC 63 (S.C.C.) at para. 23 [*Toronto*].

TAB 13
[2006] ABCA 337 (C.A.) at paras 29 and 30

51. The law of issue estoppel clearly applies in the circumstances. At the time of the DIP Facility application, Resort Funding opposed the relief sought and argued that its secured position should not be primed by the proposed DIP Facility. This Honourable Court, consistent with the current line of judicial authority, rejected that argument and granted approval of the DIP Facility. On that basis, the issue of whether, as a secured creditor, Resort Funding's secured charge should be primed by the DIP Facility is *res judicata*.

(iii) Is it just and convenient that Resort Funding's interest in the Notes/Installment Sale Contracts are affected by these *CCAA* proceedings?

52. Resort Funding correctly identifies that one of the goals of the *CCAA* is to preserve the status quo of the restructuring entity and its creditors as at the time prior to the proceedings. Resort Funding argues that the inclusion of the Notes/Installment Sale Contracts in the estate of Fairmont Resort and LORV alters the status quo so significantly as to create an unjust and inconvenient result for Resort Funding such that the Notes/Installment Sale Contracts ought to be excluded from the *CCAA* proceedings.

53. It must however, be borne in mind that the *CCAA* has long been recognized as a statutory instrument designed to ensure long-term viability of worthy enterprises. On that vein, Professor Sarra wrote:

> The *CCAA* gives public policy recognition to the value of restructuring processes. The crux of the success of the *CCAA* as a restructuring tool has been the willingness of the courts to interpret the statute in a purposive manner. As the Quebec Superior Court observed in *PCI Chemicals Canada Inc.*, the courts have consistently held that the *CCAA* should be interpreted in a fair, large and liberal manner, with the court considering the equities in each case. Mr. Justice Tysoe of the British Columbia Supreme Court has observed that the successful reorganization of *Quintette Coal* was as a result of the flexibility of the *CCAA* and the court in allowing the parties time to craft a viable plan.

TAB 14
Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*
(Toronto: Thomson Carswell, 2007) at p. 59

54. The *CCAA* gives the Court broad supervisory powers which must be exercised with certain guiding principles, including both justice and convenience. It is clear that justice and convenience are considered with reference to all affected parties. The Alberta Court of Appeal has stated that "justice and convenience can only be established by considering and balancing the position of both parties."

TAB 15
BG International Ltd. v. *Canadian Superior Energy Inc.* 2009 ABCA 127, [2009] A.W.L.D. 1936 at para. 17

55. The question of "justice" and "convenience", from the perspective of Resort Funding appears to boil down to whether it will face a shortfall on its security if the post-*CCAA* revenues from the Notes/Installment Sale Contracts remain with Fairmont Resort and LORV. Fairmont respectfully submits that this is a non-issue as the value of the Notes/Installment Sale Contracts far exceeds the value of Fairmont Resort and LORV's obligations to Resort Funding. Consequently, it would be unjust to grant the relief requested by the applicant.

56. The Henson Affidavit, in part, also purports to address the "convenience" of the relief sought by Resort Funding in the within application. In paragraphs 23 and 25 of her Affidavit, Henson suggests that revenues from the Notes/Installment Sale Contracts is not necessary to fund ongoing business operations and that, assuming certain conditions had been met, Fairmont Resort and LORV's operations should be self sufficient. That assertion was disputed in the Moore Affidavit wherein, at paragraphs 13 - 15, Moore states that the mere collection of management fees is not adequate, on their own, to render Fairmont Resort and LORV self-sufficient. Moore's evidence on that point was unchallenged on cross-examination.

Paragraphs 23 and 25 of the Henson Affidavit

Paragraphs 13 - 15 of the Moore Affidavit

57. The position advocated by Resort Funding, in addition to ignoring significant legal issues relating to the *BEA* and *CCAA*, also fails to consider the impact that the requested relief may have on the restructuring of Fairmont as a whole and the resulting prejudice to other creditors. Fairmont, despite Resort Funding's strident opposition and objection, sought and obtained approval of the Century DIP Facility. Since approval of the DIP Facility, Fairmont has drawn the sum of $1,000,000.00. The within application, to the extent that the requested relief is granted, has the potential to adversely impact Fairmont's restructuring efforts. In the event that the Notes/Installment Sale Contracts are held not to be an asset of Fairmont Resort and LORV, Century will consider it to be under no obligation to advance further funds and would likely seek leave of the Court to enforce its security and collect payment of all amounts outstanding. Such steps, according to the Moore Affidavit, would almost certainly prevent Fairmont from structuring a plan of arrangement for the benefit of its creditors. That evidence also went unchallenged in the course of the Moore cross-examination.

58. Fairmont, in response to Resort Funding's position regarding preservation of the status quo, respectfully submits that preservation of the status quo is but one consideration of the *CCAA*. The paramount objective is "to facilitate restructuring so that the company can successfully emerge from the process." In the event

that the relief requested herein by Resort Funding is granted, it is almost certain that that objective will not be attained in the case of Fairmont.

TAB 16
Re: Stelco Inc. (2005), 78 O.R. (3d) 254 (Ont. C.A.) at para. 18

59. It is clear that Resort Funding's interest in the Notes/Installment Sale Contracts is simply a mechanism to provide collateral security for its loan advances to Fairmont and LORV. The nature or description of the collateral security should not excuse Resort Funding from being an effected creditor under the CCAA, not should it exempt the pledged collateral from the priming effect of the DIP Facility or other CCAA priority charges.

60. Resort Funding's arguments are similar to those advanced by Canada Revenue Agency ("**CRA**") in *Re: Temple City Housing Inc.* In that case, CRA claimed a deemed trust interest in seeking to exempt its collateral from a Debtor-in-Possession loan facility. In rejected the position articulated by CRA, the Court, which finding was upheld on appeal, reasoned:

> This interpretation of the deemed trust provision is inconsistent with the CRA's argument that it creates a property interest that cannot be superceded by a DIP Charge, despite the concluding words of s. 227(4.1). As pointed out by counsel for the proposed DIP lender, the characterization of the deemed trust claim as a security interest, albeit one that takes priority over other secured interests, is supported by the definition of "security interest" in the ***Income Tax Act*** itself, which includes reference to a "deemed or actual trust."
>
> It is clear that a court in a CCAA proceeding is able to grant a super-priority over existing security interests for DIP financing. If it were otherwise, and if super-priority could not be granted without the consent of secured creditors, "the protection of the CCAA effectively would be denied a debtor company in many cases": ***Hunters Trailers & Marine Ltd.***, at para. 32. It is also undoubtedly true that, since DIP financing may erode the security of creditors, the Court should be cautious in exercising its inherent jurisdiction to order priority for a DIP Charge over the objection of a secured creditor. I am satisfied that, in this case, Temple requires the protection of the CCAA if there is to be any possibility that it will be able to continue in business for the benefit of its creditors, employees and other stakeholders.

TAB 17
[2007] A.J. No. 1489 (Q.B.) at paras. 13 and 14
(upheld on appeal at [2008] A.J. No. 1 (C.A)

61. Similarly, it is necessary to consider in these circumstances that Resort Funding is, in essence and substance, a secured creditor with a certain series of documents and agreements arranged to effect that security but not property interests.

(iv) Does Resort Funding have a first charge on the Notes/Installment Sale Contracts?

62. Although not relevant to the within application, the following is a review of certain issues relating to Resort Funding's claim to first priority creditor status.

Applicable law

63. Each of the individual Notes/Installment Sale Contracts contain the same jurisdiction clause that any dispute is to be interpreted and enforced "under the laws and in the Courts of British Columbia". On that basis, Fairmont acknowledges that the Notes/Installment Sale Contracts are governed by British Columbia law and, particularly, the British Columbia Personal Property Security Act ("***PPSA***").

The Notes/Installment Sale Contracts are not "Instruments" within the meaning of the PPSA

64. Section 1(1) of the *PPSA* defines "instrument" as follows:

"instrument" means

(a) a bill of exchange, note or cheque within the meaning of the Bills of Exchange Act (Canada),

(b) any other writing that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, or

(c) a letter of credit or an advice of credit if the letter of credit or advice of credit states on it that it must be surrendered on claiming payment under it,

but does not include

(d) chattel paper, a document of title or investment property, or

(e) a bond, debenture or similar document evidencing an obligation secured, in whole or in part, by a mortgage of an interest in land unless the interest being mortgaged is, itself, a mortgage of land;

TAB 18

Section 1(1) of the *Personal Property Security Act*

65. The Notes/Installment Sale Contracts do not fall within the *PPSA* definition of "instruments" for two reasons. First, the Notes/Installment Sale Contracts are not in fact "promissory notes" for the purposes of the *BEA* on the basis that they are conditional in nature. The conditional nature of the Notes/Installment Sale Contracts was confirmed in the course of the Henson cross-examination.

66. The *BEA* is clear that if an obligation is conditional in nature, it does not fit within the definition of a "promissory note". On that basis, the requirements of section 1(1)(a) of the *PPSA* are not met.

67. Second, a promissory note, by its very nature is not the type of obligation that "is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment". A true promissory note is not something that, in the ordinary course, is automatically capable of being negotiated following endorsement and delivery as in the case of a cheque. This concept of transferability of an "instrument" was considered in the *Alberta PPSA Handbook*, in the context of section 31, wherein the authors state:

> An "instrument" to which the section applies is defined in section 1(1)(u) to include not only the traditional types of negotiable instruments to which the Bills of Exchange Act applies, but, as well, any other "writing" that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment. The definition also includes a letter of credit or advice of credit if the letter or advice of credit states that it must be surrendered on claiming payment under it. These types of instruments could be described as being the midway between a negotiable instrument and a pure intangible. They need not be negotiable in the sense that the transferee may acquire a better title than that of the transferor. <u>However, they must be recognized in the commercial community as evidencing the right to collect the debt they represent or as being a method through which that right can be transferred. Accordingly, an instrument is more than just a written record of a debt.</u>
>
> [Emphasis Added]

TAB 19

Ronald Cumming and Roderick Wood, "Alberta Personal Property Security Handbook" 2nd ed. (Toronto: Carswell, 2004) at page 294

68. The concept that, to qualify as an "instrument", the writing must be recognized as evidencing the right to collect payment is of critical importance. As acknowledged in the course of the Henson cross-examination, the

Notes/Installment Sale Contracts are conditional in that they are subject to rescission rights and are not for a sum certain (i.e., the holder is not, from a review of the face page, readily able to ascertain the total amount owing). To suggest that such a document evidences a right to collect a sum certain, or even to collect at all, simply does not follow.

69. In the circumstances, in order to rely on the special priority rule contained in section 31 of the PPSA, Resort Funding must demonstrate that the transferred Notes/Installment Sale Contracts were "instruments". Given that Resort Funding acknowledges that the Notes/Installment Sale Contracts were capable of rescission, and thereby conditional in nature, the Notes/Installment Sale Contracts do not meet the test for a "promissory note" for the purposes of the *BEA*. Further, it simply cannot be said that a "promissory note", including the Notes/Installment Sale Contracts, are commonly recognized as an obligation of a right to collect. Rather, the Notes/Installment Sale Contracts are in the form of a record of an original loan amount that may be owing in a lesser sum than stated or not at all.

TAB 20
Section 31 of the *Personal Property Security Act*

The Notes/Installment Sale Contracts are "Intangibles" within the meaning of the PPSA

70. In the circumstances at issue, the Notes/Installment Sale Contracts are "intangibles" which are defined in the *PPSA* as follows:

> "intangible" means
>
> (a) personal property, but does not include goods, chattel paper, a document of title, an instrument, money or investment property, and
>
> (b) a licence;

TAB 21
Section 1(1) of the *Personal Property Security Act*

71. For the purposes of the *PPSA* an "intangible" is a residual form of collateral which covers personal property not falling under the other six categories. It is plain and obvious that the Notes/Installment Sale Contracts do not fall under the category of any of "goods", "chattel paper", "securities", or "documents of title". As such, the Notes/Installment Sale Contracts must be one of either "instruments" or "intangibles". On the basis that the Notes/Installment Sale Contracts do not fit within the definition of an "instrument", they must, by default, be "intangibles".

Perfection by Registration

72. The *PPSA* allows a secured creditor to perfect its interest in collateral by either registration or possession. The concept of registration is governed by section 25 which states:

> 25 Subject to section 19, registration of a financing statement perfects a security interest in collateral.

TAB 22
Section 25 of the *Personal Property Security Act*

73. Resort Funding's purported security interest in the Notes/Installment Sale Contracts was registered on June 27, 2003 in the Personal Property Registry ("**PPR**") of British Columbia (the "Initial PPR registration") for a term of five years. In accordance with section 25 of the *PPSA*, the Initial PPR Registration purported to perfect Resort Funding's security interest in the Notes/Installment Sale Contracts. The following third party creditors effected security registrations following the Initial PPR registration:

(a) on February 11, 2004, MRGC LLC registered against all present and after acquired personal property of Fairmont ("all PAAPP") for a term of ten years;

(b) on February 20, 2009, FRPL registered against all PAAPP of Fairmont for five years;

(c) on March 27, 2009, Cedarpointe Estate Ltd. registered against "all the benefits, rights, remedies and interest of the debtor in an to the timeshare receivables and financing contract including without limitation, the timeshare receivables and financing contracts themselves" for an infinite period; and

(d) on March 30, 2009, FRPL Finance Ltd. and FRPL Management Ltd. registered against all PAAPP for five years.

74. Resort Funding allowed the Initial PPR registration at the British Columbia PPR to lapse on June 27, 2008. Resort Funding subsequently re-registered its security interest at the Alberta and British Columbia PPRs on April 23, 2009.

75. Section 35 of the *PPSA* stipulates the residual rules for determining priority between perfected security interests for which the act does not otherwise provide. Fairmont submits that the residual priority rules in section 35 apply in the circumstances at issue.

76. Section 35(1)(a) of the *PPSA* states that priority between perfected security interests in the same collateral is determined by whichever of the following occurs first:

(a) the registration of a financing statement without regard to the date of attachment of the security interest;

(b) possession of the collateral in accordance with section 24 without regard to the date of attachment of the security interest;

(c) perfection under section 5, 7, 26, 29 or 78;

TAB 23
Section 35 of the *Personal Property Security Act*

77. In the circumstances at issue, pursuant to the operation of section 35(1) of the *PPSA*, Resort Funding originally took a first priority position over subsequently registered security interests because it was the first secured party to perfect.

78. Section 35(7) of the *PPSA* deals specifically with instances where a security interest, perfected by registration as in the case of Resort Funding, is allowed to lapse. In such instances where a security interest lapses as a result of failure to renew the registration and the secured party re-registers the security interest not later than 30 days after the lapse, the lapse does not affect the priority status of the security interest in relation to a competing perfected security interest that immediately before the lapse had a subordinate priority position. Simply stated, had Resort Funding renewed the Initial PPR registration within 30 days of the date of lapse (i.e., June 27, 2008), it would have retained its priority position vis-à-vis those creditors that registered security interests subsequent to the Initial PPR registration.

79. Resort Funding did not however re-register its security interest until approximately 10 months after the Initial PPR registration lapsed. Consequently, its priority status became subordinate to the third parties' perfected security interests.

Perfection by Possession

80. The *PPSA* also permits, in certain circumstances, a secured party to perfect by possession. Section 24 of the *PPSA* states:

> (1) Subject to section 19, possession of the collateral by the secured party, or on the secured party's behalf by another person, perfects a security interest in
>
> (a) chattel paper,

(b) goods;

(c) an instrument;

(d) repealed;

(e) a negotiable document of title, and

(f) money,

unless possession is a result of seizure or repossession.

TAB 24
Section 24 of the *Personal Property Security Act*

81. Fairmont respectfully submits that the Notes/Installment Sale Contracts do not meet the definition of "instruments" on the basis that they are not "promissory notes" pursuant to section 176 of the *BEA*. It is Fairmont's position that the Notes/Installment Sale Contracts are "intangibles" which are not capable of being perfected by possession.

82. Fairmont respectfully submits that even if it is wrong and this Honourable Court determines that the Notes/Installment Sale Contracts are "instruments" for the purposes of the *PPSA*, that does not assist Resort Funding's argument that it has achieved perfection by way of possession. While the *PPSA* permits perfection of an instrument by virtue of possession, those are not the current facts. Resort Funding has given up possession of the Notes/Installment Sale Contracts as they have been bundled up and passed on to the agent of their secured lender.

Page 16, lines 2 - 10 of the Henson cross-examination

Paragraph 16 of the Henson Affidavit

83. On the evidence of Resort Funding, it no longer retains possession of the Notes/Installment Sale Contracts as they have been pledged and delivered to Merrill Lynch as collateral for its portfolio of loans.

84. Finally, in support of its claim of a continuous perfected security interest, Resort Funding purports to rely on section 31(3) of the *PPSA* as a means of arguing that it maintains a priority position as a transferee of an instrument who has acquired physical possession for value and without knowledge that it is subject to a security interest. This claim however, ignores the fact that while Resort Funding may have had possession of the Notes/Installment Sale Contracts at one time, the Notes/Installment Sale Contracts were subsequently pledged and physically delivered to Merrill Lynch. Given that to be the case, section 31(3) is of no application in the circumstances at issue.

VI. NATURE OF RELIEF SOUGHT

85. Fairmont respectfully submits, for all of the reasons cited herein, that Resort Funding's application must be dismissed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 22ND DAY OF JUNE, 2009.

Macleod Dixon LLP

____

Howard A. Gorman
Solicitors for Fairmont Resort Properties Ltd.,
Lake Okanagan Resort Vacation (2001) Ltd.,
Lake Okanagan Resort (2001) Ltd.
and LL Developments Ltd.

CANADA

CONSOLIDATION

CODIFICATION

Bills of Exchange Act

Loi sur les lettres de change

CHAPTER B-4

CHAPITRE B-4

Current to May 27, 2009

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PART IV

PROMISSORY NOTES

Definition

176. (1) A promissory note is an unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.

Endorsed by maker

(2) An instrument in the form of a note payable to the maker's order is not a note within the meaning of this section, unless it is endorsed by the maker.

Pledge of collateral security

(3) A note is not invalid by reason only that it contains also a pledge of collateral security with authority to sell or dispose thereof.

R.S., c. B-5, s. 176.

Inland note

177. (1) A note that is, or on the face of it purports to be, both made and payable within Canada is an inland note.

Foreign note

(2) Any other note is a foreign note.

R.S., c. B-5, s. 177.

Delivery

178. A note is inchoate and incomplete until delivery thereof to the payee or bearer.

R.S., c. B-5, s. 178.

Joint and several liability

179. (1) A note may be made by two or more makers, and they may be liable thereon jointly, or jointly and severally, according to its tenor.

Individual promise

(2) Where a note bears the words "I promise to pay" and is signed by two or more persons, it is deemed to be their joint and several note.

R.S., c. B-5, s. 179.

Demand note presentment

180. (1) Where a note payable on demand has been endorsed, it must be presented for payment within a reasonable time of the endorsement.

Reasonable time

(2) In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and the facts of the particular case.

R.S., c. B-5, s. 180.

Endorser discharged

181. Where a note payable on demand that has been endorsed is not presented for payment within a reasonable time, the endorser is discharged but, if it has, with the assent of the en-

PARTIE IV

BILLETS

Définition

176. (1) Le billet est une promesse écrite signée par laquelle le souscripteur s'engage sans condition à payer, sur demande ou à une échéance déterminée ou susceptible de l'être, une somme d'argent précise à une personne désignée ou à son ordre, ou encore au porteur.

Endossement par le souscripteur

(2) L'effet rédigé sous forme de billet payable à l'ordre du souscripteur n'est pas un billet au sens du présent article, sauf s'il est endossé par le souscripteur.

Garantie

(3) Le fait pour un billet d'être assorti d'une sûreté avec autorisation de vendre ou d'aliéner le bien mis en gage ne constitue pas une cause de nullité.

S.R., ch. B-5, art. 176.

Billet intérieur

177. (1) Le billet qui est ou paraît, manifestement, souscrit et payable au Canada est un billet intérieur.

Billet étranger

(2) Tout autre billet est un billet étranger.

S.R., ch. B-5, art. 177.

Livraison

178. Le billet est incomplet tant qu'il n'a pas été remis au bénéficiaire ou au porteur.

S.R., ch. B-5, art. 178.

Obligation conjointe ou solidaire

179. (1) Un billet peut être souscrit par plusieurs personnes qui peuvent s'engager conjointement ou solidairement, selon sa teneur.

Promesse individuelle

(2) Le billet qui porte les mots « Je promets de payer » et la signature de plusieurs personnes rend les souscripteurs solidaires.

S.R., ch. B-5, art. 179.

Présentation d'un billet payable sur demande

180. (1) Le billet payable sur demande doit être présenté au paiement dans un délai raisonnable après son endossement.

Délai raisonnable

(2) Pour la détermination d'un délai raisonnable, il est tenu compte de la nature de l'effet, des usages du commerce et des circonstances particulières.

S.R., ch. B-5, art. 180.

Libération de l'endosseur

181. L'endosseur d'un billet payable sur demande est libéré lorsque celui-ci n'est pas présenté au paiement dans un délai raisonnable, étant toutefois entendu que si, avec le consente-

Indexed as:

Canadian Imperial Bank of Commerce (CIBC) v. Morgan

Between:
Canadian Imperial Bank of Commerce, Plaintiff, and
Michale M. Morgan and Don L. St. Germaine, Defendants

[1993] A.J. No. 524

[1993] 7 W.W.R. 171

11 Alta. L.R. (3d) 90

143 A.R. 36

10 B.L.R. (2d) 72

41 A.C.W.S. (3d) 425

No. 9101-16510

Alberta Court of Queen's Bench
Judicial District of Calgary

Lutz J.

June 24, 1993.

(16 pp.)

STATUTES, REGULATIONS AND RULES CITED:

Bills of Exchange Act, R.S.C. 1985, c. B-4, ss. 27(1), 27(1) (c), 176(1), 176(3).
Guarantees Acknowledgment Act, R.S.A. 1980, c. G-12.
Interest Act, R.S.C. 1985, c. I-15, s. 4.
Judgment Interest Act, S.A. 1984, c. J-0.5.

Bills of Exchange -- Promissory notes -- Requirements -- Non-conditional -- Certain as to sum -- Bank plan note to secure car loan co-signed by friend -- Note conditional as allowing for extension or altering of terms -- Uncertain as to sum where authority given to extend security beyond note -- Bank plan note falling outside Bills of Exchange Act -- Guarantees -- Co-signer of bank plan note not guarantor -- Actions -- Remedy to sue in debt where security not bill of exchange or guarantee.

This was an action to recover the deficiency owing on a bank plan note. M obtained a bank loan to purchase a car. G, a friend of M, agreed to co-sign the loan. A bank plan note was signed by M and G for $21,500 repayable with interest at 17.25 per cent per year in 12 equal monthly instalments with the balance of principal and interest due and payable in one year. M, who defaulted on the loan, was found out of jurisdiction, unemployed and without assets. The car was sold and the proceeds credited to the loan. The bank seeking the balance of the deficiency on the note from G, took money from G's account and cashed an investment certificate hypothecated towards the loan. The bank argued that the note was a promissory note. G claimed that he was given to understand that his maximum liability was limited to the $10,000 investment certificate hypothecated and argued that the note was not a promissory note as it was conditional and not made out for a sum certain. He also argued that as a guarantor, the Guarantees Acknowledgment Act governed.

HELD: The action was dismissed. The note contained additional terms allowing for extension or altering of terms without notice. The possibility of a contingency arising made the note conditional. It could not be certain on its face where the underlying contract between the parties was to be considered and therefore was not a promissory note. While an acceleration clause was permitted and was within the spirit of section 27(1) of the Bills of Exchange Act, the note here was uncertain as to sum as authority was given to extend it beyond the note to another security document. G was not a guarantor, having signed as a primary borrower. As the note was neither a bill of exchange nor a guarantee, the bank was required to sue in debt. However, such a claim was not raised in this action. The investment certificate and the sum taken from G's account were to be returned.

Quinn M. Kuefler, for the Plaintiff.
Herbert Fielding Q.C., for the Defendant Don L. St. Germaine.

REASONS FOR JUDGMENT

LUTZ J.:--

INTRODUCTION

1 These proceedings arose as a result of a default by the defendant Michale Morgan ("Morgan") on a Canadian Imperial Bank of Commerce ("C.I.B.C.") Bankplan Note BL3-88/01 dated the 21st of September, 1990, given by Morgan and to which the co-defendant, Don St. Germaine ("St. Germaine") was also a party. C.I.B.C. brought this action against St. Germaine claiming moneys owing under the terms of the Bankplan Note.

2 The Bankplan Note, it is argued by C.I.B.C., is a promissory note as defined by the Bills of Exchange Act, R.S.C. 1985, c.B-4. It is in the sum of $21,500.00 repayable with interest at 17.25% per annum in 12 equal monthly instalments of $623.17, with the balance of principal and interest due and payable on the 21st of September, 1991.

3 St. Germaine counterclaimed for the return of his Investment Certificate and the sum of $1,287.00, which represent his security given on the loan and money withdrawn from his account by the defendant by counterclaim, C.I.B.C.

FACTS

4 In September of 1991, Morgan applied for a loan from C.I.B.C. As collateral, she executed a chattel mortgage in favour of C.I.B.C. on her 1987 Chrysler LeBaron. Even though she was to take the entire proceeds of the loan, the bank required that another person co-sign as a borrower to provide additional security.

5 St. Germaine was a friend of Morgan, and at the material time, a customer of C.I.B.C.'s branch in Olds, Alberta. He was also an acquaintance of Eileen Goldbeck ("Goldbeck"). Goldbeck, at the time of the loan application, was the Administrative Officer at C.I.B.C.'s Olds branch.

6 St. Germaine spoke at length with Goldbeck about his potential liability should Morgan default, prior to executing the following documents: loan application, Statement of Disclosure, Canada Life Personal Loan Insurance Application, C.I.B.C. Bankplan Note BL3-88/01, Hypothecation of a $10,000.00 First City Trust Company Investment Certificate, and a Power of Attorney. St. Germaine maintained at the examination for discovery, and later urged upon the court while on the witness stand, that he was given to understand that his maximum exposure was limited to his Investment Certificate.

7 I am satisfied that on the entirety of the evidence, Mrs. Goldbeck made known to him that although C.I.B.C. would take all reasonable steps to collect from Morgan first, any deficiency would be claimed against him as the loan to

Morgan would not have been given but for his participation. St. Germaine felt sorry for Morgan who obviously persuaded him she needed his assistance to extricate herself from her then financial morass. He felt that Morgan's 1987 LeBaron, upon which she gave a chattel mortgage, and the likelihood of a successful wage garnishment, would, if she did default, satisfy the indebtedness. Thus, I find that St. Germaine was fully aware of his potential liability in the event of Morgan's default, particularly on the strength of the evidence of Mrs. Goldbeck.

8 Morgan did default and was later found to be living in Texas. At least partially as a result of being unemployed, she is without assets and judgment proof. C.I.B.C. learned that the 1987 LeBaron motor vehicle had been taken to Texas and was damaged such that it would cost more to repair than its value. Ultimately, Morgan or her agent sold the motor vehicle, realizing $500.00 which was voluntarily forwarded to C.I.B.C. and credited to the outstanding loan balance. Morgan had also been previously credited for the October 21 and November 21 monthly payments.

9 The January 24, 1991 payment of $1,287.36 was a debit entry made by C.I.B.C. from St. Germaine's bank account, without consultation or notice until after the event. This was an issue to which I shall later return, as there was no written or oral authorization sought or given to C.I.B.C. by St. Germaine.

10 The February 19, 1991 and March 19, 1991 payments were acknowledged to be made by Morgan or on her behalf. Throughout the attempts to collect from Morgan, C.I.B.C.'s representatives kept St. Germaine informed. When C.I.B.C. had exhausted its recourse against Morgan, it took St. Germaine's Investment Certificate proceeds and brought these proceedings for the deficiency.

11 Judgment was taken against Morgan and she neither participated nor was she represented at the trial.

12 Counsel for St. Germaine agreed with counsel for C.I.B.C. that if his client was found to be liable, the correct sum to February 22, 1993 was $26,778.17, with a per diem of $9.58 thereafter.

ISSUES

Is the note upon which C.I.B.C. sued a promissory note as defined by the Bills of Exchange Act?

13 Counsel for St. Germaine conceded that if the court found the Bankplan Note to be a promissory note as defined under the Bills of Exchange Act, supra, that the co-defendant was an accommodation party as defined by that statute. However, St. Germaine resisted the contention that the Bankplan Note is a promissory note within the Bills of Exchange Act, supra, on the following grounds:

a) The Bankplan Note is conditional; and
b) The Bankplan Note was not made out for a sum certain.

a) The Bankplan Note is Conditional

14 The applicable sub-section of the Act is s. 176(1):

> 176(1) A promissory note is an unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.

15 The Bankplan Note in this case is the same standard form that was at issue in C.I.B.C. v. MacPherson (9 January 1992), Calgary 9001-18572 (Alta. Q.B.). In that case, Justice R.P. Fraser considered whether the paragraphs appearing on the reverse side of the document, "Additional Terms of my Note", rendered the note conditional and therefore beyond the scope of the Bills of Exchange Act, supra. The following terms appear on the reverse side of the document:

ADDITIONAL TERMS OF MY NOTE

1 The Bank may, from time to time, give me a notice offering to extend, on the terms set out in the notice, the time for repayment of the balance of my loan and accrued interest beyond the date for making such payment (the "next maturity date") set out in my Note or any previous notice, and/or offering to vary any of the other provisions of my Note and/or any security held by the Bank for my loan. I may accept such offer by not paying the balance of my loan and accrued interest on the next maturity date. If I do not pay such amount on such date, I shall be conclusively deemed to have accepted and agreed to the terms of such offer.

2 In the event of any variation referred to in paragraph 1, references to my Note or any security which appear in any such document will be treated as referring to such document as so varied. For registration purposes, I will from time to time on request sign one or more documents relating to any such variation.

3 Any notice referred to in paragraph 1 and any demand for payment under my Note will be conclusively deemed to be given and received when delivered to me, or, if it is mailed to or left at my latest address appearing in the Bank's records, on the 5th day after it is mailed to or is left at such address.

16 In MacPherson, supra, R.P. Fraser J. found that these paragraphs did not make the note conditional and therefore the note remained within the scope of s. 176(1). At page 8 of his reasons, R.P. Fraser J. said:

> I am also governed by the fact that no notice of offer has been given by the Plaintiff. If it had, and the original maturity date had accordingly been extended, I would have reached a different conclusion.

With respect, I would differ from R.P. Fraser J.'s conclusion and find that it is the possibility that the note may be conditional that governs and not whether in this case the contingency arose. The paragraphs on the reverse side of the Bankplan Note permit the borrower and the bank, with or without notice to the holder, who may not be the bank, to alter the terms set out on the face of the document. If this is the case, then the note is conditional and does not meet the requirements of s. 176(1).

17 In Alberta Treasury Branches v. Smith (1989), 67 Alta L.R. (2d) 357 (Q.B.), Andrekson J. said, at pages 360 and 361:

> The question of what constitutes a valid promissory note has been judicially considered in a number of cases. In MacLeod Savings & Credit Union v. Perrett, [1981] 1 S.C.R. 78 ... Beetz J. examined an instrument containing the words [p. 193]:
>
> > "For value received, I promise to pay to the order of The Credit Union, the stated principal amount above set forth with interest on the unpaid principal from the date of advance both before and after maturity at the rate above set forth until the full amount of principal and interest has been paid..."
>
> On p. 198, Beetz J. describes the purpose of the Bills of Exchange Act:
>
> > The scheme of the Act is to insure the currency of negotiable instruments. The general rule is accordingly that of certainty on the face of the instrument, unless it is impossible to implement a particular provision of the Act without having recourse to extrinsic evidence.

Beetz J. enunciated the test of uncertainty at p. 199 when he said:

> I wish to add that while certainty of the face of the instrument is the rule, certainty is not necessarily an absolute term. It may be a matter of judgment in some cases whether an explicit or implicit reference to extrinsic circumstances creates such a degree of uncertainty as unduly to affect the currency of the instrument and alter its nature. [emphasis added]

In my view, the key words of the test are "such a degree of uncertainty". The test then is whether the extrinsic circumstances that must be referred to create such a "degree of uncertainty" on the balance of probabilities "as unduly to affect the currency of the instrument and alter its nature".

18 In this case the extrinsic evidence that would have to be referred to in order to render the note certain, would be the underlying contract between the drawer and the original holder. Whereas decisions such as MacLeod Savings & Credit Union v. Perrett, [1981] 1 S.C.R. 78, ensure that the commercial reality of a negotiable instrument is not hindered by a variable but ascertainable concept such as the prime rate of a Canadian chartered bank, it cannot be read to open the door to extrinsic evidence such as the underlying contract between two parties when this is the very mischief that the Bills of Exchange Act, supra, regime is set up to remedy.

19 It is contrary to the purpose of negotiable instruments to consider the underlying contract between the original parties. In Alberta Treasury Branches v. D & L Insulation (1985) (1991), 83 Alta. L.R. (2d) 181 (C.A.), Kerans J.A. speaking on behalf of the Court, said, at page 182:

> We disagree with the necessary implication that certainty can be divorced from negotiability. The question of certainty only arises in the context of negotiability because the certainty rule is there to protect negotiability. To the extent that the learned trial judge divorces the two concepts, we disagree. To the extent that he said that the obvious uncertainty in this note does not affect negotiability, we also disagree. The existence of this obligation [to pay costs incurred by enforcement] in the note affects the valuation of the note for negotiation and, therefore, affects the currency of the note.

20 Counsel for St. Germaine submitted that the promisor may discharge the note on the maturity date, but is not necessarily obliged to do so. If the note is not paid upon maturity, the promisor is not necessarily in default, but may have triggered an extension to the note, which creates a new maturity date. That the maturity date can be and often is extended, is a commercial reality and this was established upon cross-examination of C.I.B.C.'s witness. As a result, I find that the Bankplan Note BL3-88/01 is not a promissory note within the meaning given to that term in the Bills of Exchange Act, supra, because it is conditional.

b) The Bankplan Note was not made out for a sum certain

21 Counsel for St. Germaine also presented an argument based on s. 27(1) of the Bills of Exchange Act, supra:

> 27(1) The sum payable by a bill is a sum certain within the meaning of this Act, although it is required to be paid
> (a) with interest;
> (b) by stated instalments;
> (c) by stated instalments, with a provision that on default in payment of any instalment the whole shall become due; or
> (d) according to an indicated rate of exchange or a rate of exchange to be ascertained as directed by the bill.

22 The issue of the note not representing a sum certain was raised in the light of the acceleration clause appearing on the face of the note. The Bankplan Note provides:

> The balance of my loan and accrued interest will become due immediately at the Bank's option, and

without demand or notice to me, if I do not make a payment when due or if such amounts become due in accordance with any security held by the Bank for my loan (e.g. any security agreement, chattel mortgage, land mortgage, hypothec, etc.)

23 This issue was discussed in Canada Permanent Trust Co. v. Kowal (1981), 32 O.R. (2d) 37 (H.C.). At page 41, Boland J. said:

> The defendant submits that the notes in question do not meet the criteria as set out in s. 176(1) of the Bills of Exchange Act, because of the clause providing that on default, the whole amount owing may be accelerated "at the option of the holder". The defendant argues that this provision amounts to having the note payable on a contingency that may or may not occur.
>
> These notes are clearly not payable on demand within the meaning of s. 23 [now s. 22] of the Bills of Exchange Act and, therefore, the issue is whether or not the notes provide for payment of a "sum certain" at a "fixed or determinable future time".
>
> The provisions in the Bills of Exchange Act do not completely address themselves to the issue raised here. The notes in question do provide for a future maturity date at which time the balance owing is due ... and to this extent the notes are clearly payable at a fixed future time. The question is, therefore, whether or not the provision for payment earlier on default affects this conclusion and renders the payment date uncertain or the notes payable on a contingency. Section 28(1)(c) [now s. 27(1)(c)] regarding the meaning of "sum certain" addresses itself to acceleration clauses, but only where "the whole amount shall become due" ... Another question therefore is whether, due to the nature of the default provision in the notes in question, the sum payable is not a "sum certain".

Boland J. continued on pages 42 and 43, by quoting from the Elliott v. Beech (1886), Man. L.R. 213 (C.A.) decision:

> In Elliott v. Beech, the Manitoba Court of Appeal was dealing with a note payable at a specified date with interest from the date of the note, but with the following proviso:
>
> "... if the defendant should sooner dispose of, or sell, certain lands mentioned and described in a memorandum on said note, which the defendant then owned, then the said note should be payable on demand at said Bank."
>
> Killam J., speaking for the Court at p. 214, concluded as follows:
>
> The learned Chief Justice was of opinion that, as there were fixed dates at which at latest the notes were respectively to mature, the provisoes for making them mature earlier upon the happening of the contingency mentioned, could not render them the less negotiable promissory notes. After a careful consideration of the authorities, I have to express my concurrence in this view.
>
> .....
>
> The key principle seems to be that where there is a future fixed date upon which a note becomes payable, the fact that it may become payable at an earlier date, on the happening of an event which may or may not occur, does not render the note payable on a contingency.
>
> .....
>
> Following this reasoning, it is my view that s. 28 is not exhaustive and the notes in question are still payable for a "sum certain". The purpose of s. 28(1)(c) is to firmly establish that acceleration on default does not render the sum payable uncertain, even though, strictly speaking, the fact of default and the amount that would be owing could not be determined until default occurred. The fact that the holder has an option on default does not affect the certainty of the amount payable. The amount

owing on default can still be determined at that time.

24 The Bankplan Note before me, provides that upon default under any security held by the bank, the Bankplan Note may, at the option of the bank, be in default and any amounts owing may be accelerated. The document allows for the balance to become due upon being triggered by something other than the promissory note itself, in this case, a default under the chattel mortgage. This is not in accord with an unconditional promise to pay a sum certain as described in s. 27(1)(c) and s. 176(1) of the Bills of Exchange Act, supra.

25 In Gardiner v. Muir (1917), 38 D.L.R. 115 (Sask.S.C.), the court considered a note containing the following clause:

> I further agree to furnish security satisfactory to you at any time required; and if I fail to furnish such security when demanded, or if default in payment is made, or should I sell, mortgage or dispose of my landed property, or for any reason T.G. Gardiner should consider this note or any renewal thereof insecure, they have full power to declare it and all other notes made by me in their favour at any time due and payable forthwith.

Lamont J., speaking on behalf of himself and Haultain C.J., said at page 117:

> It has been held that, where a promissory note is payable by instalments, a clause embodied in the note by which it is agreed that in case default is made in payment of any one of the said payments the whole amount remaining unpaid shall become due and payable forthwith, does not prevent it being a promise to pay "at a fixed or determinable future time;" Kirkwood v. Carroll, [1903] 1 K.B. 531.
>
> The clause in the document sued on in this action goes much farther. It gives Gardiner the right, on the happening of certain contingencies, to declare the note due and payable at a time other than its due date. An obligation which may become due and payable at the option of the promisee on the happening of any one of a number of events cannot be said to be a promise to pay "on demand or at a fixed or determinable future time." The document in question is, therefore, not a promissory note.

Boland J. in the Canada Permanent Trust v. Kowal, supra, decision, declined to follow the Gardiner, supra, case. She noted that the "provision [was] much broader in scope" than the clause found in the case before her and the decision did not consider all of the existing authority and was decided before some other authority arose. Nonetheless, the comments in Gardiner, supra, regarding the scope of the acceleration clause, as permitted by s. 27(1)(c), are pertinent to the case at hand.

26 Subsection 27(1)(c) provides for agreement between the parties to an acceleration clause and for the bill to remain within the meaning of sum certain as that term is used in s. 27(1) and s. 176(1). However, s. 27(1) provides for the acceleration clause to be part of the bill of exchange, or in this case the Bankplan Note. The Bankplan Note provides for the triggering of the acceleration clause to be under the note itself or in a collateral security agreement to which no specific reference is made so that it could be identified by a subsequent holder. As well, under this arrangement, the holder of the note may not be aware of a default in the underlying security agreement and subsequent acceleration of the amounts due. The Bills of Exchange Act, supra, establishes and maintains the commercial reality and negotiability of bills of exchange, therefore, documents claiming to be bills of exchange must meet the criteria found within that Act. In this case the Bankplan Note does not meet s. 27(1)(c) as the acceleration clause may be triggered by an extrinsic document not identifiable on the note itself. Although s. 27(1)(c) allows for a bill to provide for payments by instalment and if default occurs, to accelerate the amount owed under the bill, that subsection does not provide for acceleration of amounts due under the bill for default under a collateral agreement. I note in passing that s. 176(3) does not aid in the interpretation of "sum certain" under s. 27(1)(c).

27 In MacLeod Savings & Credit Union, supra, at pages 86 and 87, Beetz J. said:

> The scheme of the Act is to ensure the currency of the negotiable instruments. The general

rule is accordingly that of certainty on the face of the instrument, unless it is impossible to implement a particular provision of the Act without having to resort to extrinsic evidence.

.....

I wish to add that while uncertainty on the face of the instrument is the rule, certainty is not necessarily an absolute term. It may be a matter of judgment in some cases whether an explicit or implicit reference to extrinsic circumstances create such a degree of uncertainty as unduly to affect the currency of the instrument and alter its course.

Although an acceleration clause is permissible and within the spirit of s. 27(1) of the Act, in this Bankplan Note authority is given to extend it beyond the note to another security document. This finding also brings the Bankplan Note BL3-88/01 outside the operation of the Bills of Exchange Act, supra.

2) If the answer to (1) is no, then St. Germaine submits that the note is an instrument that is in substance a guarantee and therefore governed by the Guarantees Acknowledgment Act, R.S.A. 1980, c. G-12.

28 In subsection 1(a), the Guarantees Acknowledgment Act, supra, defines a "guarantee" as "a deed or written agreement whereby a person, not being a corporation, enters into an obligation to answer for an act or default or omission of another ...".

29 St. Germaine submitted that he has enjoyed no benefit from C.I.B.C. in exchange for his liability on the note and that as such he is a guarantor within the meaning of the Act. As this Act was not complied with, if St. Germaine's argument is correct, the Bank may not recover from him.

30 In Alberta Agricultural Development Corporation v. Tiny Tym's Poultry Ltd. (1989), 66 Alta. L.R. (2d) 279 (Q.B.), Andrekson J. found that a covenant contained in a mortgage was in fact a guarantee and governed by the Act. In that case, John Tymchyshyn signed a mortgage in favour of Alberta Treasury Branches as part of loan negotiations between Agricultural Development Corporation and his son's company. Andrekson J. found that "John was unconnected with the loan except by reason of his promise to pay any loss to the mortgagee relating to the loan made to Tiny Tym's". Andrekson J. continued and said, at page 286:

> The principal debtor is, in my view, Tiny Tym's. The covenant to pay by John did not create a new liability and did not release Tiny Tym's from its obligation.
>
> In my opinion, it follows that John's mortgage was collateral to the promissory note entered into by Tiny Tym's and was in effect "an obligation to answer for an act, or default or omission of another". Therefore, the mortgage is, in my opinion, a guarantee.

31 Many cases dealing with the Guarantees Acknowledgement Act have as their primary focus the differentiation between primary and secondary obligations. In Standard Trust Co. v. 100762 Canada Ltd. (1991), 82 Alta L.R. (2d) 1 (C.A.), the defendant claimed that the mortgage assumption agreement in question was a guarantee, and as it did not comply with the Act, it was void. Stratton J.A., in giving the judgment of the court, noted that the defendant had a primary obligation as opposed to a secondary one. He said at pages 13 and 14:

> The appellant did not promise to answer for an act or default of another, but rather clearly covenanted on his own behalf. His was a primary obligation and this is made clear by the terms of the mortgage assumption agreement itself. According to McGuinness, The Law of Guarantee (Carswell, 1986), pp. 25-26:
>
> > A guarantee has been described as a contractual obligation undertaken by one person (known variously as the "guarantor" or the "surety") in which he promises that a second person (known as the "principal") shall perform a contract or fulfil some other obligation and that, if the principal does not, the surety will do it for the principal ... the guarantor undertakes that the obligation will be performed, in the sense that the guarantor will answer for the debt, default,

> or miscarriage of the principal, if the principal does not perform as required. However one would describe the nature of the surety's obligation, it is clear that a guarantee is an accessory contract which relates to the performance of some primary obligation. In every case of guarantee, there are at least two obligations. The primary obligation is that of the principal, while the surety's obligation is of a secondary nature.
>
> The appellant promised to perform. He did not promise to perform only if the corporation did not. As the trial judge stated, he cannot therefore rely upon the technical provisions of the Guarantees Acknowledgment Act to relieve him of the obligation to pay the debt. [emphasis added]

32 In the case at hand, St. Germaine did not sign a secondary agreement guaranteeing the loan made by the C.I.B.C. to Morgan; he signed the note as a primary borrower. The Act defines a guarantee as a "deed or written agreement whereby a person ... enters into an obligation to answer for an act or default or omission of another...". Although a document is not transformed into a guarantee by the placing of those words on the paper, nor is guarantee excluded from being such because of the name given to the document is not "guarantee", the Act does require that the person enter in an obligation to answer for another. In this case, St. Germaine has entered into an obligation as a primary party to the transaction; he is a "borrower".

33 Although it would appear that the parties involved expected Morgan to repay the loan, St. Germaine agreed to pay as a borrower on the face of the note and his liability does not arise only as an obligation to answer for another. There is no documentation that can bring St. Germaine within the scope of the Guarantees Acknowledgement Act, supra.

34 In light of my finding that the Bankplan Note is not a note within the meaning of the Bills of Exchange Act, supra, I need not address St. Germaine's contention that C.I.B.C.:

a) failed to present the note for payment or give notice of dishonour;
b) failed to realize on its security (the Chrysler LeBaron); and
c) gave the co-defendant Morgan various indulgences.

Furthermore, I need not address St. Germaine's final argument that the rate of interest as shown on the face of the Bankplan Note is contrary to s. 4 of the Interest Act, R.S.C. 1985, c.I-15.

CONCLUSION

35 As the Bankplan Note is neither a bill of exchange nor a guarantee, then C.I.B.C. may only sue on a debt. A claim based upon a debt owed by St.Germaine to C.I.B.C. appeared to be pleaded in paragraph 5 of the Statement of Claim. However, the parties before me only put into issue the questions of whether or not the Bankplan Note is a promissory note within the meaning given to that term in the Bills of Exchange Act, supra, and if the Bankplan Note was a guarantee within the scope of the Guarantee Acknowledgement Act, supra. C.I.B.C.'s claim is therefore dismissed with costs, including disbursements with no limiting rule to apply.

36 The remaining issue therefore, is that concerning the funds already taken by the C.I.B.C. from St. Germaine after Morgan defaulted. In light of my findings respecting the Bankplan Note, St. Germaine will have his Investment Certificate, or cash equivalent, and the sum of $1,287.00 with interest accrued on them returned to him and is granted judgment on his counterclaim with costs aforesaid therefor, together with interest as applicable pursuant to the Judgment Interest Act, R.S.A. 1984, c. J-0.5, as amended.

LUTZ J.

[1940] 1 W.W.R. 554, 48 Man. R. 1, [1940] 2 D.L.R. 204

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Edie v. Turkewich

Edie (Plaintiff) Respondent v. Turkewich (Defendant) Appellant

Manitoba Court of Appeal

Prendergast, C.J.M., Dennistoun, Trueman and Robson, JJ.A.

Judgment: March 11, 1940

Counsel: J. S. Lamont, K.C., for defendant, appellant.

H. B. Monk, for plaintiff, respondent.

Subject: Corporate and Commercial

Bills of Exchange --- Promissory notes -- Requirements for validity -- Unconditional promise in writing.

Bills of Exchange --- Promissory notes -- Holders -- Good faith of holder -- Knowledge of defect -- Condition on note.

Conditional Sales --- Transactions covered by legislation -- Lien notes -- Validity of incomplete note.

Bills of Exchange -- Promissory Note -- Lien Note Form with Blanks Not Filled in -- Endorsee's Knowledge of Defects of Title of Endorser -- Holder in Due Course -- S. 156, Bills of Exchange Act.

Plaintiff sued as holder of a promissory note. The promise to pay was on a lien note form, but the blanks within the printed words dealing with the lien were not filled in.

Held that the document was a promissory note (Overby v. McLean, [1928] 3 W.W.R. 328, 37 Man. R. 525; Metcalfe v. Adair, [1926] 2 W.W.R. 813, [1927] 1 W.W.R. 331, 36 Man. R. 255); but that, since the plaintiff had actual notice when the note was endorsed to him that it was subject to conditions which made it inoperative until they were performed, he was put on enquiry which, if it had been made, would have shown him that a fraud was being perpetrated, and, therefore, he was not a holder in due course, within the meaning of sec. 56 of The Bills of Exchange Act, R.S.C., 1927, ch. 16.

Appeal by defendant from a judgement of Adamson, J. Appeal allowed with costs.

[1940] 1 W.W.R. 554, 48 Man. R. 1, [1940] 2 D.L.R. 204

The judgement of the Court was delivered by *Dennistoun, J.A.*:

1 This action upon a promissory note was commenced in the County Court of Winnipeg and transferred to the Court of King's Bench for trial.

2 Adamson, J., who tried the case, gave judgment for the plaintiff for $448.55 and costs.

3 The learned Judge held that the document sued on was a valid promissory note of which the plaintiff was the holder in due course.

4 He pointed out that the promise to pay is written into a form of lien note, but the portion of it which deals with lien, title and right of possession had not been completed.

5 Accordingly he held following *Metcalfe v. Adair*, [1926] 2 W.W.R. 813, [1927] 1 W.W.R. 331, 36 Man. R. 255, and *Overby v. McLean*, [1928] 3 W.W.R. 328, 37 Man. R. 525, that the printed words which were designed to give a lien, not having been filled in, indicated an intention on the part of the drawer and payee to make a simple promissory note and not a conditional contract. The words relating to lien were surplusage which did not vary the promise to pay.

6 I would agree with this view were it not that Edie, the endorsee, had express notice that the payee could not give him a clear title to the note by a simple endorsement.

7 It is necessary to set out the facts. The plaintiff sold clover seed to a company and received in payment thereof a cheque for $1,083 which was dishonoured on presentation. He took the matter up with one Bannerman who had signed the cheque as president of the company. Bannerman told him that they had sold a grain separator to the defendant Turkewich who was a farmer in good financial standing and that the company would endorse to him two notes made by the defendant, one for $425 -- being the note sued on -- and another note, also for $425, which the plaintiff still holds. The plaintiff retained the dishonoured cheque and held the notes as collateral security.

8 Bannerman told the plaintiff that these notes were for the price of the machine. At the same time he gave the plaintiff the contract which the defendant had signed and a statement of his assets and liabilities. All four documents were pinned together and clearly showed the nature of the contract with the defendant, if the plaintiff had only taken the trouble to read them.

9 When the first note came due the plaintiff notified the defendant that he was the holder and demanded payment.

10 The defendant replied that the contract was conditional, and that the notes were also conditional upon its performance by the company.

11 The company had agreed to deliver to the defendant a grain separator and had failed to deliver it.

12 On the failure to receive delivery the defendant had gone to the company and was informed by Bannerman that he could not make delivery. The defendant then procured Bannerman to sign a memo of cancellation upon the duplicate of the contract which he had retained. He then demanded the return of his notes. Bannerman said they had been sent to the company which had made the machine and for whom they were acting as sale agents. He promised the return of the notes in a few days. They were never returned.

13 An examination of the notes shows a difference between them.

14 In the first note, the one sued on, the blanks in the printed form of lien are not filled in completely. In the second note they are completely filled in.

15 Under the cases relied on by the trial Judge the first is an unconditional promissory note; the second is a lien note which contains a number of conditions relating to title, ownership, and right of possession of the machine. It is a conditional contract and not a negotiable promissory note within the decisions referred to. When the plaintiff took these four documents he had all the facts before him. The notes showed they were for the purchase of a machine.

16 The second note showed that the defendant had no title to the machine and that the sale was made upon conditions.

17 The contract also showed that after delivery of the machine the defendant was to have time to try it; and, if it did not work well, he would be given another machine, or his notes would be returned to him.

18 The plaintiff was possessed of information that no liability attached to the notes until these conditions had been satisfied.

19 Under these circumstances he is not a holder in due course.

20 The *Bills of Exchange Act*, R.S.C., 1927, ch. 16, sec. 56, contains the following:

> A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions namely: --
>
> . . . . .
>
> (*b*) That he took the bill in good faith and for value, and at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

21 The plaintiff had notice that the company had no right to assign this contract until certain conditions had been performed by them. This put him on enquiry which, if it had been made, would have shown him that a fraud was being perpetrated.

22 The notes given never became effective until the defendant had received, tested and accepted the machine as the contract provides.

23 This brings the case squarely within the section quoted from the *Bills of Exchange Act* for the plaintiff had express notice that the title of the company was defective until the conditions upon which the notes were issued had been performed. He was put upon enquiry, and he made none.

24 Sec. 176 of the Act defines a promissory note as an unconditional promise to pay. The document sued on is not a promissory note in the hands of the plaintiff who had express notice in writing that it was given on conditions which made it inoperative until those conditions had been performed. The company could not have sued on the note, and when they endorsed it to the plaintiff with full information as to the equities surrounding it, the endorsee acquired no greater rights than the payee.

25 Mr. Monk in his able argument referred to a number of cases which have been examined.

26 Among them are: *Union Investment Co. v. Wells* (1908) 39 S.C.R. 625; *Monticello State Bank v. Killoran*,

[1940] 1 W.W.R. 554, 48 Man. R. 1, [1940] 2 D.L.R. 204

[1921] 1 W.W.R. 988, 61 S.C.R. 528; *O'Grady v. Lecomte*, [1918] 2 W.W.R. 267, 29 Man. R. 1, [1919] 1 W.W.R. 333, 57 S.C.R. 563.

27 These cases indicate that commercial transactions should not be hampered by mere suspicion, or by what is termed constructive notice that there may be something wrong. Here there is actual notice in writing and to give the plaintiff judgment would make him a participator in the fraud which was practised.

28 The appeal should be allowed with costs and the action dismissed with costs.

END OF DOCUMENT

CANADA

CONSOLIDATION

CODIFICATION

Bills of Exchange Act

Loi sur les lettres de change

CHAPTER B-4

CHAPITRE B-4

Current to May 27, 2009

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ceptor or endorser, without receiving value therefor, and for the purpose of lending his name to some other person.

accepteur ou endosseur sans avoir reçu de contrepartie et en vue de prêter son nom à une autre personne.

Liability of party

(2) An accommodation party is liable on a bill to a holder for value, and it is immaterial whether, when that holder took the bill, he knew that party to be an accommodation party or not.

R.S., c. B-5, s. 55.

Obligation de la partie

(2) L'effet de complaisance engage toute partie l'ayant signé envers un détenteur à titre onéreux, que celui-ci ait su ou non, au moment de le prendre, qu'il était de complaisance.

S.R., ch. B-5, art. 55.

HOLDER IN DUE COURSE

DÉTENTEUR RÉGULIER

Holder in due course

55. (1) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely,

(*a*) that he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact; and

(*b*) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

Détenteur régulier

55. (1) Est un détenteur régulier celui qui a pris une lettre, manifestement complète et régulière, dans les conditions suivantes :

a) il en est devenu détenteur avant son échéance et sans avoir été avisé d'un refus d'acceptation ou de paiement;

b) il a pris la lettre de bonne foi et à titre onéreux et, à la date de la négociation, n'avait été avisé d'aucun vice affectant le titre du cédant.

Title defective

(2) In particular, the title of a person who negotiates a bill is defective within the meaning of this Act when he obtained the bill, or the acceptance thereof, by fraud, duress or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

R.S., c. B-5, s. 56.

Vice de titre

(2) Au sens de la présente loi, le titre du négociateur d'une lettre est défectueux notamment lorsqu'il a obtenu l'effet, ou son acceptation, par fraude ou contrainte, ou par d'autres moyens illégaux ou pour cause illicite, ou lorsque la négociation constitue un abus de confiance ou est menée en des circonstances frauduleuses.

S.R., ch. B-5, art. 56.

Right of subsequent holder

56. A holder, whether for value or not, who derives his title to a bill through a holder in due course, and who is not himself a party to any fraud or illegality affecting it, has all the rights of that holder in due course as regards the acceptor and all parties to the bill prior to that holder.

R.S., c. B-5, s. 57.

Droits du détenteur subséquent

56. Le détenteur d'une lettre, à titre onéreux ou non, qui tient son titre d'un détenteur régulier et qui n'a participé à aucune fraude ni illégalité viciant ce titre jouit, en ce qui concerne l'accepteur et les parties à cette lettre antérieures au détenteur régulier, des droits de celui-ci.

S.R., ch. B-5, art. 57.

Presumption of value

57. (1) Every party whose signature appears on a bill is, in the absence of evidence to the contrary, deemed to have become a party thereto for value.

Présomption

57. (1) Toute partie dont la signature figure sur une lettre est réputée, en l'absence de preuve contraire, y être devenue partie à titre onéreux.

Presumed holder in due course

(2) Every holder of a bill is, in the absence of evidence to the contrary, deemed to be a holder in due course, but if, in an action on a bill, it is admitted or proved that the acceptance, issue or subsequent negotiation of the bill

Présomption de régularité de la détention

(2) Le détenteur d'une lettre est réputé, en l'absence de preuve contraire, en être le détenteur régulier; néanmoins, s'il est admis ou établi dans le cadre d'une action concernant l'effet que l'acceptation, l'émission ou la négociation

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Presumption

70. Except where an endorsement bears date after the maturity of the bill, every negotiation is, in the absence of evidence to the contrary, deemed to have been effected before the bill was overdue.

R.S., c. B-5, s. 71.

Taking bill with notice of dishonour

71. Where a bill that is not overdue has been dishonoured, any person who takes it with notice of the dishonour takes it subject to any defect of title attaching thereto at the time of dishonour, but nothing in this section affects the rights of a holder in due course.

R.S., c. B-5, s. 72.

Reissue of bill

72. Where a bill is negotiated back to the drawer, to a prior endorser or to the acceptor, that party may, subject to this Act, reissue and further negotiate the bill, but he is not entitled to enforce the payment of the bill against any intervening party to whom he was previously liable.

R.S., c. B-5, s. 73.

RIGHTS AND POWERS OF HOLDER

Rights and powers of holder

73. The rights and powers of the holder of a bill are as follows:

(*a*) he may sue on the bill in his own name;

(*b*) where he is a holder in due course, he holds the bill free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill;

(*c*) where his title is defective, if he negotiates the bill to a holder in due course, that holder obtains a good and complete title to the bill; and

(*d*) where his title is defective, if he obtains payment of the bill, the person who pays him in due course gets a valid discharge for the bill.

R.S., c. B-5, s. 74.

PRESENTMENT FOR ACCEPTANCE

When presentment for acceptance necessary

74. (1) Where a bill is payable at sight or after sight, presentment for acceptance is necessary in order to fix the maturity of the instrument.

Présomption

70. La négociation d'une lettre est réputée, en l'absence de preuve contraire, avoir eu lieu avant l'échéance, sauf lorsque l'endossement porte une date postérieure à cette échéance.

S.R., ch. B-5, art. 71.

Réception d'une lettre non échue et refusée

71. Quiconque prend une lettre non échue, après avoir été avisé qu'elle a été refusée à l'acceptation ou au paiement, la reçoit entachée de tout vice de titre qui l'affectait lors du refus. Le présent article ne porte toutefois pas atteinte aux droits d'un détenteur régulier.

S.R., ch. B-5, art. 72.

Remise en circulation

72. Le tireur, un endosseur antérieur ou l'accepteur, à qui une lettre est retournée par négociation, peut, sous réserve des autres dispositions de la présente loi, la remettre en circulation et la négocier de nouveau, mais il n'a pas le droit d'en exiger le paiement d'une partie intermédiaire envers qui il était antérieurement obligé.

S.R., ch. B-5, art. 73.

DROITS ET POUVOIRS DU DÉTENTEUR

Droits et pouvoirs du détenteur

73. Les droits et pouvoirs du détenteur d'une lettre sont les suivants :

a) il peut intenter en son propre nom une action fondée sur la lettre;

b) le détenteur régulier détient la lettre libérée de tout vice de titre des parties qui le précèdent ainsi que des défenses personnelles que pouvaient faire valoir les parties antérieures entre elles; il peut exiger le paiement de toutes les parties obligées par la lettre;

c) le détenteur dont le titre est défectueux qui négocie la lettre à un détenteur régulier confère à celui-ci un titre valable et parfait sur la lettre;

d) la personne qui paie en temps voulu la lettre au détenteur dont le titre est défectueux est valablement libérée.

S.R., ch. B-5, art. 74.

PRÉSENTATION À L'ACCEPTATION

Présentation nécessaire

74. (1) La présentation à l'acceptation d'une lettre payable à vue ou à un certain délai de vue est nécessaire pour en fixer l'échéance.

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Bonenfant v. Canadian Bank of Commerce

Bonenfant (Defendant), Appellant v. Canadian Bank of Commerce (Plaintiff), Respondent

Cour du Banc du Roi du Québec

Greenshields, Dorion (dissenting), Rivard, Letourneau, and Cannon (dissenting)

Date: February 14, 1929

Docket: 27 (S.C. 676)

Counsel: None given

Subject: Corporate and Commercial; Insolvency

Per Curiam:

1 Whereas respondent claims from appellant the sum of $6,584.98, being the amount of twelve promissory notes, each for the sum of $500, and all dated the first day of April, 1924, payable to the order of F.X. Bertrand, Limited, and endorsed by appellant, by F.X. Bertrand, Limited, payee, and by one, N.P. Dussault, and payable in one to twenty-three months from date; and respondent alleges, that it is the holder in due course of the said notes, and all were duly protested on their due dates, and notice thereof duly given;

2 Whereas appellant pleads, admitting his endorsation on the said notes; denying that the same were duly and regularly protested and notice thereof given; denying that respondent is the holder in due course, for value, of the said notes, and specially alleging; that the notes were originally deposited with respondent as collateral security for an indebtedness due respondent by F.X. Bertrand, Limited, and N.P. Dussault, the other endorsers of the said notes; that the original debt having been paid and discharged, appellant is not liable on the said notes for any amount whatever;

3 Considering that respondent is the holder in due course of the said notes, and the same were duly and legally protested on their due dates, and notice thereof was duly and regularly given to appellant;

4 Considering that the notes sued upon were on the 11th day of April, 1924, given by one, N.P. Dussault to respondent, and were by respondent received as collateral security for a debt then due by Dussault, the pledgor, and which debt amounted on the date of the institution of the present action, in capital and interest, to the sum of $4,972.30, representing a personal indebtedness of Dussault towards respondent, amounting to $2,502.90, and the further sum of $2,409.40, being the amount due to respondent by F.X. Bertrand, or, and, F.X. Bertrand, Limited, and for the payment of which latter sum respondent held the written guarantee of the said Dussault;

5 Considering that there is to be added to the said sum of $4,972.30 the sum of $233.85, being the costs incurred by respondent in a certain action taken by respondent against the said N.P. Dussault and F.X. Bertrand,

Limited, and which action was discontinued at the request of the said Dussault and Bertrand, Limited, in consideration of the collateral security received by respondent, in the form of promissory notes sued upon, fixing the total indebtedness due to respondent by Dussault and Bertrand at the sum of $5,208.15;

6 Considering that before the institution of the present action respondent received from appellant the sum of $2,331.25, which must go in reduction of the amount due respondent by Dussault and Bertrand, and which sum was by the respondent, in fact, credited to the said account, leaving a total balance due to respondent by Dussault and Bertrand, at the date of the institution of the present action of $2,876.90;

7 Considering that Dussault, the pledgor of the notes, has no claim upon the same against appellant;

8 Considering, therefore, that appellant's liability as endorser on the said notes is limited to the amount of $2,776.70;

9 Considering there was error in the judgment *a quo*, of date the 29th day of June, 1925; doth cancel and annul the said judgment;

10 And proceeding to render the judgment which should have been rendered;

11 Doth condemn appellant to pay to the respondent the sum of $2,876.90, with interest thereon at the rate of five per cent *per annum* from the date of the service of the action, and costs in the Superior Court, but doth condemn respondent to pay the costs of the present appeal.

***Mr. Justice Greenshields*:**

12 Respondent succeeded in obtaining from the trial judge a judgment against appellant for the sum of $6,584.98, representing the capital amount of twelve promissory notes, each for the sum of $500, and all dated at St. Hyacinthe the 1st day of April, 1924, and all being of a like tenor and effect, except as to their due dates. They were all presented for payment on their due dates, and were regularly and properly protested for non payment, and the protests or copies of the protests are filed.

13 I produce here the first of the twelve notes, with the endorsations, as a type or example of them all: ...

14 I state the grounds of appellant's defence to this action:

> (*a*) Respondent was not the holder of the notes in due course; (*b*) Respondent took the notes as collateral security for a debt existing at the time of the getting possession of the notes; (*c*) The notes are held and can only be held as collateral security for a debt of F.-X. Bertrand, Limited, if there was any such, and not as security for the debt of one, N.-P. Dussault; (*d*) That in any event, respondent having already received from the appellant a sum of $2,500 with interest, this amount was more than sufficient to pay the original debt for the payment of which the notes in question were transferred to respondent as collateral security;

15 And appellant concludes, that no right of action lies against him in favor of respondent on the notes.

16 I propose to take up *seriatim*, and in the order stated, the grounds of defence. *Prima facie* respondent is entitled to judgment. Appellant's endorsation is admitted. The demand for payment and protest are regular, and in the absence of an affirmative plea, established by proof, or founded in law, the judgment must stand.

17 *A*. Respondent is not the holder in due course.

18 The manager of the bank at the time of the trial frankly admits, that the notes were not discounted; no amount was placed to the credit of Dussault, or any one else; on the contrary, the notes were held by the bank as collateral security for the debt, present and future, due by Dussault to the bank, respondent, and the debt, present and future, due by the Bertrand Manufacturing Company, or the Bertrand Company, Limited, to the Bank, and which debt had been guaranteed by Dussault under a letter of guarantee dated the 10th of October, 1921. Under that letter, Dussault was jointly and severally liable towards the bank for the debt of Bertrand Limited.

19 On the 11th of April, 1924, there was pending an action by the Bank, respondent, against Dussault and Bertrand Limited. In consideration of obtaining security in the shape of the notes sued upon, the Bank stayed its action. That was a consideration, but even in the absence of that consideration the Bank was quite entitled to take the notes in question as collateral security for the debt due by it. When, and so soon as the Bank obtained these notes, endorsed as they were, it became the holder in due course, without notice of any defect, and was entitled to collect the same in extinguishment or payment of the debt due it, and for the payment of which the notes had been given as security.

20 Upon the first ground of defence I hold, that appellant cannot succeed.

21 *B*. Respondent received the notes as collateral security for pre-existing debts. That is true. There is nothing in the law governing banks and banking to prevent or prohibit a bank taking or receiving promissory notes as security for an existing or pre-existing debt. The bank obtains a perfectly good title to a note received in the regular course of business as collateral security for a debt due by its customer, even though no new debt is created at the time. This is the distinction between the discount of a note and the deposit of a note as collateral security. A note is made payable to the Bank's customer; the maker of the note is the debtor of the bank's customer; the customer endorses the note and delivers it to the bank, as collateral security for a then existing debt. The bank may sue, in its own name, the maker of the note and recover from the maker the whole, even though its customer is not indebted to an amount equal to that claimed by the bank on the note. The bank sues as the agent or representative of the customer. If the maker of the note is not indebted to the customer in any amount, then the bank is limited in its claim on the note, as against the maker, to the actual amount due the bank by its customer, and no greater amount. I will, however, have a further statement to make upon this in considering the last ground of appellant's defence. In the meantime I dispose of this ground by the statement, that because respondent received these notes as collateral security for the then existing or pre-existing debt, in no way, in itself, affects the bank's right to recover against appellant.

22 *C*. The notes cannot be held or applied as collateral security against any debt, except that of Bertrand Limited, if there was any, and particularly cannot be held as security against or for the personal debt of Dussault.

23 With this statement I cannot possibly agree. All the proof, documentary and oral, shows the contrary. Under the letter dated the 11th of April, 1924, it clearly appears, that the notes were received by the bank from Dussault as collateral security for any debt he owed them, or might in future owe. I should not hesitate to say, that the manner in which Dussault's debt was created, whether an advance made by the bank to him personally, or by a letter of guarantee by which he became jointly liable with another for the debt of the other to the bank, is a matter of indifference. On this ground of defence I hold, that Dusault's debt was secured by the notes. If he guaranteed the debt of another, as he did under the contract of October 10th, 1921, he was a principal debter, so far as the bank is concerned.

24 I dispose, therefore, of this ground of defence by the statement, that if Dussault was indebted to the bank at the time the present action was instituted in an amount equal to or exceeding $6584.98, the bank, respondent must succeed on the present appeal. I make this statement without reference to the manner in which Dussault's indebtedness may have originated, provided it does exist as a valid debt or claim against him.

25 I now proceed to the consideration of the last ground of defence, *D*.

26 In any event, says appellant, on this ground, respondent has received from appellant the sum of $2,500, with certain interest charges, and this amount is more than sufficient to extinguish or pay the original debt for which these notes were given the bank as collateral security.

27 Just here I cannot but observe, that the statement made by appellant is not complete as made. Even if the debt of Dussault as it existed on the 11th of April, 1924, was less than $2,500, but was subsequently increased, the security would attach to the subsequent debt. In other words, the bank obtained the notes as a general continuing security for any debt incurred by Dussault up to, at least, the due date of the last note. That does not dispose of the question.

28 As between Dussault and appellant, I have already stated, no relation of creditor and debtor existed. Appellant was not the debtor of Dussault, and Dussault had no action whatever against appellant by reason of appellant's endorsation on the notes. Again, appellant was not the debtor of the bank, respondent, other than as an endorser on the notes. By his endorsation and the transfer to the bank of the notes, appellant became liable towards the bank for the amount of the notes, provided Dussault's debt amounted to a sum equal to the notes bearing appellant's endorsation.

29 The powers of the bank, respondent, as defined in sec. 76 of the Bank Act, included the power to take as collateral security for any loan made by it, promissory notes and other negotiable securities. It has been repeatedly held, and is our law, that a bank may take promissory notes as collateral or further security for loans already made by it. This is distinguished from the discount of a note. The discount is the selling of the note and the bank becomes the absolute owner of the instrument. Delivering or transferring to the bank as collateral security is a pledging, and the customer, or the pledgor, remains the owner of the note, subject always to the lien of the bank for the amount of its debt, or the debt by its customer, with interest, and any accessory charges.

> The Bank becomes the holder of the paper within the meaning of the Bills of Exchange Act, and can exercise all the rights of a holder, one of which is, that it may sue upon it in its own name.

30 I read from McLaren, on *Banks and Banking*.

31 In the present case, I should state, the rights and obligations between appellant and the respondent to be the following: Dussault could not collect from appellant one cent on these notes. The bank by receiving the notes as collateral security for Dussault's debt, has a right against appellant greater than and independent of Dussault. The bank can collect from appellant, and appellant is obliged towards the bank on the notes only for the amount of Dussault's actual indebtedness towards the bank at the date of the institution of the action, or at the date when judgment is rendered. To use the words of Falconbridge[FN1] the position of the pledgee is this:

> If he sue a third party, he sues as trustee for the pledgor as regards the difference between the amount he has advanced and the amount of the bill; if the pledgor could have sued on the bill, the pledgee could recover the whole; if the title of the pledgor is defective, the pledgee can recover the amount of his ad-

vance, provided he took the bill without notice.

32 The notes transferred by appellant and Dussault to respondent were tainted with no defect, but Dussault could not sue on the notes; could not maintain an action against appellant for one dollar. Therefore, I repeat, the pledgee's claim against appellant is limited to the actual amount due by Dussault.

33 I now will proceed to discover, if I can, from the evidence, the exact amount Dussault owed the bank at the time of the institution of the action, and the date of the judgment, from whatever cause or source that indebtedness arose.

34 The proof as to figures is unsatisfactory, but the only proof in the record is that of Mr. Labbé. There is no doubt that credit must be given to Dussault's account of the sum of $2,331.25. That was collected from appellant and it was bound to be credited to the account for which the notes were given as collateral security. I, therefore, hold, that the only amount that can be collected from appellant on the present action is, the sum of $2,579.05, unless that amount can be increased by costs which were paid by the bank, respondent, in connection with previous litigation between it and appellant.

35 On the 17th of May, 1926, respondent obtained judgment against appellant for the sum of $4,292.50 upon eight of the twenty-four notes which formed part of the collateral security held by respondent against the debt of Dussault and the Bertrand Company. On appeal by the present appellant from that judgment, this Court, on the 23rd day of February, 1927, cancelled the judgment and modified the condemnation, reducing it to the sum of $2,146.26, for which amount appellant was condemned. The judgment of this Court was based entirely on the irregularity or illegality of the protest and notice with respect to four of the notes sued upon, and the claim of respondent on these four notes was rejected. The appeal of the present appellant was maintained, and the bank, respondent, was condemned to pay all costs of appeal, and did pay those costs to the exoneration and acquittal of appellant.

36 Respondent now charges the costs which it was condemned to pay to the account of Dussault and seeks to hold the present appellant responsible for those costs. In fact, the bank seeks to make appellant pay the costs in an indirect way, which it, respondent, was condemned to pay by a judgment of this Court.

37 The bank, respondent, failed in its action against appellant on these four notes, exclusively on the ground, that the bank had failed to comply with the law in the protest and the notice thereof. The act which brought about the dismissal of respondent's action on these notes was the act of respondent. Action on these notes was the act of respondent, or the notary, its agent. It was not the fault of Dussault, much less was it the fault of appellant. I express no opinion at the moment as to whether the bank, respondent, could maintain a claim against Dussault for the amount of costs paid by it under the judgment of this Court of the 23rd of February, 1927. I am of opinion, however, that as between appellant and respondent on this issue, appellant could not be made liable for the costs paid by respondent in execution of a judgment rendered by this Court.

38 I determine, therefore, the present appeal by the following statements of law and fact:

First: respondent at the date of the institution of the action was the holder, in due course, of the promissory notes sued upon;

Second: respondent is entitled to recover from appellant the total balance of Dussault's indebtedness to it, whether that indebtedness was a personal indebtedness or arose from a guarantee given by Dussault to the bank securing the debt of the Bertrand Company.

Third: that appellant being not liable to Dussault for any amount, respondent cannot collect from appellant any amount in excess of Dussault's indebtedness to it, respondent.

Fourth: I fix the amount of that indebtedness at the sum of $2,579.05.

39 I would maintain the appeal; modify the judgment, and condemn appellant to pay to respondent the sum of $2,579.05, together with interest from the service of proces, and respondent will have to pay the costs in appeal.

***M le juge Letourneau*:**

40 Pour les raisons que donne dans ses notes mon collègue le juge Greenshields, je ferais droit à l'appel, et infirmant le jugement de la Cour supérieure, je réduirais à $2,876.90 le montant de la condamnation.

41 Je me suis demandé si pour pouvoir profiter de cette limitation, l'appelant n'aurait pas dû plaider plus explicitement que bien qu'endosseur par aval à la face des billets, il n'a cependant ainsi endossé que concurrement avec l'endosseur subséquent N.-P. Dussault, et pour permettre à celui-ci d'utiliser ces billets comme garantie collatérale d'une lettre qu'il devait à l'intimée.

42 Si le litige eût été entre l'appelant et Dussault, il est possible que le plaidoyer eût dû être selon cette formule, mais vis-à-vis la banque intimée, il suffisait, il me semble, d'alléguer que ces billets ont été donnés en garantie collatérale, puis de réclamer la limitation que, juridiquement, comporte un endossement pour fins de garantie collatérale soulement, c'est-à-dire un endossement limité à la dette qu'il s'agissait de garantir.

43 C'est ainsi qu'après avoir dit dans son plaidoyer que ces billets ont "été remis à la demanderesse par un nommé N.-P. Dussault, en garantie collatérale de sa dette à l'égard de la banque, ainsi qu'en garantie collatérale de la compagnie Bertrand et de F.-X. Bertrand Limitée vis-à-vis de la demanderesse", l'appelant plaide spécialement que ces dettes, réduites à une somme de $5,391.40 lors de la remise de la garantie collatérale par Dussault, le 11 avril 1924, ont en outre été éteintes jusqu'à concurrence d'un montant de $2500, qu'il lui a fallu verser à la suite d'un précédent jugement. A l'allégation 12 de son plaidoyer, l'appelant dit encore en toutes lettres que s'il est lié par son endossement, il "ne peut l'être que jusqu'à concurrence de la dette qui était garantie".

44 C'était là je le répète, invoquer la limitation de responsabilité que réclame devant nous l'appelant, et à défaut de précisions qu'aurait pu réclamer l'intimée, il faut dire que la preuve que nous trouvons au dossier pouvait se faire légalement, était suffisamment justifiée par le plaidoyer. Or, le témoignage de Dussault ne laisse aucune ambiguité quant aux circonstances de cet endossement par l'appelant des billets en question.

45 Je crois donc que la contestation telle que faite et telle qu'instruite, nous permet d'appliquer les conclusions de M. le juge Greenshields, et auxquelles je me suis arrêté, comme je le disais en commençant.

46 Je ferais droit à l'appel et je réduirais à $2,876.90 la condamnation qui a été prononcée contre l'appelant, avec intérêt de l'assignation et les dépens.

***M. le juge Dorion* (dissident):**

47 La Banque poursuit Bonenfant pour le montant de six billets signés par Brouillette & Cie pour $500

chacun, avec intérêt échu à date. Ces billets sont faits à l'ordre de F.-X. Bertrand; ils ont été endossés dans l'ordre suivant par Bonenfant, F.-X. Bertrand et N.-P. Dussault.

48 Bonenfant plaide que ces billets ont été transportés à la banque comme sûreté collatérale pour garantir les dettes de F.-X. Bertrand; que ces dettes ont été entièrement payées et que, par conséquent, la banque ne peut plus le poursuivre pour réaliser un gage qui n'existe plus, puisque la dette qu'il garantissait est éteinte.

49 Bonenfant invoque d'autres moyens qu'il est inutile d'examiner, car ils ne sont pas sérieux.

50 La question qui se pose dans le plaidoyer se réduit pratiquement à une question de droit, car les faits essentiels allégués par la défense sont prouvés jusqu'à un certain montant.

51 Voyons quelles sont les responsabilités des parties signataires et endosseurs des billets, telles qu'elles apparaissent à la face des billets. Brouillette & Cie doit les billets à tout événement. Il ne peut opposer aucune défense à la banque, qui en est détenteur régulier vis-à-vis de lui, puisqu'elle est aux droits de Bertrand, le bénéficiaire. S'il était poursuivi, il ne pourrait invoquer le moyen résultant de ce que les billets ont été donnés par F.-X. Bertrand pour garantir une dette éteinte. Ce serait exciper du droit d'autrui. Il doit payer au porteur sur remise de ses billets.

52 Bonenfant, son aval, est caution solidaire de Brouillette & Cie envers tout détenteur subséquent.

53 Bertrand et Dussault, détenteurs subséquents, s'ils étaient poursuivis, pourraient repousser l'action et réclamer les billets que la banque ne peut plus retenir, sa créance étant payée. Cela ne regarde aucunement Bonenfant: si Bertrand, ainsi que Dussault, veulent bien laisser la banque collecter le montant des billets du faiseur et de son aval, ceux-ci sont tenus de le payer.

54 Or il n'est pas même allégué dans l'action que les billets ne sont pas dus par Brouillette à Bertrand. Il n'est pas allegue que Bonenfant est l'endosseur et non l'endosseur de Brouillette. Par conséquent, je ne puis pas concevoir quelle défense Bonenfant peut avoir à l'action du détenteur, puisqu'il est étranger à tout ce qui s'est passé entre les détenteurs et endosseurs subséquents à sa signature; à moins qu'il n'apparaisse qu'il était convenu entre la banque et Bonenfant que celui-ci devait être traité comme endosseur subséquent à Bertrand. Il est possible que telle était l'intention de Bonenfant, mais je ne trouve pas de preuve que la banque ait acquiescé à cette intention. Nous ne pouvons pas juger sur des faits qui ne sont pas invoqués dans la plaidoierie et que la banque n'a pas été mise en demeure de contredire, en l'absence de Bertrand, qui n'est pas en cause.

55 Je rejetterais l'appel.

M. le juge Cannon **(dissident):**

56 Je suis d'avis que les billets endossés par l'appelant ont été transportés contre valeurs et en conséquence, comme l'appelant l'admet dans son factum, la banque a évidemment le droit de recouvrer le paiement de tous les billets portant l'endossement de Bonenfant.

57 Il est prouvé que Dussault a transporté ces billets à la banque pour obtenir du délai sur des poursuites que la banque avait intentées contre Dussault et la compagnie Bertrand. Cela constitue une considération valable d'après l'article 53 de l'acte des lettres de change. Bien plus, même en admettant la prétention de l'appelant que ces billets auraient été donnés en garantie collatérale des dettes de Dussault et de la compagnie Bertrand, j'en viens à la conclusions que la banque avait le droit de recouvrer le plein montant de ces billets, parcequ'à mon avis,

Dussault qui les a donnés en gage avait un recours personnel contre Bonenfant endoseur avant lui, et les faiseurs des billets et la citation de Falconbridge dans le factum de l'appelant tourne contre lui.

> The position of a pledgee is this: If he sue a third party, he sues as trustee for the pledgor, as regards the difference between the amount he has advanced and the amount of the bill. *If the pledgor could have sued on the bill, the pledgee can recover the whole.* If the title of the pledgor is defective, the pledgee can recover the amount of his advance, provided he took the bill without notice.

58 Je crois que dans la circonstance actuelle, the *pledgor could have sued on the bill*, et en conséquence, the *pledgee* can recover the whole.

59 Je partage l'opinion de mon collègue l'honorable juge Dorion et je confirmerais avec dépens.

FN1. P. 644.

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COURT OF APPEAL

Before Macdonald, C.J.A., Martin, Galliher and McPhillips, JJ.A.

BANK OF MONTREAL (Plaintiff) *Appellant*
v. WEISDEPP (Defendant) *Respondent*

Money Paid in Mistake—Money Paid After Suing Out Process—No Allegation of Fraud.

Bank—Notes Held as Collateral Security—Bank with Power to Collect—Full Title of Bank—"Discount" of Notes.

Promissory notes to the order of B, were pledged to a bank as collateral security for his current account, with power to the bank to collect and apply the proceeds upon the account. The maker of the notes refused to pay them on the grounds that the money had already been paid to B. Upon suit being brought by the bank, the maker gave a new note for 50% of the value of the notes, the statement that the promissory notes had been "discounted" to the bank, having been made by the manager. The maker thereafter refused to pay on the grounds that the bills had not been "discounted" but merely given as collateral security and was sued by the bank upon the new note.

Held upon appeal that the bank was entitled to recover on the note, an amendment at the trial making an allegation of wilful misrepresentation (or rather a proposed amendment as to the statement as to "discounting" not going so far as an allegation of wilful misrepresentation) not having been allowed.

Where promissory notes are held under a pledge in writing as additional collateral security for the payment of all debts present and future of the pledgor with the right in the bank to collect the same or sue therefor, such notes no longer remain part of the customer's estate so as to deprive the banker of the full title in law and equity, which arises out of such transactions between bankers and their customers. (*Ex parte Schofield,* 12 Ch. D. 337 applied. Per McPhillips, J.A.).

Where money is paid after the suing out process to recover it, the defendants in the former action knowing the cause of action for which the writ was sued out before they paid the money, and there being no fraud on the part of the plaintiff in that action, no action is maintainable to recover it back. (*Hamlet v. Richardson,* 9 Bing. 644).

Appeal by plaintiff from a judgment of Grant, Co. Ct. J. The appeal was allowed.

Chas. Wilson, K.C., for plaintiff, appellant.

S. S. Taylor, K.C., for defendant, respondent.

April 3, 1917.

MACDONALD, C.J.A.—I would allow the appeal. **Macdonald, C.J.A.**

MARTIN, J.A.—If the case set up here had been that the plaintiff had "taken an unfair advantage or acted unconscientiously knowing that (it) had no right to the money" it received from the defendant or the note sued on herein, then it would have been within *Ward v. Wallis* [1900] 1 Q.B. 675; 69 L.J.Q.B. 423, and "the settlement under legal process was **Martin, J.A**

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not *bona fide* on (its) part" and the defendant would have been entitled to re-open it. But we stated during the argument that we were of opinion that the amendment making the necessary allegation of wilful misrepresentation had not been allowed, indeed the revised proposed amendment refrained from going that length, so the action cannot on the pleadings be maintained, and the appeal must be allowed.

GALLIHER, J.A.—At the conclusion of the argument I was prepared to allow this appeal, and further consideration has confirmed me in that view.

McPhillips, J.A.

MCPHILLIPS, J.A.—It would appear that the bank held two promissory notes the respondent being the maker of one of the notes, the other note being the joint note of one Ed. Brooks and the respondent.

The bank, it would appear, had as a customer one J. H. Brooks, a dealer in horses, and the business of J. H. Brooks was a large one involving the making of very considerable advances by the bank; the notes were made to the order of J. H. Brooks and were pledged to the bank by an agreement in writing covering many other notes as well, the pledge being in the following terms:

Collateral Account Sheets

The undersigned J. H. Brooks herewith delivers from time to time in pledge to the Bank of Montreal, all negotiable paper described below as additional collateral security for the payment of all my present and future debts and liabilities of whatever nature, to said Bank, and with the understanding that said Bank may, if it see fit, collect all or any of said negotiable paper, and may impute the moneys received therefrom to such of the said debts and liabilities as to the said Bank may appear expedient, and further that said Bank shall not be held liable to use any greater diligence, touching the said negotiable paper, or in collecting the same, or in suing thereon, than to said Bank in its discretion may seem advisable.

Date.................. (Sd.) J. H. Brooks.

It would seem that the bank took no steps to advise the respondent that it was the holder of these notes, but upon the evidence it is perfectly clear that the bank is well entitled to invoke sec. 54 (2) of *The Bills of Exchange Act* which reads as follows:

2. Where the holder of a bill has a lien on it, arising either from contract or implication of law, he is deemed to be a holder for value to the extent of the sum for which he has a lien. (53 V., c. 33, s. 27).

In *Maclaren on Bills, Notes and Cheques*, at p. 180, we read:

A lien is the right to retain possession of a thing belonging to another until a claim is satisfied. Where bills and notes are deposited as collateral security for a debt, the creditor acquires a lien upon them by contract: *Ex parte Twogood* (1812) 19 Ves. 229; *Ex parte Schofield* (1879) 12 Ch. D. 337; *Belanger v. Robert* (1902) Q.R. 21 S.C. 518; *Sterling v. Zuber* (1914) 32 O.L.R. 123

The evidence shows that when the respondent was called upon to pay the promissory notes—by the bank—his statement was that they had been paid to Brooks, the customer of the bank who had pledged them to the bank and he refused to pay, then suit was brought, and, upon suit being brought, and under the pressure of the legal proceedings, a new promissory note was given by the respondent to the bank less in amount by 50 per cent., which the bank agreed to take in full of all liability to it in respect of the two overdue notes, the evidence being that it was at the time of the giving of this new note the statement was made that the promissory notes held by the bank had been discounted to the bank. Later and after a sum of $155 had been paid on the new promissory note the respondent refused to make any further payments alleging that he had discovered the fact to be that the promissory notes held by the bank were not discounted to the bank, and suit followed. At the trial when evidence was sought to be adduced upon this point, objection was taken that the pleadings did not allege fraud, counsel for the respondent refused to amend by alleging that the promissory note was obtained by fraud and asked to amend in the following terms:

Mr. Grant: I will change the amendment, then: That the said moneys and notes herein were given by the defendant in the mistaken belief that the notes for which the note in question herein was given, and that the plaintiffs at the time of giving said note were not entitled to the same, and obtained the same by stating that the said note had *been discounted by the said plaintiff*.

Mr. Wilson: In other words, an action of deceit, that he told him a lie, and that certainly is a fraud.

Mr. Grant: I am not saying anything about whether it was a fact or not, that is for the court to find out, but surely we can set up that. It is setting up an absolute fact, and we can set that up at any time.

At the close of the trial the amendment was again referred to as follows:

Court: The amendment you ask to make now is really alleging fraud?

Mr. Grant: Oh, no, your honour. A person can make a mis-statement of an existing fact, that is what I am asking to make.

Court: The court will consider it. You would not expect anything else upon the abundant authorities I have had submitted. I will look this matter up just as early as possible.

Therefore, it is clear that fraud was not pleaded, nor do we find that the learned trial Judge held that there had been fraud in the obtaining of the promissory note sued upon, nevertheless the judgment went dismissing the action and allowing the counter-claim for $155 being the amount paid on the promissory note before becoming acquainted with the fact that the two promissory notes held by the bank as collateral security had not been discounted. In law two courses were open to the defendant, assuming for the moment (although I do not

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agree) that the contract was a voidable one, (a) elect to repudiate it, or (b) elect to be bound by it and bring an action for deceit. In strictness the defendant adopted neither of these courses. Then as to whether either of these courses could have been taken with success.

The respondent in respect to the giving of the note gave the following evidence in cross-examination:

Q. But you knew with respect to such documents that they were liable to be handed to some one else; you knew that as a man of affairs? A. I knew that all right, sure.

Q. And as a matter of fact, they did ultimately get into the hands of the Bank of Montreal? A. It appears that way.

Q. Now, after these two actions were brought against you, you went to Mr. Hogg, and settled them? A. Went to Mr. Hogg.

Q. Went to Mr. Hogg, and the two actions were settled? A. My account was settled; he claimed I owed him, and I settled it.

Q. And no further proceedings were taken in that action, and you gave another promissory note which is now sued on, is that not so? A. I gave it to him thinking I owed him.

Q. I don't care what you thought. I want to know what you did. You gave him that note, and the two actions were settled. Your name was struck off one of the notes, was it not, in consequence of that? A. Struck off both of them.

Court: That is, as I understand it, your name was struck off both the notes sued upon in the former actions. A. Yes, sir.

The only official of the bank examined at the trial was Hugh McKay, a clerk of the bank. Under cross-examination upon the question of the circumstances under which the note sued upon was given he made answer as follows:

Q. You know nothing about the circumstances under which that note was given from any conversation that you had with Mr. Weisdepp? A. No.

Q. And you don't know anything at all about what led up to that? A. No.

To further indicate that fraud was never contended for at the trial reference may be made to what counsel for the respondent during the course of the trial said:

Mr. Grant: We are not setting up fraud. It might be innocent misrepresentation.

Then we have the respondent in direct examination saying:

Mr. Grant: Now, Mr. Weisdepp, tell us what occurred between you and the manager of the bank just before giving this note in question. A. Well, he told me that the note was *discounted* by the Bank of Montreal, and that I would have to settle it; if I did not settle it he would commence suit against me at once, in fact, he did commence suit.

Q. This was after he had commenced proceedings, was it? A. Yes.

Q. And you went to settle? A. Yes, they sent me word to come up and see them.

Q. Who did? A. I don't know, the bank I guess.

Q. Did you say anything about what had happened to the other two notes? A. Yes, I told him they had been paid.

Q. Did you tell him who they had been paid to? A. Yes.

Q. Did he question that at all? A. No, he said it might be true, but it didn't help my case any with him.

Q. Why? A. Because he said the notes were discounted, and Brooks had obtained the money on them, and he had not got it back.

Q. Was anybody with you? A. Yes.

Q. Who? A. Mr. Alley.

Q. This gentleman here? A. Yes.

Q. Did you find out anything to the contrary? A. I did not for quite a while, a year after, or so, I guess.

Q. A year or so after? A. Yes, pretty near that; I don't remember exactly, but it was quite a while after.

Q. How did you find that out? A. The first I found out about it was through Ed. Brooks, I think. He came down from Edmonton.

Q. There were some proceedings started by the Bank of Montreal for the other part of this note? A. Yes, Bank of Montreal sued him for the other part of the note, and it came out in the investigation that the notes were only there as collateral.

With respect to the payment of the two notes the respondent was originally liable upon and which were held by the bank he had the following to say as to payment thereof to J. H. Brooks:

Q. With respect to the two notes sued on. When you paid Brooks, why didn't you get these notes back again? A. Well, it was not the way we were doing business. At that time everybody was doing business in a reckless way. I used to get them back sometimes, and I would get half a dozen back at the same time. I paid a good many thousand dollars in those days.

Then Fred R. Alley, a friend of the respondent, who had some seven years' experience in banking, in the Canadian Bank of Commerce and had acted as teller and accountant, in direct examination said:

Q. You know the defendant, Weisdepp, Mr. Alley? A. Yes, sir.

Q. And you were in his company, I believe, when he went to see the manager of the Bank of Montreal? A. At one time, yes.

Q. Now, tell us what happened, and what conversation you heard between Mr. Weisdepp and Mr. Hogg, was it? A. Hogg, yes. Mr. Hogg, *Mr. Hogg had recently come there.* Really I put the question as I was a friend of Mr. Weisdepp, and he had asked me to go with him.

Q. What question did you put? A. I asked him if these notes under question had been discounted by the bank, as, with my little knowledge of banking—

Court: When you say you asked him, I understand you mean Mr. Hogg, the Manager? A. Yes, sir.

Mr. Grant: What did Mr. Hogg say?

Court: He asked him if the notes had been discounted.

Witness: Yes. He said they had been discounted by the bank; and the bank had given the money for them.

Mr. Wilson: He said what?

Mr. Grant: That the notes had been discounted by the bank, and that the bank had given the money for them.

Q. Is that all that occurred? A. Then I advised Mr. Weisdepp if the notes had been discounted by the bank they were entitled to the money, and rather than have a suit to give a note forthwith, and pay it in small payments as he could afford it. That occurred in the office.

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Q. Did Mr. Hogg acquiesce in that? A. He did, and the note was made.

* * * * * * * * * * *

Mr. Grant: Was that note, to your knowledge, given in pursuance of any statement made by Mr. Hogg? A. Undoubtedly.

Mr. Wilson: I object to the question. In other words, it is an attempt still to get in the suggestion which your honour over-ruled in the examination of Mr. Weisdepp, that they could not give evidence of any inducement without an amendment to the pleadings, and that the pleadings could not be amended without alleging fraud.

Mr. Grant: I have made an amendment that the note was given by reason of statements made.

Court: You have given evidence of the conversation that took place?

Mr. Grant: Yes.

Court: I do not see why you want to go any further.

Mr. Grant: I am quite willing to leave that for your honour to draw your own conclusion.

Court: I think that would be the proper thing. You have the facts and the next is the conclusion of the Court from these facts.

Mr. Grant: Exactly; I am quite willing to leave it at that.

Now it is quite clear that the bank was not called upon at the trial to meet a case of fraud—and there is no evidence upon which fraud could have been found, in fact the learned trial Judge makes no finding of fraud. In *Kerr on Fraud and Mistake*, 4th ed. 1910, at p. 9, we find it said that:

If the subject-matter of the transaction be a contract, no man is bound by a bargain into which he has been induced by fraud to enter, because assent is necessary to a valid contract, and there is no real assent when fraud and deception have been used as instruments to control the will and influence the assent. But a contract or other transaction induced or tainted by fraud is not void, but only voidable at the election of the party defrauded. (*Rawlins v. Wickham*, 3 De G. & J. 322; *Western Bank of Scotland v. Addie*, L.R. 1 H.L. Sc. 156).

Now unquestionably the respondent was bound to establish fraud. Had he even set up such a case, then only could he escape liability to the bank and were we entitled upon this appeal to treat the case as one in which fraud was pleaded, can it be said that it was in any way established? And in considering this question it is to be remembered that Mr. Hogg, the Manager of the Bank of Montreal, had only as appears by the evidence of Mr. Alley "recently come there", that is to the branch of the Bank of Montreal at Vancouver, and it would follow, would not be very familiar with the very extensive business that had been transacted previous to his taking over the management. The law as to what proof is necessary in the establishment of fraud is well set forth in *Kerr on Fraud and Mistake* at p. 447:

A man who alleges fraud must clearly and distinctly prove the fraud he alleges. The *onus probandi* is upon him to prove his case as it is alleged in the statement of claim (*Bellamy v. Sabine*, 2 Ph. 425, 448; *Blair v. Bromley* 5 Hare 559; *Jennings v. Broughton*, 17 Beav. 239; *Smith v. Kay*, 7 H.L.C. 750; *Moxon v. Payne*, 8 Ch. 881; *Craig v. Phillips*, 3 Ch. D. 733), or in his particulars (*Sachs v. Spielman*, 37 Ch. D. 295). Every material step in the evidence which makes out a case of fraud must be proved by sufficient evidence (*Angus v. Clifford* [1891] 2 Ch. at p. 479). If he complains of fraud in the prospectus of a company, it is for him to prove that it was false, and false to the knowledge of the defendant, or at all events that he did not believe it, and that he was misled by it to his prejudice (*Smith v. Chadwick*, 9 App. Cas. 187; *Glasier v. Rolls*, 42 Ch. D. 436). If the fraud is not strictly and clearly proved, as it is alleged, relief cannot be had, although the party against whom relief is sought may not have been perfectly clear in his dealings (*Mowatt v. Blake*, 31 L.T. 387). Fraud will not be carried by way of relief one tittle beyond the manner in which it is proved to the satisfaction of the Court (11 Jur. N.S. p. 52, *per* Lord Westbury).

In *Seddon v. North Eastern Salt Co.* (1905) 74 L.J. Ch. 199, at p. 202, Joyce, J. in his judgment makes use of language peculiarly applicable to this case:

As to the misrepresentation, a claim is founded upon an alleged misrepresentation, and it appears to me, as it has done all through, that the plaintiff's way of succeeding in his claim is beset with difficulties. In the first place, there is no allegation of fraud, and, in point of fact, the imputation of fraud upon the defendants has been expressly disclaimed and properly so.

And later on in the case at p. 203 said:

It appeared to me from the first in this case that the absence of fraud and of any allegation of fraud is a fatal objection to the action, and I should be perfectly justified in disposing of it on this ground, and this ground alone, and saying no more about the facts of the case; but I will add just a few words about the facts as they have been gone into so fully.

In the present case the facts disclose nothing more than the statement that the two promissory notes held by the bank, which were sued upon and following which suit the respondent effected a settlement with the bank being relieved of one half of his indebtedness, had been discounted, it is a fair inference to draw that Mr. Hogg was not fully acquainted with the facts. Further "discounted" has really no magical meaning. It could as well mean in general language exactly what was the fact, paper of the payee of the promissory notes J. H. Brooks was under discount to the bank and the particular notes were held as collateral thereto, and under sec. 54, sub-sec. 2 of *The Bills of Exchange Act* the bank was entitled to recover from the respondent to the extent of its lien. It is utterly impossible upon the evidence before us on this appeal to hold that any fraud has been established, even were it open to the Court to consider the point, which it is clearly disentitled to do. In *Sterling Bank of Canada v. Zuber* (1914) 32 O.L.R. 123, the headnote in part reads as follows:

The defendant made a promissory note for $250 in favour of a customer of the plaintiff bank; the note was transferred by the customer to the bank as collateral security to a draft for $150, which was discounted by the bank for the customer, the proceeds, $149.60, being placed to his credit. This draft was not accepted or paid. The customer had in fact no right to pledge the note, but should have given it up for the defendant:—

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Held: upon the evidence, that the note was completed by the defendant and delivered as a promissory note, and was given to the bank, before maturity, for value, without notice of any defect; and so the bank became the holder in due course, and was entitled to recover from the defendant thereon to the extent of its lien, *i.e.*, $149.60 and interest: *Bills of Exchange Act*, sec. 54, sub-sec. 2.

It may be further stated that in banking phraseology the word "discounted" is used to indicate that that is the nature of the transaction as between the bank and its customer, the customer's paper is discounted, and the discounter (the bank) is entitled to the collateral. Here we have a case where the promissory notes held by the bank (upon two of which the respondent was liable) were held under a pledge in writing as additional collateral security for the payment of all debts present and future of J. H. Brooks to the bank with the right in the bank to collect the same or sue therefor.

In *Ex parte Schofield* (1879) 12 Ch. D. 337, at p. 342; 48 L.J. Bk. 122, Bacon, C.J. said:

A man indorses bills of exchange to his banker, and says "I owe you a good deal of money; you can collect these bills for me and carry them to my account." Those bills no longer remain part of the customer's estate, so as to deprive the banker of the full title in law and equity, which arises out of such transactions between bankers and their customers.

And upon appeal James, L.J., said at p. 346: "Upon full consideration of this matter, we are of opinion that we cannot differ from the conclusion at which the Chief Judge arrived."

There is the further point of law that the giving of the new note was consequent upon pressure of legal proceedings, and the respondent cannot now be heard to dispute his liability upon the new note or claim the return of moneys paid thereon. Lord Halsbury in *Moore v. Fulham Vestry* [1895] 1 Q.B. 399; 64 L.J.Q.B. 226, at pp. 227-8, said:

The principle is based upon this—that when a person has had an opportunity of defending an action if he chooses, but has thought proper to pay the money claimed by the action, the law will not allow him to try in a second action what he might have set up in the defence to the original action. In *Milnes v. Duncan* (6 B. & C. 671; 5 L.J. (O.S.) K.B. 176) Mr. Justice Holroyd states quite accurately what I think is the principle. He says: "If the money had been paid after proceedings had actually commenced, I should have been of opinion that, inasmuch, as there was no fraud in the defendant, it could not be recovered back." And in *Hamlet v. Richardson* (9 Bing. 644), Chief Justice Tindal, delivering the judgment of the Court, says, "We think the rule of law is accurately laid down by Mr. Justice Holroyd, and that, as the money was paid in this case after the suing out (of) process to recover it, the defendants in the former action knowing the cause of action for which the writ was sued out before they paid the money, and there being no fraud on the part of the plaintiff in that action, it appears to us that no action is maintainable to recover it back." That is the broad principle, and it is manifest that the effort to confine it to a case where judgment has been delivered is inconsistent with what is laid down in all the cases, because I think in every one of them, so far as I remember, the money was paid before the process had arrived at judgment. In *Caird v. Moss* (55 L.J.

Ch. 854; L.R. 33 Ch. D. 22, 36), upon which such reliance has been placed, my brother Lopes, in dealing with the case then before him, not unnaturally referred to the fact of the judgment still standing; and for this reason, because the money in that case was paid under a judgment founded on the construction of an agreement. Then an action was brought to rectify that agreement, on the ground that such a construction was contrary to the intention of all the parties. My brother Lopes, without going into the merits of the case, practically says this: "Why, this judgment stands now. You cannot re-open that question. You had full opportunity of commencing these proceedings while the former action was pending, and ought to have done so; and we cannot now interfere with that judgment. That judgment still stands." It is quite true that that, read without connection with the matter that was then being decided, looks as if my brother Lopes was putting a qualification upon the general rule of law; but when the facts are looked at it is quite clear that he was doing nothing of the sort. He was referring to the fact that the money was paid in that particular case under a judgment, and that that judgment was still standing, and no effort had been made to upset it. Under those circumstances, it was *a fortiori*, of course, that the money could not be recovered back. I am of opinion that the judgment of my brother Day was quite right, and that the appeal ought to be dismissed.

In the present case the promissory note is a subsisting contract. No case has been made out for its rescission nor has a case been made out of deceit, in fact neither case has been properly set up upon the pleadings, but even were the case as presented viewed in either phase, and of course there must be an election, the respondent could not claim rescission as well as an action for deceit; the evidence adduced at the trial fails in supporting either case. It is regrettable that the respondent should be required to pay moneys twice over, but there is this to be considered, that owing to the settlement made with the bank the liability of the respondent was reduced by one half of what really was the legal liability which was upon him to the bank. The respondent could have prevented this happening by following prudent and necessary procedure when paying promissory notes, that is, make payment only to the holder thereof and obtain delivery of same.

In my opinion the appeal should be allowed, the judgment of the Court below should be set aside, and judgment entered for the appellant for the amount of the promissory note together with interest and costs, and the counter-claim dismissed.

Appeal Allowed.

CANADA

CONSOLIDATION

CODIFICATION

Bills of Exchange Act

Loi sur les lettres de change

CHAPTER B-4

CHAPITRE B-4

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our of a bill may be given or addressed under this Act.

R.S., c. B-5, s. 50.

Procuration signatures

50. A signature by procuration operates as notice that the agent has but a limited authority to sign, and the principal is bound by such signature only if the agent in so signing was acting within the actual limits of his authority.

R.S., c. B-5, s. 51.

Signing in representative capacity

51. (1) Where a person signs a bill as drawer, endorser or acceptor and adds words to his signature indicating that he has signed for or on behalf of a principal, or in a representative character, he is not personally liable thereon, but the mere addition to his signature of words describing him as an agent, or as filling a representative character, does not exempt him from personal liability.

Rule for determining capacity

(2) In determining whether a signature on a bill is that of the principal or that of the agent by whose hand it is written, the construction most favourable to the validity of the instrument shall be adopted.

R.S., c. B-5, s. 52.

CONSIDERATION

Valuable consideration

52. (1) Valuable consideration for a bill may be constituted by

(*a*) any consideration sufficient to support a simple contract; or

(*b*) an antecedent debt or liability.

Form of bill

(2) An antecedent debt or liability is deemed valuable consideration, whether the bill is payable on demand or at a future time.

R.S., c. B-5, s. 53.

Holder for value

53. (1) Where value has, at any time, been given for a bill, the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to that time.

In case of lien

(2) Where the holder of a bill has a lien on it, arising either from contract or by implication of law, he is deemed to be a holder for value to the extent of the sum for which he has a lien.

R.S., c. B-5, s. 54.

Accommodation bill

54. (1) An accommodation party to a bill is a person who has signed a bill as drawer, ac-

50. La signature par procuration vaut avis de pouvoir limité de signer et n'oblige le mandant qu'en tant que son auteur, le mandataire, a agi dans le cadre strict de son mandat.

Signature par procuration

S.R., ch. B-5, art. 51.

51. (1) Le fait de signer une lettre en qualité de tireur, d'endosseur ou d'accepteur et d'y préciser que cette signature est faite pour le compte d'autrui, à titre de mandataire ou de représentant, n'oblige pas le signataire personnellement. Toutefois, la simple addition à sa signature de mots désignant le signataire comme mandataire ou représentant ne le dégage pas de sa responsabilité personnelle.

Signature pour le compte d'autrui

(2) L'interprétation la plus favorable à la validité de l'effet est retenue quand il s'agit d'établir quel en est le véritable signataire, du mandant ou du mandataire qui l'a effectivement signé.

Règle d'interprétation

S.R., ch. B-5, art. 52.

CAUSE

52. (1) Est à titre onéreux la lettre dont la cause :

Titre onéreux

a) peut faire l'objet d'un contrat simple;

b) est une dette ou une obligation antérieure.

(2) Cette dette ou obligation constitue une cause à titre onéreux, que la lettre soit payable sur demande ou à terme.

Forme de la lettre

S.R., ch. B-5, art. 53.

53. (1) Le détenteur d'une lettre pour laquelle valeur a été donnée à une date quelconque est réputé détenteur à titre onéreux à l'égard de l'accepteur et de tous ceux qui sont devenus parties à la lettre avant cette date.

Détenteur à titre onéreux

(2) Le détenteur d'une lettre ayant sur celle-ci un droit de gage qui découle d'un contrat ou, par implicite, de la loi est réputé en être détenteur à titre onéreux jusqu'à concurrence de la somme pour laquelle il possède ce droit.

Droit de gage

S.R., ch. B-5, art. 54.

54. (1) Est partie à un effet de complaisance la personne qui a signé une lettre comme tireur,

Effet de complaisance

The Canada Life Assurance Company *Appellant*;

and

The Canadian Imperial Bank of Commerce *Respondent*.

1978: May 8; 1979: May 22.

Present: Laskin C.J. and Martland, Ritchie, Spence, Pigeon, Dickson, Beetz, Estey and Pratte JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Conflict of laws — Choice of law — Banks and banking — Bills and notes — Foreign bills — Cheque drawn on New York Agency of Canadian bank — Cheque drawn on resident of Canada — Whether an inland bill — Bills of Exchange Act, R.S.C. 1970, c. B-5, ss. 25, 161.

Appellant, Canada Life, is engaged in the business of life insurance in both Canada and the U.S. The respondent Bank is a chartered bank carrying on banking in both countries with its head office in Toronto and with an office in New York known as *The Agency, Canadian Imperial Bank of Commerce*, where for many years Canada Life has maintained bank accounts one of which was entitled "Head Office Account". Canada Life seeks to restore to its bank account moneys removed therefrom by the Bank in honouring several cheques issued by Canada Life on which the payee's endorsement had been forged. These 31 cheques were all payable to the insured or an assignee. All payees were resident or had a place of business in the U.S. The cheques which were cashed in various New York financial institutions had been drawn in Toronto by Canada Life and forwarded by mail to their New York representative who ultimately pleaded guilty to forgery. It was common ground that the liability of the Bank depended upon whether the effect in law of the forged endorsements fell to be determined by the law of Canada or by the law of New York State. If the former applies the Bank has no defence, if the latter, the Bank may succeed. The situation is substantially controlled by two sections of the *Bills of Exchange Act*, R.S.C. 1970, c. B-5, s. 161 which provides that an inland bill drawn in Canada and endorsed in a foreign country shall as regards the payer be interpreted according to the law of Canada and s. 25 which defines an "inland bill" and a "foreign bill". At trial the judge concluded that the cheques were inland bills as they were drawn within Canada and upon a

The Canada Life Assurance Company *Appelante*;

et

La Banque Canadienne Impériale de Commerce *Intimée*.

1978: 8 mai; 1979: 22 mai.

Présents: Le juge en chef Laskin et les juges Martland, Ritchie, Spence, Pigeon, Dickson, Beetz, Estey et Pratte.

EN APPEL DE LA COUR D'APPEL DE L'ONTARIO

Droit international privé — Quel est le droit applicable? — Banques et opérations bancaires — Lettres et billets — Lettres de change étrangères — Chèque tiré sur l'agence new-yorkaise d'une banque canadienne — Chèque tiré sur une personne qui réside au Canada — S'agit-il d'une lettre de change intérieure? — Loi sur les lettres de change, S.R.C. 1970, chap. B-5, art. 25, 161.

L'appelante, Canada Life, se consacre à l'assurance-vie au Canada et aux États-Unis. La banque intimée est une banque à charte qui effectue des opérations bancaires dans les deux pays; son siège social est à Toronto et elle a un bureau à New York, appelé *The Agency, Canadian Imperial Bank of Commerce*, auprès duquel Canada Life a, pendant plusieurs années, conservé des comptes de banque dont un était appelé «compte du siège social». Canada Life cherche à obtenir la restitution, dans son compte de banque, de fonds que la banque y a retirés pour payer plusieurs chèques émis par Canada Life. Les endossements des preneurs avaient été contrefaits. Ces 31 chèques étaient tous payables à des assurés ou à leurs cessionnaires. Tous les preneurs résidaient aux É.-U. ou y avaient un établissement d'affaires. Les chèques, qui ont été encaissés dans plusieurs institutions financières new-yorkaises, ont été tirés à Toronto par Canada Life et transmis par courrier à son représentant de New York qui a finalement plaidé coupable à l'accusation de faux. Les parties reconnaissent que la responsabilité de la banque est subordonnée à la question de savoir si l'effet juridique des endossements contrefaits devait être établi par la loi canadienne ou la loi de l'État de New York. Si la loi canadienne s'applique, la banque ne peut invoquer aucun moyen de défense; si c'est la loi de New York qui s'applique, la banque peut obtenir gain de cause. La solution se trouve en grande partie dans l'analyse de deux articles de la *Loi sur les lettres de change*, S.R.C. 1970, chap B-5: l'art. 161 prévoit qu'une lettre de change intérieure tirée au Canada et endossée à l'étranger doit, quant au payeur, person resident in Canada. Accordingly he applied the law of Canada under which the Bank had no defence. The trial judge also found that if New York law applied the provisions of Article 3-405(1) of the *Uniform Commercial Code* provided the Bank with a complete defence in that the New York representatives had in substance supplied the names of the payees to Canada Life intending the payees to have no interest. [clause (3) of Article 3-405(1)]. The Court of Appeal did not disturb the findings at trial on the facts or as to the applicable law of the State of New York but concluded that the cheques were not "inland bills", and that under s. 161 the law of New York applied in the determination of the legal effect of the forged endorsements and that the action of Canada Life should be dismissed.

Held: The appeal should be dismissed.

Section 25(1)(*b*) of the *Bills of Exchange Act*, when read in the context of the Act as a whole manifests an intention to limit "inland bills" in the case of cheques to those which are drawn within Canada and which are directed to a bank in Canada. In the cheques here issued by Canada Life the direction was not to the Canadian Imperial Bank of Commerce at large but "TO THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York." Payment was on demand to payees in the State of New York and was to be in United States currency. While the Agency is not a separate corporation, at least for the purposes of the *Bills of Exchange Act*, a bank may in some circumstances be a person resident in more than one jurisdiction. In the circumstances of this case the Agency had limited banking powers under the licence issued in the State of New York and consequently the Agency (i.e., the respondent Bank) was a resident therein. The cheques should therefore be regarded as foreign bills. Under s. 161, the law of the State of New York applies and the Bank has its defence under Article 3-405(1) *supra*.

De Beers Consolidated Mines Limited v. Howe [1906] A.C. 455; *Prince v. Oriental Bank Corporation* (1878), 3 H.L. 325; *Woodland v. Fear* (1857), 7 El. & Bl. 519; *The Bank of Montreal v. The Dominion Bank* (1921), 60 D.L.R. 403; *King v. Lovitt*, [1912] A.C. 212; *Bank of Toronto v. Pickering* (1919), 46 O.L.R. 289;

être interprétée suivant la loi du Canada et l'art. 25 définit une «lettre de change intérieure» et une «lettre de change étrangère». Au procès, le juge a conclu que les chèques étaient des lettres de change intérieures puisqu'ils avaient été tirés au Canada sur une personne qui y réside. Il a par conséquent appliqué la loi canadienne qui prive la banque de tout moyen de défense. Le juge de première instance a également conclu que si la loi applicable avait été celle de New York, les dispositions de l'art. 3-405(1) du *Uniform Commercial Code* auraient offert à la banque une défense complète en ce que le représentant de New York avait fourni à Canada Life les noms des preneurs dans l'intention de ne leur attribuer aucun droit. [clause (3) de l'art. 3-405(1).] La Cour d'appel n'a pas modifié les conclusions que le juge de première instance a tirées sur les faits ou sur la loi applicable de l'État de New York, mais elle a conclu que les chèques n'étaient pas des «lettres de change intérieures», que selon l'art. 161, l'effet juridique des endossements contrefaits devait être établi aux termes de la loi de New York et que l'action de Canada Life devait être rejetée.

Arrêt: Le pourvoi doit être rejeté.

L'alinéa 25(1)*b*) de la *Loi sur les lettres de change*, lu dans tout le contexte de la Loi, montre l'intention de limiter les «lettres de change intérieures», dans le cas des chèques, à ceux qui sont tirés au Canada et qui sont adressés à une banque au Canada. Les chèques émis ici par Canada Life ne s'adressent pas à la Banque Canadienne Impériale de Commerce en général mais à «THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York». Le paiement était fait sur demande aux personnes dans l'État de New York et devait être fait en devise américaine. Bien que l'agence ne soit pas une compagnie distincte, au moins aux fins de la *Loi sur les lettres de change*, une banque peut, dans certains cas, résider à plus d'un endroit. Dans les circonstances de l'espèce, l'agence jouissait de pouvoirs bancaires illimités en vertu du permis délivré dans l'État de New York et, en conséquence, l'agence (c.-à-d. la banque intimée) y résidait. Les chèques doivent donc être considérés comme des lettres de change étrangères. En vertu de l'art. 161, la loi de l'État de New York s'applique et l'art. 3-405(1), précité, constitue un moyen de défense pour la banque.

Jurisprudence: *De Beers Consolidated Mines Limited v. Howe*, [1906] A.C. 455; *Prince v. Oriental Bank Corporation* (1878), 3 H.L. 325; *Woodland v. Fear* (1857), 7 El. & Bl. 519; *The Bank of Montreal v. The Dominion Bank* (1921), 60 D.L.R. 403; *King v. Lovitt*, [1912] A.C. 212; *Bank of Toronto v. Pickering* (1919), *Ex Parte Breull: In Re Bowie* (1880), 16 Ch. D. 484; *Naef v. Mutter* (1862), 31 L.J.C.P. 357; *Wallace v. John Souther & Co.* (1878), 2 S.C.R. 598; *Irwin v. Bank of Montreal* (1876), 36 U.C.Q.B. 375 referred to.

APPEAL from a judgment of the Court of Appeal for Ontario[1] allowing an appeal from a judgment of Lerner J. at trial[2] for the plaintiff. Appeal dismissed.

George D. Finlayson, Q.C., and *John H. Francis, Q.C.*, for the appellant.

J. J. Fitzpatrick, Q.C., and *H. Poss*, for the respondent.

The judgment of the Court was delivered by

ESTEY J.—In these proceedings, the appellant, The Canada Life Assurance Company (herein called "Canada Life") seeks to restore to its bank account with the respondent, The Canadian Imperial Bank of Commerce (herein called the "Bank"), moneys removed from that bank account by the Bank in honouring several cheques issued by Canada Life. The ultimate issue is the determination of the final impact of the loss resulting from the forgery of the payee's endorsement on several cheques issued by Canada Life and directed to the Bank. The outcome turns on the proper interpretation and application of the *Bills of Exchange Act*, R.S.C. 1970, c. B-5 (herein called the "Act") and for these purposes, only a brief outline of the main facts is required.

Canada Life is engaged in the life insurance business in Canada and in the United States with its head office in Toronto. The Bank is a chartered bank carrying on a banking business in both countries with its head office in Toronto and with an office in New York known as, THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York, (herein called the "Agency"). Since about 1914, Canada Life, in the course of the conduct of its business, has maintained bank accounts in the Agency, one of which was entitled "Head Office Account". Canada Life, in response to requests from one of

[1] (1976), 14 O.R. (2d) 777.
[2] (1975), 8 O.R. (2d) 210.

46 O.L.R. 289; *Ex Parte Breull: In Re Bowie* (1880), 16 Ch. D. 484; *Naef v. Mutter* (1862), 31 L.J.C.P. 357; *Wallace c. John Souther & Co.* (1878), 2 R.C.S. 598; *Irwin v. Bank of Montreal* (1876), 36 U.C.Q.B. 375.

POURVOI à l'encontre d'un arrêt de la Cour d'appel de l'Ontario[1] qui a accueilli un appel d'un jugement du juge Lerner, en première instance[2], en faveur de l'appelante. Pourvoi rejeté.

George D. Finlayson, c.r., et *John H. Francis, c.r.*, pour l'appelante.

J. J. Fitzpatrick, c.r., et *H. Poss*, pour l'intimée.

Le jugement de la Cour a été rendu par

LE JUGE ESTEY—En l'espèce, l'appelante, The Canada Life Assurance Company (ci-après appelée «Canada Life»), cherche à obtenir la restitution, dans son compte de banque ouvert chez l'intimée, la Banque Canadienne Impériale de Commerce (ci-après appelée la «banque»), de fonds retirés de ce compte par la banque pour payer plusieurs chèques émis par Canada Life. Il s'agit de déterminer qui doit en définitive subir la perte résultant de la contrefaçon de l'endossement du preneur sur plusieurs chèques émis par Canada Life et adressés à la banque. L'issue dépend de l'interprétation et de l'application de la *Loi sur les lettres de change*, S.R.C. 1970, chap. B-5 (ci-après appelée la «Loi») et, dans cette optique, il suffit de résumer brièvement les principaux faits.

Canada Life, dont le siège social est à Toronto, se consacre à l'assurance-vie au Canada et aux État-Unis. La banque est une banque à charte qui effectue des opérations bancaires dans les deux pays; son siège social est à Toronto et elle a un bureau à New York, appelé THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York, (ci-après appelé l'«agence»). Depuis 1914, Canada Life, dans la poursuite de ses opérations, a conservé des comptes de banque auprès de l'agence, dont un était appelé «compte du siège social». Répondant à la demande d'un de ses représentants de New

[1] (1976), 14 O.R. (2d) 777.
[2] (1975), 8 O.R. (2d) 210.

its New York representatives, purportedly made on behalf of policy holders for repayment of the cash surrender values or other moneys under certain insurance policies issued by Canada Life, issued 31 cheques payable to the insured or sometimes to an assignee of the insured. All payees were resident or had a place of business in the United States. The cheques, by means of forged endorsements were cashed in various New York financial institutions and were passed through the New York Clearing House to the Agency where they were debited to Canada Life's Head Office Account. Each of the 31 cheques was found by the learned trial judge, whose judgment is reported at (1975), 8 O.R. (2d) 210, to have been drawn in Toronto by Canada Life and forwarded by mail to their New York representative who was ultimately charged with the forgery. Each of the cheques had prominently printed at the top of the face of the cheque, "HEAD OFFICE ACCOUNT", were made "payable through the New York Clearing House in United States Currency" to the order of the insured and/or its assignee, and were directed "to THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York". The New York representative was ultimately prosecuted and convicted on a plea of guilty. The amount debited to the Head Office Account of Canada Life in respect of all 31 cheques totalled $350,000, and it is this sum together with interest which is claimed in these proceedings by Canada Life. At trial the learned trial judge found:

1. All cheques were issued in Toronto in response to requests from the New York representative who, for the purpose of making the requested payments, supplied Canada Life with the policy numbers and a part of the name of the insured, all pursuant to Canada Life procedures in this connection;

2. The signatures of all payees were forged without any knowledge whatever of the transaction on the part of the payees;

3. The Agency was established pursuant to a limited banking licence from the State of New York which prohibited the Agency from carrying on a general banking business but permitted the acceptance of deposits and the transaction of

York qui réclamait, au nom de détenteurs de police, le remboursement de valeurs de rachat ou d'autres sommes dues aux termes de polices d'assurance émises par Canada Life, cette dernière a émis 31 chèques payables à des assurés ou à leurs cessionnaires. Tous les preneurs résidaient aux États-Unis ou y avaient un établissement d'affaires. Les chèques, dont les endossements ont été contrefaits, on été encaissés dans plusieurs institutions financières new-yorkaises et sont passés de la New York Clearing House à l'agence où ils ont été portés au débit du compte du siège social de Canada Life. De l'avis du savant juge de première instance, dont le jugement est publié à (1975), 8 O.R. (2d) 210, chacun des 31 chèques a été tiré à Toronto par Canada Life et transmis par courrier à son représentant de New York qui a finalement été accusé de faux. Chaque chèque portait au recto, en haut et bien en vue, l'inscription [TRADUCTION] «COMPTE DU SIÈGE SOCIAL», était fait [TRADUCTION] «payable en devises américaines par l'entremise de la New York Clearing House» à l'ordre de l'assuré et (ou) à l'ordre de son cessionnaire et était adressé à «THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York». Le représentant de New York a finalement été poursuivi et déclaré coupable à la suite d'un plaidoyer de culpabilité. Les 31 chèques portés au débit du compte du siège social de Canada Life totalisaient $350,000 et Canada Life réclame ce montant avec intérêt. En première instance, le savant juge a conclu que:

1. Tous les chèques ont été émis à Toronto, à la demande du représentant de New York qui, pour obtenir les paiements demandés, a fourni à Canada Life les numéros de police et une partie du nom de l'assuré, conformément aux règles suivies par Canada Life dans ces cas;

2. Les signatures de tous les preneurs ont été contrefaites à leur insu;

3. L'agence avait un permis restreint accordé par l'État de New York qui lui interdisait de faire un commerce général de banque mais lui permettait d'accepter des dépôts de clients qui n'étaient pas de l'État de New York et d'effec-

banking business for customers foreign to the State of New York. The Agency was not incorporated.

These findings were not disturbed in the Court of Appeal and were not challenged in this Court.

It is conceded by counsel for both parties to this appeal that the liability of the Bank depends upon whether the effect in law of the forged endorsements is to be determined by the law of Canada or by the law of New York State. If the law of Canada applies, the Bank has no defence, but if the law of New York applies, the Bank may succeed. Two sections of the *Bills of Exchange Act* are of controlling importance.

161. Subject to this Act, the interpretation of the drawing, endorsement, acceptance or acceptance *supra* protest of a bill, drawn in one country and negotiated, accepted or payable in another, is determined by the law of the place where such contract is made; but where an inland bill is endorsed in a foreign country, the endorsement shall, as regards the payer, be interpreted according to the law of Canada.

25. (1) An inland bill is a bill that is, or on the face of it purports to be,

(*a*) both drawn and payable within Canada; or

(*b*) drawn within Canada upon some person resident therein.

(2) Any other bill is a foreign bill.

The learned trial judge concluded that the cheques were "inland bills" as all the cheques were drawn within Canada and drawn upon a person resident in Canada. He thereupon applied the law of Canada under which all parties agreed the Bank had no defence. The learned trial judge at the same time found that if New York law applied, the provisions of Article 3-405(1) of the *Uniform Commercial Code* provided the Bank with a complete defence by reason of the fact that the New York representatives had in substance furnished the names of the payees to Canada Life, intending all the while that they should have no interest in the moneys to be obtained through these cheques. Article 3-405(1) provides:

tuer des opérations bancaires pour leur compte. L'agence n'était pas constituée en corporation.

Ces conclusions n'ont pas été modifiées en Cour d'appel et n'ont pas été contestées devant cette Cour.

Les avocats des deux parties ont admis que la responsabilité de la banque était subordonnée à la question de savoir si l'effet juridique des endossements contrefaits devait être établi par la loi canadienne ou la loi de l'État de New York. Si la loi canadienne s'applique, la banque ne peut invoquer aucun moyen de défense, mais si la loi de New York s'applique, la banque peut obtenir gain de cause. Deux articles de la *Loi sur les lettres de change* sont d'une importance capitale:

161. Sous réserve de la présente loi, l'interprétation du tirage, de l'endossement, de l'acceptation ou de l'acceptation sous protêt d'une lettre de change tirée dans un pays et négociée, acceptée ou payable dans un autre, est régie par la loi du lieu où est fait ce contrat. Toutefois, lorsqu'une lettre de change intérieure est endossée à l'étranger, cet endossement doit, quant au payeur, être interprété suivant la loi du Canada.

25. (1) Une lettre de change intérieure est une lettre qui est ou qui paraît à sa face même,

a) à la fois, tirée et payable en Canada; ou

b) tirée en Canada sur une personne qui y réside.

(2) Toute autre lettre de change est une lettre étrangère.

Le savant juge de première instance a conclu que les chèques étaient des «lettres de change intérieures» puisqu'ils avaient été tirés au Canada sur une personne qui y réside. Il a donc appliqué la loi canadienne qui, les parties l'admettent, prive la banque de tout moyen de défense. Le savant juge de première instance a également conclu que si la loi applicable avait été celle de New York, les dispositions de l'art. 3-405(1) du *Uniform Commercial Code* auraient offert à la banque une défense complète parce que le représentant de New York avait fourni à Canada Life les noms des preneurs dans l'intention de ne leur attribuer aucun droit au paiement de ces chèques. Voici le texte de l'art. 3-405(1):

3-405(1) An endorsement by any person in the name of a named payee is effective if

. . .

(*c*) an agent or employee of the maker ... has supplied him with the name of the payee intending the latter to have no such interest.

The Court of Appeal of Ontario did not disturb the findings at trial on the facts and as regards the applicable law of the State of New York, but concluded, however, that the cheques were not "inland bills" and by virtue of s. 161 of the Act, the law of the State of New York and not the law of Canada applied in the determination of the legal effect of the forged endorsements and the action of Canada Life should therefore be dismissed.

The process of determining ultimate liability, in this case, begins with a determination of the law properly applicable to this transaction according to the provisions of s. 161 of the Act. This section provides a choice of law according to the circumstances described in the section:

(a) where an inland bill is endorsed in a foreign country, the endorsement, as regards the payer, is to be interpreted according to the law of Canada; and,

(b) in the case of other bills ('foreign bills') the interpretation of the drawing, endorsement, acceptance or acceptance supra protest is to be determined by the law of the place where such contract is made.

The reference to an "inland bill" in s. 161 throws us back to s. 25 wherein an inland bill is defined. In determining whether or not these cheques are inland bills as therein defined, the focus can immediately be centered on subs. (1)(*b*). Subsection (1)(*a*) is clearly inapplicable as the cheques are payable in New York.

At first blush it would appear that there really is no distinction between the condition described in s. 25(1)(*a*) and (1)(*b*) because each subsection refers to a bill being drawn in Canada, the one referring to a bill payable within Canada and the other to a bill drawn on a person resident in Canada. It may be, however, that a bill is, in the words of s. 75(2), "drawn payable elsewhere than at the residence or

[TRADUCTION] 3-405(1) L'endossement apposé par une personne au nom du preneur désigné est valable si

. . .

c) un mandataire ou un employé du tireur ... lui a fourni le nom du preneur dans l'intention de n'attribuer à ce dernier aucun droit au paiement.

La Cour d'appel de l'Ontario n'a pas modifié les conclusions que le juge de première instance a tirées sur les faits et sur la loi applicable de l'État de New York, mais elle a cependant conclu que les chèques n'étaient pas des «lettres de change intérieures», qu'en vertu de l'art. 161 de la Loi, l'effet juridique des endossements contrefaits devait être établi non pas aux termes de la loi canadienne mais de la loi de l'État de New York et que l'action de Canada Life devait donc être rejetée.

Pour déterminer en l'espèce la responsabilité finale, il faut d'abord établir quel droit s'applique à cette opération conformément aux dispositions de l'art. 161 de la Loi. Celui-ci prévoit que, suivant les circonstances décrites, une loi ou l'autre s'applique:

a) lorsqu'une lettre de change intérieure est endossée à l'étranger, cet endossement doit, quant au payeur, être interprété suivant la loi du Canada; et

b) dans le cas d'autres lettres de change («lettres de change étrangères») l'interprétation du tirage, de l'endossement, de l'acceptation ou de l'acceptation sous protêt est régie par la loi du lieu où est fait ce contrat.

Le renvoi, à l'art. 161, à une «lettre de change intérieure» nous ramène à l'art. 25 qui définit ce qu'est une lettre de change intérieure. Pour décider si ces chèques répondent à la définition de lettre de change intérieure, l'attention doit se porter sur l'al. (1)*b*). Il est manifeste que l'al. (1)*a*) ne s'applique pas puisque les chèques sont payables à New York.

A première vue, il semblerait qu'il n'existe aucune distinction entre la condition décrite à l'al. 25(1)*a*) et celle visée à l'al. (1)*b*) puisque les deux alinéas parlent d'une lettre de change tirée au Canada, l'un, d'une lettre de change payable au Canada et l'autre d'une lettre de change tirée sur une personne qui réside au Canada. Cependant une lettre de change peut être, selon le par. 75(2), place of business of the drawee" and hence subsections (*a*) and (*b*) may indeed provide for bills of two categories, namely payable inside and outside of Canada. Indeed, it would seem to be an accurate summary of s. 25(1) and (2) to say that an inland bill is a bill drawn in Canada and is either payable in Canada or drawn on a person resident in Canada or both; and that all other bills are foreign. Conversely, subs. (2) of s. 25 in effect provides that a foreign bill is any bill drawn outside Canada or any bill (wherever drawn) drawn on a person not resident in Canada and not payable within Canada.

It is necessary in order to interpret (1)(*b*) to determine the meaning of 'resident'. The terms 'resident' and 'residence' have come under scrutiny of the courts principally in connection with taxing statutes. In many cases the courts have had to determine the meaning of these words with reference to a corporation. In *Unit Construction Co. Ltd. v. Bullock*[3] for example, Viscount Simonds states the general rule at p. 360 as follows:

> For it has been trite law for two generations or more that a limited company "resides for purposes of income tax where its real business is carried on," and that its "real business is carried on where the central management and control abides.";

and continues on p. 361:

> ... it must now be regarded as clear law that an artificial person may, like a natural person, have more than one residence.

Lord Cohen spoke to the same effect at p. 372. Lord Radcliffe agreed but regarded this result as a factual refinement of the rule in *De Beers Consolidated Mines Limited v. Howe*[4] and not as an independent rule or principle of corporate law (*vide* p. 369).

[3] [1960] A.C. 351.
[4] [1906] A.C. 455.

«tirée payable ailleurs qu'à la résidence ou au siège d'affaires du tiré», les al. *a*) et *b*) peuvent donc envisager deux catégories de lettres de change, soit payables à l'intérieur soit à l'extérieur du Canada. De fait, il semblerait exact de dire qu'aux termes des par. (1) et (2) de l'art. 25, une lettre de change intérieure est une lettre de change tirée au Canada et qui est, soit payable au Canada, soit tirée sur une personne qui réside au Canada, ou les deux; toutes les autres lettres de change seraient étrangères. Réciproquement, le par. 25(2) prévoit qu'une lettre de change étrangère est une lettre de change tirée à l'extérieur du Canada ou une lettre de change tirée (n'importe où) sur une personne qui ne réside pas au Canada et qui n'est pas payable au Canada.

Pour interpréter l'al. (1)*b*), il est nécessaire de déterminer le sens du verbe «résider». Les cours ont eu à examiner les termes «résider» et «résidence» particulièrement en matière de droit fiscal. A plusieurs reprises, les cours ont eu à déterminer le sens de ces mots à l'égard d'une compagnie. Par exemple, dans l'arrêt *Unit Construction Co. Ltd. v. Bullock*[3], le vicomte Simonds a formulé la règle générale (à la p. 360):

> [TRADUCTION] Car il est de droit constant depuis deux générations ou plus qu'une compagnie à responsabilité limitée «réside aux fins de l'impôt sur le revenu là où elle exploite son entreprise véritable» et que son «entreprise véritable est exploitée là où se trouvent la direction et le pouvoir central»;

et il poursuit à la p. 361:

> [TRADUCTION] ... il faut maintenant considérer qu'il est clairement établi en droit qu'une personne morale peut, comme une personne physique, avoir plus d'une résidence.

Lord Cohen a abondé dans le même sens à la p. 372. Lord Radcliffe était du même avis mais considérait cette décision comme une subtilité en fait de la règle énoncée dans l'arrêt *De Beers Consolidated Mines Limited v. Howe*[4] et non comme une règle indépendante ou un principe de droit des compagnies (voir p. 369).

[3] [1960] A.C. 351.
[4] [1906] A.C. 455.

Here we do not have a taxing statute and thus no legislative inclination to establish a simple *situs* for the taxation of a natural or artificial person. The Legislature has enacted a code of rules for the guidance of commerce in negotiable instruments. Rather than evidencing some kind of legislative presumption or assumption that a taxpayer should ordinarily have but one exposure to taxation through one residence or *situs*, the *Bills of Exchange Act* reveals, if anything, the broader intent to clarify and simplify the conduct of commerce through the use of negotiable instruments. It is from this facilitative rather than restrictive viewpoint that the use of the word "resident" should be viewed in its position in s. 25. In my view, such an approach to the meaning of the words "person resident" in that subsection makes it even clearer than do the taxation cases mentioned above that 'resident' has a functional or business connotation in s. 25 which reflects the commercial realities which the statute was designed to serve. So interpreted, the subsection contemplates a person, organized as are the banks, as having more than one residence in which its business might be carried on and in which for those purposes such person would be 'resident'.

The reverse interpretation might be advanced by the Bank, that is that the section may be read to mean that an inland bill is one drawn within Canada on a person resident in any number of places so long as one of such multiple residences is in Canada. In essence, this approach requires the subsection to be understood as including the phrase at the end "wherever else it may be resident". This is an unnatural and artificial reading of the section and can hardly be said to represent the plain meaning of the words used by Parliament.

The Agency is not incorporated. Its premises in New York are those of the Bank. The only legal entity with which we are here concerned is the Bank. It is the Bank which holds the licence to do business in the State of New York. Thus not only should a court faced with the issue arising in this appeal examine the general law relating to 'corporate resident', but also recourse should be had to the rules evolved by the courts in determining

Nous n'avons en l'espèce aucune loi fiscale et donc aucune disposition législative pour établir un unique *situs* aux fins d'imposition d'une personne physique ou morale. La législature a adopté des règles régissant les effets de commerce en matière commerciale. Plutôt que d'introduire une présomption ou notion législative qu'un contribuable ne doit habituellement être imposé que pour une seule résidence ou *situs*, la *Loi sur les lettres de change* laisse voir une intention plus large de clarifier et de simplifier le commerce par l'utilisation d'effets négociables. C'est de ce point de vue conciliant plutôt que d'un point de vue restrictif qu'il faut considérer l'emploi du verbe «résider» à l'art. 25. A mon avis, cette façon de déterminer le sens de l'expression «personne qui réside» à l'art. 25 montre encore plus clairement que ne le font les arrêts susmentionnés en matière fiscale que le verbe «résider» a, à l'art. 25, une connotation fonctionnelle et commerciale qui reflète les réalités commerciales auxquelles la loi est censée répondre. Interprété ainsi, l'alinéa prévoit qu'une personne, organisée comme le sont les banques, peut avoir plus d'une résidence où elle exploite son entreprise et dans lesquelles elle «réside» à cette fin.

La banque peut faire valoir l'interprétation opposée, soit que l'article peut vouloir dire qu'une lettre de change intérieure est une lettre de change tirée au Canada sur une personne qui réside à plusieurs endroits à condition qu'une de ses résidences soit située au Canada. Cette façon de voir exige que l'on interprète le paragraphe comme s'il comprenait à la fin les mots [TRADUCTION] «même s'il se trouve qu'elle réside aussi ailleurs». Cette interprétation de l'article est forcée et artificielle et on peut difficilement dire qu'elle traduit le sens clair des mots employés par le Parlement.

L'agence n'est pas constituée en corporation. Les locaux qu'elle occupe à New York sont ceux de la banque. La seule entité juridique à laquelle nous avons affaire en l'espèce est la banque. C'est la banque qui détient le permis d'exploitation de l'État de New York. Aussi, une cour saisie de la présente affaire doit-elle examiner le droit relatif à la résidence des compagnies et tenir compte des règles élaborées par les cours pour déterminer si whether a corporation is within the geographic jurisdiction of the court.

For the purpose of service of writs and notices on legal entities, the courts have evolved the principle that such service is effective when made inside the geographic jurisdiction of the court either at a place where the legal entity is carrying on its undertaking or by service on a person in the directing staff of the organization. In any case, service is only effective when made at a place of business or an establishment owned by the legal entity when such service is made upon a person who might reasonably be expected to refer the fact of service of the documents in question to persons in positions of management of the legal entity. For example, in this appeal it is conceded by counsel for Canada Life that the Agency would be a place where service of judicial process might be properly effected under the rules of court if the person upon whom service was effected was an employee or representative of such status as could reasonably be expected to relay the documents in question to persons in positions of authority in the management of the Bank.

However, the Court of Appeal sought to take the matter one step further. Speaking through Arnup J.A. it stated:

It is common ground that a bank can be "resident" in many places. I understood Mr. Finlayson to agree that if the Agency were a true "branch" of the Bank, the Bank would be "resident" in New York (at the premises occupied by the Agency). However, he made a distinction between the position of a bank which has a true "branch" and a mere agency, with limited powers, not carrying on a full banking business.

Counsel for the appellant, Mr. Finlayson, in this Court stated that the Court of Appeal misconstrued his submission. He only conceded in this Court that the Agency was (subject to the usual rules about delivery of judicial notice to an individual in a position found to be appropriate in law for the acceptance of service on behalf of the corporation) a place where service might be made on the corporation for the purpose of exercise of jurisdiction within the State of New York; or for

une compagnie relève de sa compétence territoriale.

En ce qui concerne la signification de brefs et d'avis à des entités juridiques, les cours ont énoncé le principe que la signification est valable lorsqu'elle est faite à l'intérieur de la compétence territoriale de la cour, soit au lieu où l'entité juridique exploite son entreprise, soit à une personne faisant partie de la direction de la société. La signification n'est valable que si elle est faite à une place d'affaires ou à un établissement appartenant à l'entité juridique, à une personne dont on peut raisonnablement s'attendre qu'elle porte la signification des documents à la connaissance de personnes occupant des postes de direction à l'intérieur de l'entité juridique. Par exemple, l'avocat de Canada Life a admis qu'en l'espèce l'agence serait un endroit où la signification de procédures judiciaires pourrait être faite valablement aux termes des règles judiciaires si la personne à qui la signification a été faite est un employé ou un représentant dont le statut peut raisonnablement laisser croire qu'elle transmettra les documents en cause à des personnes compétentes de la direction de la banque.

La Cour d'appel a cependant cherché à aller plus loin. Parlant au nom de la Cour, le juge Arnup a dit:

[TRADUCTION] On s'accorde à dire qu'une banque peut «résider» à plusieurs endroits. J'ai cru que M^e^ Finlayson avait convenu que si l'agence était une véritable «succursale» de la banque, la banque aurait «résidé» à New York (aux lieux occupés par l'agence). Il a cependant fait une distinction entre la situation d'une banque qui a une véritable «succursale» et celle qui n'a qu'une simple agence, aux pouvoirs limités, qui n'effectue pas toutes les opérations bancaires.

L'avocat de l'appelante, M^e^ Finlayson, a déclaré devant cette Cour que la Cour d'appel avait mal interprété sa plaidoirie. Il a simplement admis devant cette Cour que l'agence était (sous réserve des règles habituelles régissant la signification d'avis judiciaires à une personne dans une position jugée appropriée en droit pour accepter la signification au nom de la compagnie) un endroit où la signification à la compagnie pourrait être faite aux fins d'exercer une compétence à l'intérieur de succession taxation purposes. He did not concede that the Bank was a 'resident' in the State of New York within the meaning of the term employed in s. 25(1)(*b*) even if the Agency was what is conveniently referred to as a branch of the Bank.

In all of the statutes or rules of court, discussed above, the words 'residency' or 'resident' have been interpreted and applied generally in the manner I have indicated according to a rule or principle evolved from the interpretation of the wording of the statute or rule of court as the case may be. Such interpretations are not of universal application although they may have some analogical value. In the field of general corporate law the residence of the corporation has been held to be the head office or other place designated in the incorporating instrument as being the chief place of business of the corporation. None of these tests and considerations are of much assistance in the circumstances of this case. The narrow question before us is whether or not the Bank is 'a person resident' in Canada within the meaning of s. 25(1)(*b*) when the reference to the Bank on the cheques is to the Agency in New York.

The term 'resident' is not defined in the Act. In s. 75(2) of the Act, it is provided that:

> Where a bill expressly stipulates that it shall be presented for acceptance, or where a bill is drawn payable elsewhere than at the residence or place of business of the drawee, it must be presented for acceptance before it can be presented for payment.

In this provision it may be that 'residence' is used with reference to the home of an individual drawee and is not intended to be a place in addition to a place of business of a corporation. There appears to be no other reference in the Act to 'resident' or 'residence' except incidentally in provisions unrelated to this issue; for example, s. 103(1) and (2) wherein provision is made for notice of dishonor.

Some light may be thrown on the meaning of the word 'resident' in relation to banks by the cases in England dealing with the proper place for presentment of cheques where the place of payment is a branch of a bank which has more than one branch. Some of these cases, while dealing

l'État de New York ou à des fins d'impôt successoral. Il n'a pas admis que la banque «réside» dans l'État de New York au sens où ce terme est employé à l'al. 25(1)*b*) même si l'agence est commodément désignée comme une succursale de la banque.

Dans toutes les lois ou règles judiciaires analysées précédemment, les mots «résidence» et «résider» ont généralement été interprétés et appliqués de la façon indiquée, conformément à une règle ou à un principe formulé à partir de l'interprétation du texte de la loi ou de la règle judiciaire, selon le cas. Ces interprétations ne sont pas d'application universelle même si elles peuvent présenter une certaine analogie. En matière de droit des compagnies, on a jugé que la résidence de la compagnie est le siège social ou un autre lieu désigné dans ses statuts constitutifs comme le principal siège d'affaires de la compagnie. Aucun de ces critères et considérations n'est d'un grand secours en l'espèce. La question à résoudre est de savoir si la banque est «une personne qui ... réside» au Canada au sens de l'al. 25(1)*b*) lorsque la mention de la banque sur les chèques désigne l'agence à New York.

Le terme «résider» n'est pas défini dans la Loi. Le paragraphe 75(2) de la Loi prévoit:

> Quand une lettre de change stipule expressément qu'elle doit être présentée à l'acceptation, ou quand elle est tirée payable ailleurs qu'à la résidence ou au siège d'affaires du tiré, elle doit être présentée à l'acceptation avant de l'être à l'encaissement.

Il est possible que le terme «résidence» soit employé dans cette disposition pour désigner le lieu d'habitation du tiré et qu'il ne vise pas un lieu autre qu'un siège d'affaires d'une compagnie. Les termes «résider» et résidence» ne se trouvent nulle part ailleurs dans la Loi, sauf de façon incidente dans des dispositions qui ne sont pas pertinentes en l'espèce; par exemple, les par. 103(1) et (2) qui traitent d'un avis de refus.

Les arrêts anglais portant sur le lieu approprié de présentation de chèques lorsque le lieu de paiement est une succursale d'une banque qui en compte plusieurs, peuvent contribuer à dégager le sens du verbe «résider» eu égard aux banques. Certains d'entre eux, qui traitent de billets à ordre, with promissory notes, such as *Prince v. Oriental Bank Corporation*[5], indirectly bring into question the status of branch banks. Sir Montague Smith at p. 332 said:

In principle and in fact, they [the branches] are agencies of one principal banking corporation or firm, . . .

and on p. 333 the judgment continues:

. . . ; though separate agencies, the latter [the branches] were still agencies of one principal bank, with which alone the Plaintiffs contracted.

On the other hand, in *Woodland v. Fear*[6] it was found that a bank having several branches was bound to pay the cheques of a customer only at the branch in which the customer kept his account; and this was so for the practical reason that the bank would not know the state of the customer's account at distant branches at the time the customer or his payee presented his cheques to the branch in question. This may be on the basis of an implied contract between customer and bank or perhaps an express contract, but it is difficult to find any precise authority for such a conclusion in the present bills of exchange legislation. The case was of course decided before the codification of the law of bills of exchange in the Act of 1882 in England. In the result, the Court treated the two branches of the plaintiff bank in question as separate banks and thus enabled the plaintiff bank to recover from the defendant moneys paid out to the defendant's payee from a branch other than that in which the defendant maintained his account. Lord Campbell C.J., in giving the judgment of the Court, stated, at p. 521:

: the cheque was not drawn on the banking Company generally, but on the banking Company at Glastonbury; and this, coupled with the fact that Helyar kept his account and his balance only there, shews that the Bridgwater establishment was not bound to honour his cheque . . . To hold that the customer of one branch, keeping his cash and account there, has a right to have his cheques paid at all or any of the branches, is to suppose a state of circumstances so inconsistent with any safe dealing on the part of the banker, that it cannot be presumed without direct evidence of such an agreement;

[5] (1878), 3 H.L. 325.

[6] (1857), 7 El. & Bl. 519.

comme l'arrêt *Prince v. Oriental Bank Corporation*[5], soulèvent indirectement la question du statut des succursales bancaires. Sir Montague Smith a dit (à la p. 332):

[TRADUCTION] En principe et en pratique, elles [les succursales] sont les agences d'une société ou d'un établissement bancaire principal, . . .

et le jugement continue à la p. 333:

[TRADUCTION] . . .; bien qu'elles soient des agences distinctes, les dernières [les succursales] sont des agences d'une banque principale avec laquelle les demandeurs ont contracté.

D'autre part, on a jugé dans *Woodland v. Fear*[6], qu'une banque comptant plusieurs succursales était tenue de payer les chèques d'un client uniquement à la succursale où se trouvait le compte du client; il en était ainsi parce que la banque ne connaîtrait pas l'état du compte du client dans des succursales éloignées au moment où le client ou le preneur présente les chèques à la succursale en cause. Cette conclusion peut être fondée sur un contrat implicite entre le client et la banque ou peut-être sur un contrat explicite, mais il est difficile de lui trouver un fondement précis dans l'actuelle loi sur les lettres de change. Cet arrêt est antérieur à la codification de la législation des lettres de change réalisée dans la Loi de 1882 en Angleterre. La cour a donc considéré les deux succursales de la banque demanderesse en cause comme des banques distinctes et a permis à la banque demanderesse de recouvrer du défendeur l'argent versé au preneur du défendeur par une succursale autre que celle où se trouvait le compte du défendeur. En rendant le jugement de la cour, lord Campbell, J. C., a affirmé à la p. 521:

[TRADUCTION] : Le chèque n'était pas tiré sur la banque en général mais sur la banque de Glastonbury; ceci, conjugué au fait que Helyar gardait son compte et son solde seulement là, montre que l'établissement de Bridgwater n'était pas tenu d'honorer son chèque . . . Soutenir que le client d'une succursale qui y garde son argent et son compte a le droit de faire payer ses chèques par n'importe quelle succursale, suppose des circonstances tellement inconciliables avec des opérations sûres pour une banque qu'on ne peut en présumer l'existence sans une preuve directe d'une telle entente;

[5] (1878), 3 H.L. 325.

[6] (1857), 7 El. & Bl. 519.

For an application of this case in Canada, see *The Bank of Montreal v. The Dominion Bank*[7].

There are other instances in the law where branches of a bank take on a personality separate and different from the head office or other branches of the same bank, as for example in the case of succession taxation. Thus a debt on a deposit certificate was found to have a *situs* in law at the branch of the bank which issued the deposit certificate rather than the head office and principal place of business of the banking corporation. (*vide King v. Lovitt*)[8]. This result was reached not on the basis of an interpretation of "residence" but on an interpretation of an expression in the taxing statute "property situate within the province". In the course of judgment, however, Lord Robson stated at pp. 219-220 after referring to *Woodland and Fear*, *supra*, and other cases to the same effect:

In each of these cases the Courts, having regard to the necessary course of business between the parties, held that the bank had in some measuer localized its obligation to its customer or creditor, so as to confine it, primarily at all events, to a particular branch.

Somewhat similar reasoning has been applied by the courts in relation to the service of notices and other documents required to be served pursuant to rules of court on corporations. In some such instances the courts have found that while a corporation has only one 'domicile', it has, for the purpose of making service of court processes, several residences. *Vide Bank of Toronto v. Pickering*[9] wherein Middleton J. stated at pp. 290-1:

For many purposes a branch bank is regarded as an independant organization .... When it is borne in mind that what is spoken of is "residence" and not "domicile", it appears to me that the word is of such flexible meaning that it may well be held to apply to the branch bank ...

A corporation, strictly speaking, can have no residence as distinct from domicile; and I can see no reason why it, like an individual, may not have many residences, within

[7] (1921), 60 D.L.R. 403.
[8] [1912] A.C. 212.
[9] (1919), 46 O.L.R. 289.

On voit une application de cet arrêt au Canada dans *The Bank of Montreal v. The Dominion Bank*[7].

On trouve dans la jurisprudence d'autres cas où les succursales d'une banque revêtent une personnalité distincte et différente de celle du siège social ou des autres succursales de la même banque, comme par exemple en matière d'impôt successoral. Ainsi, on a jugé qu'un certificat de dépôt avait en droit un *situs* à la succursale de la banque qui l'a émis plutôt qu'au siège social de la banque (Voir *King v. Lovitt*[8]) On n'est pas venu à cette conclusion par une interprétation du mot «résidence» mais par l'interprétation de l'expression dans la loi fiscale: [TRADUCTION] «bien situé dans la province». Cependant, dans son jugement, lord Robson, après avoir parlé de l'arrêt *Woodland and Fear*, précité, et d'autres arrêts au même effet, a dit aux pp. 219-220:

[TRADUCTION] Dans chacune de ces affaires, les cours, ayant considéré la marche nécessaire des affaires entre les parties, ont jugé que la banque avait dans une certaine mesure localisé son obligation vis-à-vis de son client ou créancier, afin de la restreindre, en principe du moins, à une succursale en particulier.

Les cours ont appliqué un raisonnement quelque peu semblable en ce qui concerne les avis ou autres documents signifiés à des compagnies conformément à la procédure judiciaire. Dans quelques-uns de ces cas, les cours ont jugé que bien qu'une compagnie n'ait qu'un seul «domicile», elle a plusieurs résidences aux fins de la signification de procédures judiciaires. Voir *Bank of Toronto v. Pickering*[9] où le juge Middleton a dit (pp. 290 et 291):

[TRADUCTION] Pour plusieurs fins, une succursale bancaire est considérée comme une organisation indépendante ... Lorsqu'on garde à l'esprit qu'il est question de «résidence» et non de «domicile», le terme me paraît avoir un sens tellement large qu'on peut très bien conclure qu'il s'applique à une succursale bancaire ...

A proprement parler, une compagnie ne peut pas avoir une résidence distincte de son domicile; et je ne vois pas pourquoi elle ne peut avoir, comme les personnes physi-

[7] (1921), 60 D.L.R. 403.
[8] [1912] A.C. 212.
[9] (1919), 46 O.L.R. 289.

the meaning of the Rule, although it can have but one domicile.

The analysis of s. 25(1)(*b*) in my view does not depend in any way upon the adoption of principles in courts dealing with taxation or other statutes which happen to employ the same terminology. It has been said by James L.J.:

There are cases in which it has been judicially decided, and I think rightly, that the words "residence" and "business" have no actual definite technical meaning but that you must construe them in every case in accordance with the object and intent of the Act in which they occur.

(*Ex Parte Breull. In Re Bowie*[10] at pp. 486-7; *vide* Erle C.J. to the same effect in *Naef v. Mutter*[11], at p. 359.)

The *Bills of Exchange Act* is of course a codification of the common law relating to bills of exchange which finds its origins in the United Kingdom statute of 1882 and first enacted in this country in 1890. The evident design and purpose of the statute is to promote the negotiability of commercial paper by the adoption of a comprehensive set of rules relating to bills of exchange generally and more particularly to drafts, cheques and promissory notes. By s. 10 of the statute, the rules of the common law of England are made applicable to bills of exchange, promissory notes and cheques "save insofar as they are inconsistent with the express provisions of this Act". Part 2 of the Act deals with bills of exchange, Part 3 with cheques and Part 4 with promissory notes. Certain general provisions relating to specific topics are found in Part 1. It is unfortunate that the *Bills of Exchange Act* has carried down to these times the terminology, in substantially unrevised form, of the 1882 statute. In those times, the principal bill of exchange was the draft and the cheque was of much less significance in daily commerce. Thus a great deal of the terminology of the statute, including that employed in s. 25, is either inappropriate to the cheque or is awkward in its application to the cheque. There may be some doubt as to the adaptation of the language of the statute to the cheque because s. 165(2) is limited in its operation

[10] (1880), 16 Ch. D. 484.
[11] (1862), 31 L.J.C.P. 357.

ques, plusieurs résidences, au sens de la règle, bien qu'elle ne puisse avoir qu'un seul domicile.

Pour l'analyse de l'al. 25(1)*b*) il n'y a pas lieu à mon avis d'adopter les principes formulés par les cours en traitant de lois fiscales ou d'autres lois qui emploient la même terminologie. Le lord juge James a dit:

[TRADUCTION] Il existe des arrêts où il a été décidé, à bon droit selon moi, que les mots «résidence» et «entreprise» n'ont aucune signification technique définie et qu'ils doivent être interprétés dans chaque cas conformément à l'objet et à l'intention de la loi où ils se trouvent.

(*Ex Parte Breull. In Re Bowie*[10], aux pp. 486 et 487; voir, au même effet, le juge en chef Erle dans *Naef v. Mutter*[11], à la p. 359.)

La *Loi sur les lettres de change* est une codification de la *common law* sur les lettres de change qui remonte à la loi de 1882 du Royaume-Uni; elle a été édictée ici pour la première fois en 1890. Cette loi a comme intention et but évidents de favoriser la négociabilité des effets de commerce en adoptant un ensemble complet de règles relatives aux lettres de change en général et plus particulièrement aux traites, aux chèques et aux billets à ordre. En vertu de l'art. 10, les règles de la *common law* d'Angleterre s'appliquent aux lettres de change, aux billets à ordre et aux chèques, «sauf dans la mesure où elles sont opposées aux dispositions formelles de la présente loi». La Partie II de la Loi traite des lettres de change, la Partie III des chèques et la Partie IV des billets à ordre. La Partie I comprend certaines dispositions générales relatives à des questions déterminées. Il est malheureux que la *Loi sur les lettres de change* garde encore, presque sans retouches, la terminologie de la loi de 1882. A ce moment-là, la principale lettre de change était la traite, le chèque ayant beaucoup moins d'importance dans le commerce quotidien. En conséquence, une grande partie de la terminologie de la loi, y compris celle de l'art. 25, ne convient pas au chèque ou s'y applique difficilement. L'application du texte de la loi au chèque est toujours un peu douteuse parce que l'effet du par. 165(2) est limité par l'introduction: «Sauf prescrip-

[10] (1880), 16 Ch. D. 484.
[11] (1862), 31 L.J.C.P. 357.

by the preface: "Except as otherwise provided in this Part (III)", which curtails the meaning and application of the succeeding words: " ... the provisions of this Act applicable to a bill of exchange payable on demand apply to a cheque". Subsection (1), however, states: "A cheque is a bill of exchange drawn on a bank, payable on demand" and while this definition is found only in Part III entitled "Cheques on a Bank", it is clear in my view that a cheque is a bill of exchange for all purposes under the Act. Hence in the interpretation of s. 25, one must construe the language employed broadly so as to make it applicable wherever possible to all bills of exchange including cheques. Nevertheless the difficulties in terminology are numerous. For example, a cheque is not, strictly speaking, drawn on a bank in the sense that a draft is drawn upon the drawee. Nevertheless the wording of both s. 165(1) and s. 25(1) refer to "drawn" and not "directed to", which is in fact what occurs in the case of a cheque. That is to say, the drawer of a cheque thereby makes a direction to the indicated bank to pay on demand (as in this case) a specified amount of money in a specified currency to payees designated on the face of the cheque.

It has been suggested by this Court in *Wallace v. John Souther & Co.*[12] that the word 'draws' with reference to promissory notes, drafts or bills of exchange includes both the manual act of forming the instrument in question but also, in the case of a bill of exchange, its delivery. The case is of little assistance to us, however, because it was concerned not with the *Bills of Exchange Act* but with legislation relating to the placing of stamps on certain negotiable instruments and in any case, the court was there not concerned with bills of exchange generally but rather with promissory notes where the concept of 'drawing' has quite a different connotation and with which we are here not concerned.

Reading s. 25(1)(*b*) only in the sense of a cheque for the moment, it would appear to establish as an "inland cheque" one that is drawn, in the manual sense of the term, within Canada upon a person resident therein. In the cheques here

[12] (1878), 2 S.C.R. 598.

tions contraires de la présente Partie (III)» qui restreint le sens et la portée de la suite du texte: « ... les dispositions de la présente loi concernant la lettre de change payable sur demande s'appliquent au chèque». Le paragraphe (1) prévoit cependant: «Un chèque est une lettre de change tirée sur une banque et payable sur demande» et bien que cette définition se trouve uniquement à la Partie III intitulée «Chèques sur une banque», il est clair à mon avis qu'un chèque est une lettre de change aux fins de la Loi. Pour interpréter l'art. 25, il faut donc interpréter le langage employé de façon assez large pour le rendre applicable, dans la mesure du possible, à toutes les lettres de change, y compris les chèques. Les difficultés terminologiques sont cependant nombreuses. Par exemple, un chèque n'est pas, à proprement parler, tiré sur une banque au sens qu'une traite est tirée sur le tiré. Néanmoins au par. 165(1) et au par. 25(1) on trouve le mot «tirée» et non «adressée à», ce qui est en fait le cas pour un chèque. Ce qui veut dire que le tireur d'un chèque donne l'ordre à la banque désignée de payer sur demande (comme en l'espèce) un montant déterminé d'argent en devise spécifiée aux preneurs désignés sur le chèque.

Dans l'arrêt *Wallace c. John Souther & Co.*[12], cette Cour a suggéré que le mot «tirer» se rapportant à des billets à ordre, à des traites ou à des lettres de change comprend le geste manuel que constituent la rédaction du document en question et également, dans le cas d'une lettre de change, sa livraison. Cet arrêt nous aide peu cependant car il ne porte pas sur la *Loi sur les lettres de change* mais sur une loi relative à l'apposition de timbres sur certains effets négociables et la Cour n'avait pas à se pencher sur les lettres de change en général mais plutôt sur les billets à ordre dont le «tirage» est un concept qui évoque une connotation tout à fait différente et non pertinente en l'espèce.

Si on lit l'al. 25(1)*b*) en ayant à l'esprit un chèque, il semble qu'un «chèque intérieur» est celui qui est, au sens du geste manuel, tiré au Canada sur une personne qui y réside. Les chèques émis ici par Canada Life ne s'adressent pas à la Banque

[12] (1878), 2 R.C.S. 598.

issued by Canada Life, the direction is not to the Imperial Bank of Commerce at large but "TO THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York". The direction includes a reference to the Head Office Account, no doubt for the purpose of instructing the Agency as to the account against which the cheque in question is to be charged. The cheque is payable on demand to joint payees who, on the evidence here, have been found concurrently by the courts below to be business organizations in the State of New York. Payment is of course to be in United States currency. A typical cheque bore on its face the following wording, imprinted by rubber stamp:

> "Paid
> Canadian Imperial Bank of Commerce
> March 1, 1967
> New York Agency."

I conclude on all these considerations that s. 25(1)(*b*), when read in the context of the *Bills of Exchange Act* as a whole, manifests an intention in Parliament to limit "inland bills" in the case of cheques to those which are drawn within Canada (the precise meaning of which we do not, in these proceedings, need to determine) and which are directed to a bank in Canada. It is not sufficient, in my interpretation of the section, to say that the bank to whom the direction is issued has its head office in Canada and therefore, whatever else appears in the cheque, the instrument is drawn on a person resident in Canada. Clearly all the parties to the transaction recognize that the cheque was directed to the New York Agency because the commerce in question was centered exclusively in the State of New York, and indeed, Canada Life, for that very reason, had long ago established banking facilities in that area. It is an irrelevant consideration that the business mechanics followed by the Bank and Canada Life included daily reporting to the respective head offices in Toronto of the state of the bank balance for the head office account in the New York Agency.

As I mentioned earlier, the learned trial judge concluded that these cheques were inland bills. Apparently he did so principally because s. 165 defines a cheque as " . . . a bill of exchange drawn

Impériale de Commerce mais à «THE AGENCY, CANADIAN IMPERIAL BANK OF COMMERCE, 20 Exchange Place, New York». Chacun porte une mention du compte du siège social, sans doute pour dire à l'agence à quel compte elle doit débiter le chèque en question. Le chèque est payable sur demande aux preneurs conjoints qui, selon la preuve, ont été reconnus par les cours d'instance inférieure comme des entreprises commerciales de l'État de New York. Le paiement devait donc être fait en devise américaine. Un chèque type porte la mention suivante, imprimée au tampon de caoutchouc:

> [TRADUCTION] «Payé
> Banque Canadienne Impériale de Commerce
> 1er mars 1967
> Agence de New York.»

Toutes ces considérations m'amènent à conclure que l'al. 25(1)*b*), lu dans le contexte de la *Loi sur les lettres de change* en son entier, montre l'intention du Parlement de limiter les «lettres de change intérieures» dans le cas des chèques, à ceux qui sont tirés au Canada (nous n'avons pas besoin en l'espèce de déterminer le sens précis de ce terme) et qui sont adressés à une banque au Canada. Il n'est pas suffisant de dire, selon moi, que la banque à qui l'ordre est émis a son siège social au Canada et que, peu importent les autres mentions figurant sur le chèque, le document est tiré sur une personne qui réside au Canada. Toutes les parties à l'opération ont reconnu que le chèque était adressé à l'agence de New York parce que l'opération en cause se limitait à l'État de New York et c'est en fait pour cette raison que Canada Life a décidé il y a longtemps d'établir un centre d'opérations bancaires dans cette région. On ne peut prendre en considération le fait que la pratique commerciale suivie par la banque et Canada Life exigeait un rapport quotidien à leur siège social respectif de Toronto sur l'état du compte du siège social à l'agence de New York.

Comme je l'ai mentionné précédemment, le savant juge de première instance a conclu que ces chèques étaient des lettres de change intérieures. Sa décision repose principalement sur ce que l'art.

on a bank ... ", and a bank is in turn defined in the Act as "an incorporated bank". Thus, since the New York Agency is not a separate corporation, the term "bank" must mean the respondent bank which, by reason of the location of its head office, is resident in Canada and not in New York. All this is predicated on the unstated major premise that a corporation for all purposes has but one place of residence, although at the outset of the judgment at trial, it is recognized that "a bank may have many residences: *Irwin v. Bank of Montreal*[13]; *Bank of Toronto v. Pickering*[14]." For these and other considerations mentioned above, I have concluded, as did the Court of Appeal, that at least for the purposes of the *Bills of Exchange Act*, a bank may, in some circumstances, be a person resident in more than one place.

It is also an irrelevant consideration in my view that the New York Agency was, by the laws of the State of New York, limited in the operations which it might undertake. So far as concerns the Bank and Canada Life, the New York Agency had, for the purposes of this transaction, unlimited banking powers under the licence issued by authorities in the State of New York. It is of no significance that as regards the residents of the State of New York, the Agency may have had other and lesser powers and responsibilities. I therefore conclude that the cheques in question are foreign bills.

This takes us back then to s. 161 where in its opening portion it states:

Subject to this Act, the interpretation of the drawing, endorsement, acceptance or acceptance, *supra*, protest of a bill, drawn in one country and negotiated, accepted or payable in another is determined by the law of the place where such contract is made; ...(I omit the concluding part which refers to an inland bill).

In this case the reference to "such contract" applies to the contract arising from the forged endorsement. Thus the law of the State of New York is applicable to the endorsement. Whether

[13] (1876), 36 U.C.Q.B. 375.
[14] (1919), 46 O.L.R. 289.

165 définit un chèque comme « ... une lettre de change tirée sur une banque ...», et une banque est définie dans la Loi comme une «banque (...) constituée en corporation». Donc, puisque l'agence de New York n'est pas une compagnie distincte, le terme «banque» doit viser la banque intimée qui, en raison de l'emplacement de son siège social, réside au Canada et non à New York. Cette affirmation repose sur la prémisse principale sous-entendue qu'une compagnie n'a à toutes fins qu'un seul lieu de résidence, même s'il est reconnu au début du jugement de première instance que [TRADUCTION] «une banque peut avoir plusieurs résidences: *Irwin v. Bank of Montreal*[13]; *Bank of Toronto v. Pickering*[14].» Pour ces raisons et d'autres déjà mentionnées, j'ai conclu, comme la Cour d'appel, qu'aux fins de la *Loi sur les lettres de change* au moins, une banque peut, dans certains cas, résider à plus d'un endroit.

A mon avis, il n'est pas pertinent en l'espèce que l'agence de New York n'ait pu, aux termes des lois de l'État de New York, effectuer que certaines opérations bancaires. En ce qui concerne la banque et Canada Life, l'agence de New York jouissait, aux fins de cette opération, de pouvoirs bancaires illimités en vertu du permis délivré par les autorités de l'État de New York. Il est sans importance qu'à l'égard des habitants de l'État de New York, l'agence de New York ait pu avoir des responsabilités et pouvoirs différents et moins étendus. J'en arrive donc à la conclusion que les chèques en cause sont des lettres de change étrangères.

Ceci nous ramène à l'art. 161 dont le début se lit ainsi:

Sous réserve de la présente loi, l'interprétation du tirage, de l'endossement, de l'acceptation ou de l'acceptation sous protêt d'une lettre de change tirée dans un pays et négociée, acceptée ou payable dans un autre, est régie par la loi du lieu où est fait ce contrat; ... (J'omets la dernière partie qui traite des lettres de change intérieures.)

En l'espèce, l'expression «ce contrat» vise le contrat qui naît de l'endossement contrefait. Donc, la loi de l'État de New York s'applique à l'endossement. En dernière analyse, il importe peu de répondre à

[13] (1876), 36 U.C.Q.B. 375.
[14] (1919), 46 O.L.R. 289.

the word "endorsement', in s. 161 means simply the bare language used in the endorsement or whether it means the legal effect of the endorsement on the rights of the parties and the bill of exchange as a legal instrument is, in the final analysis, of little importance. If the word 'interpretation' is given a narrow construction, then we are left with the application of the general law of conflicts to determine the appropriate law to be applied by the forum. If the word 'interpretation' is given a broad meaning, then s. 161 makes applicable the law of the State of New York. In the former case, the law of the forum, will operate to select as the appropriate law the law of the place of performance of the contract, which is New York, or the law of the place of the contract of endorsement which is also the State of New York.

The law of the State of New York applicable to this transaction is that which is embodied in Article 3, s. 405(1)(*c*) which is set out above. Under that provision of the *Uniform Commercial Code*, the learned trial judge found as fact that the endorsement is effective and therefore may be relied upon by the Bank as a good defence against the claims herein made by Canada Life.

On this disposition of the claims of Canada Life, it is unnecessary to proceed into those considerations relating to the claim by the Bank for credit for such restitution as has allegedly been made by the wrongdoer, the agent of Canada Life; or of the claim for interest herein made by Canada Life. I therefore would dismiss the appeal with costs to the Bank throughout.

Appeal dismissed with costs.

Solicitors for the appellant: McCarthy & McCarthy, Toronto.

Solicitors for the respondent: Fitzpatrick, O'Donnell & Poss, Toronto.

la question de savoir si le mot «endossement» de l'art. 161 ne vise que les termes employés pour l'endossement ou s'il vise l'effet juridique de l'endossement sur les droits des parties et la lettre de change à titre de document légal. Si on donne au mot «interprétation» un sens étroit, nous devons appliquer la règle générale des conflits de lois pour déterminer quelle loi le tribunal doit appliquer. Si le mot «interprétation» reçoit un sens large, l'art. 161 rend la loi de l'État de New York applicable. Dans le premier cas, la loi du lieu aura pour effet que la loi appropriée sera soit la loi du lieu d'exécution du contrat, qui est New York, soit la loi du lieu du contrat que constitue l'endossement, qui est également l'État de New York.

La loi de l'État de New York applicable à cette opération est contenue à l'art. 3, al. 405(1)*c*), précité. En vertu de cette disposition du *Uniform Commercial Code*, le savant juge de première instance a reconnu comme un fait que l'endossement est valide et peut constituer un moyen de défense valable pour la banque à l'encontre des réclamations de Canada Life.

Étant donné ma conclusion sur les réclamations de Canada Life, il n'est pas nécessaire d'examiner les moyens relatifs à la demande de la banque visant les remboursements qui auraient été effectués par l'auteur des faux, l'agent de Canada Life; il en est de même pour la demande d'intérêt de Canada Life. En conséquence, je suis d'avis de rejeter le pourvoi avec dépens à la banque en toutes les cours.

Pourvoi rejeté avec dépens.

Procureurs de l'appelante: McCarthy & McCarthy, Toronto.

Procureurs de l'intimée: Fitzpatrick, O'Donnell & Poss, Toronto.

Boma Manufacturing Ltd. and Panabo Sales Ltd. *Appellants*

v.

Canadian Imperial Bank of Commerce *Respondent*

INDEXED AS: BOMA MANUFACTURING LTD. *v.* CANADIAN IMPERIAL BANK OF COMMERCE

File No.: 24520.

1996: March 26; 1996: November 21.

Present: Lamer C.J. and La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Bills of exchange — Cheques — Conversion — Defences — Companies' bookkeeper issuing series of fraudulent cheques payable to third parties and depositing them to her bank accounts — Bookkeeper forging payees' signature on certain cheques — Other cheques accepted by collecting bank without endorsement — Whether collecting bank liable to companies for conversion — Whether cheques payable to fictitious or non-existing person — Whether collecting bank holder in due course — Bills of Exchange Act, R.S.C., 1985, c. B-4, ss. 20(5), 165(3).

The appellants, two small, family-owned companies whose only shareholders and officers are M and his wife, were defrauded by their bookkeeper A through a series of fraudulent cheques issued over a five-year period. A, along with the two principals, was a duly authorized signing officer on the bank accounts maintained by the companies. Cheques drawn on these accounts required only one authorized signature. A used the appellants' pre-printed cheque forms to create some 155 cheques totalling $91,289.54, payable to a number of persons connected with the appellants, including the principals, several employees, and one of the subcontractors, Van Sang Lam (all but one of the cheques payable to Lam were made to "J. Lam" or "J. R. Lam", the initials and the last name mimicking the name of A's first husband). A signed 146 of the cheques on behalf of the appellants, and fraudulently obtained M's signature

Boma Manufacturing Ltd. et Panabo Sales Ltd. *Appelantes*

c.

Banque Canadienne Impériale de Commerce *Intimée*

RÉPERTORIÉ: BOMA MANUFACTURING LTD. *c.* BANQUE CANADIENNE IMPÉRIALE DE COMMERCE

N° du greffe: 24520.

1996: 26 mars; 1996: 21 novembre.

Présents: Le juge en chef Lamer et les juges La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci et Major.

EN APPEL DE LA COUR D'APPEL DE LA COLOMBIE-BRITANNIQUE

Lettres de change — Chèques — Détournement — Moyens de défense — Aide-comptable des compagnies émettant une série de chèques frauduleux payables à des tierces parties pour ensuite les déposer dans ses comptes bancaires — Aide-comptable contrefaisant la signature des preneurs sur certains chèques — Autres chèques acceptés sans endossement par la banque d'encaissement — La banque d'encaissement est-elle responsable de détournement envers les compagnies? — Les chèques étaient-ils payables à des personnes fictives ou qui n'existaient pas? — La banque d'encaissement était-elle un détenteur régulier? — Loi sur les lettres de change, L.R.C. (1985), ch. B-4, art. 20(5), 165(3).

Les appelantes, deux petites entreprises familiales dont les seuls actionnaires et dirigeants sont M et son épouse, ont été escroquées par leur aide-comptable A qui a émis une série de chèques frauduleux au cours d'une période de cinq ans. À l'instar des deux dirigeants, A était une signataire autorisée relativement aux comptes bancaires des compagnies. Les chèques tirés sur ces comptes n'exigeaient qu'une signature autorisée. A s'est servie des formulaires de chèque préimprimés des appelantes pour rédiger quelque 155 chèques dont le montant total s'élevait à 91 289,54 $ et qui étaient payables à un certain nombre de personnes ayant des liens avec les appelantes, y compris les dirigeants, plusieurs employés et un sous-traitant, Van Sang Lam (tous les chèques payables à Lam étaient faits, sauf un, à l'ordre de «J. Lam» ou «J. R. Lam», les initiales et le nom de famille imitant le nom du premier mari de A).

on the other nine. She deposited all the cheques into one of her accounts at the respondent bank. The respondent bank's policy with respect to a customer wishing to deposit a third party cheque to her account was to require that the cheque be endorsed by the payee. However, the bank accepted 107 of the cheques payable to "J. Lam" or "J. R. Lam" for deposit without endorsement. The tellers apparently assumed that the payee was A's first husband. A forged endorsements on some of the Lam cheques, and on all of the cheques payable to other third parties. The appellants brought an action in negligence, and in the alternative, conversion, against their own bank and against the respondent. They were successful at trial, and the respondent was ordered to pay $91,289.54. A majority of the Court of Appeal allowed the respondent's appeal, reducing the judgment so as to reflect only the amount of the nine cheques bearing M's signature.

Held (La Forest and McLachlin JJ. dissenting on the appeal): The appeal should be allowed and the cross-appeal dismissed.

Per Lamer C.J. and L'Heureux-Dubé, Sopinka, Gonthier, Cory, Iacobucci and Major JJ.: A bill of exchange is a chattel that can be negotiated from party to party. Title to a bill, such as a cheque, is obtained through negotiation. Once an individual has obtained title, that individual has the right to present the bill to the drawee for payment, as well as a right of recovery against the drawer if the bill is dishonoured by the drawee. If a bank pays to its customer the amount of a cheque to which that customer is not entitled, the bank will be strictly liable to the owner of the cheque for conversion. As a matter of principle contributory negligence is not available in the context of a strict liability tort. If the contributory negligence approach is to be introduced into this area of the law, it must be at the instance of the legislative branch.

The respondent is *prima facie* liable to the drawer for conversion in this case. The general rule is that a forged or unauthorized endorsement is wholly inoperative, and no right to retain the bill or to enforce payment thereof can be acquired through or under such a signature. An exception to this rule appears in s. 20(5) of the *Bills of Exchange Act*, which provides that a bill payable to a fictitious or non-existing person may be treated as payable to bearer. A cheque payable to bearer can be negotiated by simple "delivery" to the bank; endorsement is

A a signé 146 des chèques pour le compte des appelantes et a frauduleusement obtenu la signature de M pour les neuf autres chèques. Elle a déposé tous les chèques dans l'un de ses comptes à la banque intimée. Dans le cas où un client souhaitait déposer à son compte le chèque d'une tierce partie, la banque intimée avait comme politique d'exiger l'endossement du chèque par le preneur. Cependant, la banque a accepté pour dépôt, sans endossement, 107 des chèques payables à «J. Lam» ou à «J. R. Lam». Les caissiers ou caissières ont apparemment supposé que le preneur était le premier mari de A. A a contrefait l'endossement de certains chèques à l'ordre de Lam et de tous les chèques payables à d'autres tierces parties. Les appelantes ont intenté une action pour négligence et, subsidiairement, une action pour détournement contre leur propre banque et contre l'intimée. Elles ont eu gain de cause au procès, le tribunal ordonnant à l'intimée de payer la somme de 91 289,54 $. La Cour d'appel à la majorité a accueilli l'appel de l'intimée, réduisant le montant du jugement de façon à ne refléter que les neuf chèques portant la signature de M.

Arrêt (les juges La Forest et McLachlin sont dissidents quant au pourvoi principal): Le pourvoi principal est accueilli et le pourvoi incident est rejeté.

Le juge en chef Lamer et les juges L'Heureux-Dubé, Sopinka, Gonthier, Cory, Iacobucci et Major: Une lettre de change est un bien qui peut être négocié d'une partie à une autre. Le titre sur une lettre de change, comme un chèque, s'obtient par négociation. La personne qui obtient ce titre a le droit de présenter la lettre de change au tiré pour paiement, ainsi que celui de recouvrer cette somme auprès du tireur si la lettre est refusée par le tiré. Lorsqu'une banque verse à son client le montant d'un chèque auquel il n'a pas droit, cela constitue un détournement dont elle a la responsabilité stricte envers le propriétaire du chèque. En principe, la négligence contributive ne saurait être invoquée dans le contexte d'un délit de responsabilité stricte. S'il faut introduire la notion de négligence contributive dans ce domaine du droit, ce doit être à la demande du législateur.

L'intimée est, en l'espèce, responsable à première vue de détournement envers le tireur. La règle générale veut qu'un endossement contrefait ou non autorisé n'ait aucun effet et qu'une telle signature ne confère pas le droit de garder la lettre ou d'obliger à en effectuer le paiement. Une exception à cette règle est prévue au par. 20(5) de la *Loi sur les lettres de change*, qui prévoit qu'une lettre payable à une personne fictive ou qui n'existe pas peut être considérée comme payable au porteur. Un chèque payable au porteur peut être négocié par not required. If the cheques in question were payable to fictitious persons, and could accordingly be treated as bearer cheques, the bank would become a "holder in due course" pursuant to s. 73 of the Act despite the forged and missing endorsements and would consequently have a defence against liability for conversion. The policy underlying the fictitious person rule seems to be that a drawer who has drawn a cheque payable to order, not intending that the payee receive payment, loses, by his or her conduct, the right to the protections afforded to a bill payable to order.

Many of the cheques in question were payable to "real" persons, albeit persons to whom no money was owed by the companies. Because A, the writer of the cheques, did not intend these payees to receive the proceeds of the cheques, the Court of Appeal concluded that the drawer of the cheques intended them to be payable to bearer. The Court of Appeal erred in focussing on A's intention. It is the intention of the drawer that is significant for the purpose of s. 20(5), not the intention of the signatory of the cheque. A is not the drawer because she cannot be said to be the guiding mind of the corporate appellants; she simply had signing authority within limited circumstances. The relevant intention in this case is that of the appellant companies, as expressed by their guiding mind.

Where a drawer is fraudulently induced by another person into issuing a cheque for the benefit of a real person to whom no obligation is owed, the cheque is to be considered payable to the payee and not to a fictitious person. Here the cheques payable to actual persons associated with the appellants were not payable to fictitious persons, and could not be treated by the respondent bank as payable to bearer. While many of the cheques were made payable not to actual persons associated with the companies, but to "J. Lam" and "J. R. Lam", M was reasonably mistaken in thinking that the payee was an individual associated with his companies. These cheques thus could not be treated by the respondent bank as payable to bearer. While the cheques certainly were "delivered" by A to the respondent bank within the meaning of s. 2 of the Act, for negotiation to be effected endorsement by the payee was required.

Under s. 165(3) of the Act, a bank that collects a cheque for deposit to the credit of a person and that

simple «livraison» à la banque; il n'a pas besoin d'être endossé. Si les chèques en question étaient payables à des personnes fictives et pouvaient donc être considérés comme des chèques payables au porteur, la banque deviendrait un «détenteur régulier», conformément à l'art. 73 de la Loi, même s'il y avait falsification ou absence d'endossement, et disposerait donc d'un moyen de défense opposable à une action pour détournement. Le principe sous-jacent à la règle de la personne fictive semble être le suivant: si une personne a tiré un chèque payable à ordre, sans vouloir que le preneur reçoive paiement, elle perd, en raison de sa conduite, le droit aux mesures de protection dont bénéficie une lettre de change payable à ordre.

Bon nombre des chèques en cause étaient payables à des personnes «réelles», quoique ce fussent des personnes à qui les compagnies ne devaient pas d'argent. Parce que A, l'auteur des chèques, ne voulait pas que ces preneurs reçoivent les montants en question, la Cour d'appel a conclu que le tireur des chèques voulait qu'ils soient payables au porteur. La Cour d'appel a commis une erreur en se concentrant sur l'intention de A. C'est l'intention du tireur qui est importante pour les fins du par. 20(5) et non celle du signataire du chèque. A n'est pas le tireur parce que l'on ne peut dire qu'elle est l'âme dirigeante des compagnies appelantes; elle était tout simplement autorisée à signer dans certaines circonstances. En l'espèce, l'intention pertinente est celle des compagnies appelantes, exprimée par leur âme dirigeante.

Lorsqu'un tireur est amené frauduleusement par une autre personne à émettre un chèque au profit d'une personne existante envers qui il n'existe aucune obligation, le chèque doit être considéré comme payable au preneur et non à une personne fictive. En l'espèce, les chèques payables à des personnes existantes ayant des liens avec les appelantes n'étaient pas payables à des personnes fictives, et la banque intimée ne pouvait pas les considérer comme payables au porteur. Même si de nombreux chèques étaient payables non pas à des personnes existantes ayant des liens avec les compagnies, mais plutôt à «J. Lam» et à «J. R. Lam», M a raisonnablement cru à tort que le preneur était une personne ayant des liens avec ses compagnies. Ces chèques ne pouvaient donc pas être considérés par la banque intimée comme payables au porteur. Bien que les chèques aient sûrement été «livrés» par A à la banque intimée, au sens de l'art. 2 de la Loi, ils devaient, pour être négociés, porter l'endossement du preneur.

Aux termes du par. 165(3) de la Loi, lorsqu'une banque encaisse un chèque en vue de le déposer au credits that person with the amount of the cheque acquires all the rights and powers of a holder in due course of the cheque. The "person" in this section means a person who is entitled to the cheque. Consequently, s. 165(3) does not apply to the facts of this case. A was not the payee or a legitimate endorsee of the cheques in question, and accordingly she was not a "person" within the meaning of s. 165(3). Absent valid endorsements, the cheques were not validly negotiated to the bank. As a result, the respondent bank took the cheques subject to the equities of the situation. A was not entitled to the cheques, but the respondent bank credited her with the amount of those cheques. This constitutes conversion, for which the bank is strictly liable.

Per La Forest and McLachlin JJ. (dissenting on the appeal): The underlying conflict that arises when trying to decide the scope and application of s. 20(5) of the *Bills of Exchange Act* is that of the allocation of loss as between the accepting bank and the drawer of a fraudulent cheque. This conflict becomes ripe when it is an employee of the drawer, or a third person, who perpetrates the fraud and the loss must be borne by one of two innocent parties. As between the employer/drawer and the accepting bank, the employer/drawer should bear the risk of any loss and is in the best position to minimize that risk. As demonstrated by the facts of this case, it is easy enough for the perpetrator to forge the endorsement of the named payee and there is no way for the bank to verify the authenticity of the signature. On the other hand, the employer/drawer is in a much better position to put a stop to fraud of this type and is at least in an equal position to bear any loss. As a matter of course, any risk of loss on the part of a large corporation is generally covered by fidelity insurance. It is also possible for large-scale fraud to be discovered through audits or other protective measures. Allocating the loss to the accepting bank removes all incentive from a corporation to pursue business practices that will minimize such losses. Furthermore, such an allocation does not fit in well with the general scheme of bills of exchange, since the essence of a bill of exchange is its negotiability and the finality of payment inherent to such a negotiation.

Of the 155 fraudulent cheques, 41 were made out to existing employees of the appellants. With respect to the three cheques out of the 41 which A fraudulently produced and then induced M to sign, the respondent bank's defence under s. 20(5) must fail in light of this

compte d'une personne et qu'elle porte au crédit de celle-ci le montant du chèque, elle acquiert tous les droits et pouvoirs du détenteur régulier du chèque. La «personne» visée à ce paragraphe est une personne ayant droit au chèque. En conséquence, le par. 165(3) ne s'applique pas aux faits de la présente affaire. A n'était ni le preneur ni un endossataire légitime des chèques en question et n'était donc pas une «personne» au sens du par. 165(3). Sans endossement valide, les chèques n'ont pas été validement négociés à la banque. Par conséquent, la banque intimée a accepté les chèques sous réserve des droits susceptibles d'exister en *equity*. A n'avait pas droit aux chèques, mais la banque intimée lui en a crédité le montant. Cela constitue un détournement dont la banque a la responsabilité stricte.

Les juges La Forest et McLachlin (dissidents quant au pourvoi principal): Le conflit sous-jacent à toute tentative de déterminer la portée et l'application du par. 20(5) de la *Loi sur les lettres de change* réside dans la répartition de la perte entre la banque qui a accepté un chèque frauduleux, et le tireur de ce chèque. Ce conflit atteint son paroxysme quand c'est un employé du tireur, ou un tiers, qui commet la fraude et que la perte doit être assumée par l'une de deux parties innocentes. En ce qui concerne l'employeur-tireur et la banque-accepteur, c'est l'employeur-tireur qui doit assumer le risque de perte et qui est le mieux placé pour réduire au minimum ce risque. Comme le montrent les faits de la présente affaire, le fraudeur peut assez aisément falsifier l'endossement du preneur nommé et la banque n'a aucun moyen de vérifier l'authenticité de la signature. En revanche, l'employeur-tireur est beaucoup mieux placé pour mettre fin à ce genre de fraude et est au moins aussi bien placé pour assumer toute perte subie. Il va sans dire que tout risque de perte auquel est exposée une grande entreprise est généralement couvert par une assurance contre les détournements. Il est également possible de déceler la fraude sur grande échelle par des vérifications et d'autres mesures de protection. Faire assumer la perte par la banque-accepteur enlève à une société toute incitation à poursuivre des pratiques commerciales propres à réduire au minimum ces pertes. De plus, faire assumer la perte par la banque-accepteur ne cadre pas bien avec l'économie du régime des lettres de change, puisque l'essence d'une lettre de change est sa négociabilité et l'irrévocabilité du paiement inhérent à la négociation de cette lettre.

Parmi les 155 chèques frauduleux, 41 étaient payables à des employés existants des appelantes. En ce qui concerne les trois chèques, sur les 41, que A a rédigés frauduleusement, pour ensuite inciter M à les signer, le moyen de défense que la banque intimée a invoqué en

Court's decision in *Concrete Column Clamps*. However, the remaining 38 cheques prepared and signed by A, and payable by way of pretence to employees of the appellants, are payable to fictitious persons within the meaning of s. 20(5) of the Act and consequently must be treated as payable to bearer. The respondent bank is a holder in due course of these cheques and cannot be liable to the appellants for conversion. The application of the law of agency leads to the inevitable conclusion that where the fraudulent employee is a signing officer of the drawer, then his or her intent must be taken as being the intent of the drawer. While A clearly acted beyond the ambit of what the appellants had in mind when she prepared and signed cheques made out to payees who were not their creditors, it is equally clear that to the eyes of a third party she would have had the apparent authority to sign the cheques as she was an acknowledged signing officer of both companies. The intent of A is thus also the intent of the appellants, the drawer of the cheques. Assuming it is possible to do so, this is not an appropriate case for apportionment.

The test for a non-existent person under s. 20(5) is an objective one and involves a determination of whether the payee is a matter of invention and not a real person. The 114 cheques payable to D. Lam, J. Lam or J. R. Lam were payable to non-existent persons within the meaning of s. 20(5) and are therefore to be treated as payable to bearer. The respondent bank is accordingly a holder in due course of these cheques and has a complete defence against the action of the appellants. Section 165(3) should be given the interpretation adopted by Iacobucci J. both to avoid disharmony with the general scheme for cheques set out in the Act and to prevent injustice, and is thus not available as a defence to the respondent bank on the facts of this case. Since the respondent did not cross-appeal with respect to the application of s. 20(5), the judgment of the Court of Appeal should stand as is.

Cases Cited

By Iacobucci J.

Distinguished: *Fok Cheong Shing Investments Co. v. Bank of Nova Scotia*, [1982] 2 S.C.R. 488; **disapproved:** *Toronto-Dominion Bank v. Dauphin Plains Credit Union Ltd.* (1992), 98 D.L.R. (4th) 736; **referred to:** *Number 10 Management Ltd. v. Royal Bank of*

vertu du par. 20(5) doit échouer, compte tenu de l'arrêt *Concrete Column Clamps* de notre Cour. Cependant, les 38 autres chèques rédigés et signés par A, et apparemment payables à des employés des appelantes, sont payables à des personnes fictives au sens du par. 20(5) de la Loi et doivent donc être tenus pour payables au porteur. La banque intimée est le détenteur régulier de ces chèques et ne saurait être responsable de détournement envers les appelantes. L'application du droit des mandats amène inévitablement à conclure que, lorsque l'employé malhonnête est un signataire autorisé du tireur, son intention doit alors être considérée comme étant celle du tireur. Bien qu'il soit clair que A est allée au-delà de ce que les appelantes avaient à l'esprit quand elle a rédigé et signé les chèques payables à des preneurs qui n'étaient pas leurs créanciers, il est également clair qu'aux yeux d'une tierce partie elle était apparemment autorisée à signer les chèques, car elle était une signataire reconnue des deux compagnies. L'intention de A est donc aussi l'intention des appelantes qui sont le tireur des chèques. À supposer que cela soit possible, la présente affaire ne se prête pas à une répartition de la perte.

Le critère applicable à la personne qui n'existe pas au sens du par. 20(5) est un critère objectif et consiste notamment à se demander si le preneur d'un chèque est une invention et n'est pas une personne réelle. Les 114 chèques payables à D. Lam, J. Lam ou J. R. Lam étaient payables à des personnes qui n'existaient pas au sens du par. 20(5) et doivent être considérés comme payables au porteur. Par conséquent, la banque intimée est le détenteur régulier de ces chèques et jouit d'un moyen de défense complet contre l'action des appelantes. Le paragraphe 165(3) devrait être interprété comme le fait le juge Iacobucci, à la fois pour éviter qu'il soit incompatible avec l'économie du régime des chèques établi dans la Loi et pour empêcher qu'une injustice ne soit commise, et d'après les faits du présent pourvoi, il ne saurait donc être invoqué comme moyen de défense par la banque intimée. Étant donné que l'intimée n'a pas formé de pourvoi incident relativement à l'application du par. 20(5), l'arrêt de la Cour d'appel doit demeurer inchangé.

Jurisprudence

Citée par le juge Iacobucci

Distinction d'avec l'arrêt: *Fok Cheong Shing Investments Co. c. Banque de Nouvelle-Écosse*, [1982] 2 R.C.S. 488; **arrêt critiqué:** *Toronto-Dominion Bank c. Dauphin Plains Credit Union Ltd.* (1992), 98 D.L.R. (4th) 736; **arrêts mentionnés:** *Number 10 Management*

Canada (1976), 69 D.L.R. (3d) 99; *Marfani & Co. v. Midland Bank, Ltd.*, [1968] 2 All E.R. 573; *Jervis B. Webb Co. v. Bank of Nova Scotia* (1965), 49 D.L.R. (2d) 692; *Ontario Woodsworth Memorial Foundation v. Grozbord*, [1969] S.C.R. 622; *Norwich Union Fire Insurance Society Ltd. v. Banque Canadienne Nationale*, [1934] S.C.R. 596; *Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd.*, [1977] 2 S.C.R. 456; *Bank of England v. Vagliano Brothers*, [1891] A.C. 107; *Gough Electric Ltd. v. Canadian Imperial Bank of Commerce* (1986), 34 B.L.R. 17; *Royal Bank of Canada v. Wild* (1974), 51 D.L.R. (3d) 188.

By La Forest J. (dissenting on the appeal)

Bank of England v. Vagliano Brothers, [1891] A.C. 107; *Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd.*, [1977] 2 S.C.R. 456; *Fok Cheong Shing Investments Co. v. Bank of Nova Scotia*, [1982] 2 S.C.R. 488; *Vinden v. Hughes*, [1905] 1 K.B. 795; *Harley v. Bank of Toronto*, [1938] 2 D.L.R. 135; *London Life Insurance Co. v. Molsons Bank* (1904), 8 O.L.R. 238; *Metropolitan Life Insurance Co. v. Quebec Bank* (1916), 50 C.S. 214; *Canadian Laboratory Supplies Ltd. v. Engelhard Industries of Canada Ltd.*, [1979] 2 S.C.R. 787; *Clutton v. George Attenborough & Son*, [1897] A.C. 90; *Grey v. Pearson* (1857), 6 H.L.C. 60; *Caledonian Railway Co. v. North British Railway Co.* (1881), 6 App. Cas. 114.

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Citée par le juge La Forest (dissident quant au pourvoi principal)

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APPEAL and CROSS-APPEAL from a judgment of the British Columbia Court of Appeal (1994), 99 B.C.L.R. (2d) 201, 120 D.L.R. (4th) 250, [1995] 2 W.W.R. 435, 52 B.C.A.C. 161, 86 W.A.C. 161, 19 B.L.R. (2d) 166, varying a judgment of the British Columbia Supreme Court (1993), 81 B.C.L.R. (2d) 197, [1993] 7 W.W.R. 368, allowing the appellants' action in damages. Appeal allowed, La Forest and McLachlin JJ. dissenting, and cross-appeal dismissed.

POURVOI PRINCIPAL et POURVOI INCIDENT contre un arrêt de la Cour d'appel de la Colombie-Britannique (1994), 99 B.C.L.R. (2d) 201, 120 D.L.R. (4th) 250, [1995] 2 W.W.R. 435, 52 B.C.A.C. 161, 86 W.A.C. 161, 19 B.L.R. (2d) 166, qui a modifié une décision de la Cour suprême de la Colombie-Britannique (1993), 81 B.C.L.R. (2d) 197, [1993] 7 W.W.R. 368, qui avait accueilli l'action en dommages-intérêts des appelantes. Pourvoi principal accueilli, les juges La Forest et McLachlin sont dissidents, et pourvoi incident rejeté.

Bruce B. Clark, for the appellants.

Bruce B. Clark, pour les appelantes.

Keith E. W. Mitchell and *H. Rhys Davies*, for the respondent.

Keith E. W. Mitchell et *H. Rhys Davies*, pour l'intimée.

The judgment of Lamer C.J. and L'Heureux-Dubé, Sopinka, Gonthier, Cory, Iacobucci and Major JJ. was delivered by

Version française du jugement du juge en chef Lamer et des juges L'Heureux-Dubé, Sopinka, Gonthier, Cory, Iacobucci et Major rendu par

IACOBUCCI J. — In the main, this appeal raises issues concerning the tort of conversion with respect to cheques, the meaning of fictitious or non-existing persons in s. 20(5) of the *Bills of Exchange Act*, R.S.C., 1985, c. B-4 (the "Act"),

LE JUGE IACOBUCCI — Dans l'ensemble, le présent pourvoi soulève des questions concernant le délit de détournement relatif à des chèques, l'interprétation de l'expression «personne fictive ou qui n'existe pas» au par. 20(5) de la *Loi sur les lettres* 1 and the defence of a holder in due course under s. 165(3) of the Act.

de change, L.R.C. (1985), ch. B-4 (la «Loi»), et le moyen de défense du détenteur régulier au sens du par. 165(3) de la Loi.

I. Background

I. Le contexte

2 The appellants Boma Manufacturing Ltd. and Panabo Sales Ltd. are associated companies in the business of manufacturing and marketing small souvenir items. The only shareholders and officers of the companies are Boris Mange and Ursula Mange.

Les appelantes Boma Manufacturing Ltd. et Panabo Sales Ltd. sont des compagnies associées dans le commerce de la fabrication et de la commercialisation des petits souvenirs. Les seuls actionnaires et dirigeants de ces compagnies sont Boris Mange et Ursula Mange.

3 The appellants' bookkeeper Donna Alm committed fraud against the companies by way of issuing a long series of fraudulent cheques. These cheques were honoured by her bank, the respondent Canadian Imperial Bank of Commerce ("CIBC") over the course of five years. The appellants brought an action in negligence, and in the alternative, conversion, against their bank, the Royal Bank of Canada, and against the respondent.

L'aide-comptable des appelantes, Donna Alm, a fraudé les compagnies en émettant toute une série de chèques frauduleux. Ces chèques ont été honorés par sa banque, la Banque Canadienne Impériale de Commerce intimée («CIBC») pendant une période de cinq ans. Les appelantes ont intenté une action pour négligence et, subsidiairement, une action pour détournement contre leur banque, la Banque Royale du Canada, et contre l'intimée.

4 Donna Alm had been working for the appellants since 1967. Her responsibilities included preparing the payroll, handling accounts receivable and payable, preparing cheques and reconciling bank statements. She was never an officer, director or shareholder of the companies. She was, however, a duly authorized signing officer on the bank accounts maintained by the companies, along with Boris and Ursula Mange. Cheques drawn on these accounts required only one authorized signature. It was understood that Alm was to sign cheques only when the others were unavailable to do so, and only with respect to legitimate obligations of the companies.

Donna Alm était au service des appelantes depuis 1967. Ses tâches consistaient notamment à préparer les feuilles de paye, à s'occuper des comptes débiteurs et des comptes créditeurs, à préparer les chèques et à rapprocher les relevés bancaires. Elle n'a jamais été dirigeante, administratrice ou actionnaire des compagnies. Cependant, à l'instar de Boris et d'Ursula Mange, elle était une signataire autorisée relativement aux comptes bancaires des compagnies. Les chèques tirés sur ces comptes n'exigeaient qu'une signature autorisée. Il était entendu que Alm ne signerait des chèques que dans le cas où les autres personnes ne pourraient pas le faire, et ce, uniquement à l'égard des obligations légitimes des compagnies.

5 Donna Alm's sole supervisor was Boris Mange. He would occasionally look at the cheque register and monthly bank statements. However, no routine, internal or independent audits were ever undertaken prior to discovery of the fraud.

Le seul superviseur de Donna Alm était Boris Mange. Ce dernier vérifiait, à l'occasion, le registre des chèques et les relevés bancaires mensuels. Cependant, avant la découverte de la fraude, aucune vérification systématique, interne ou indépendante n'avait été effectuée.

Between 1982 and 1987, Donna Alm operated three bank accounts at a CIBC branch in North Vancouver, as follows:

(a) a chequing account in the name of Donna Alm's first husband, John R. Alm;

(b) a joint chequing account in the name of Donna and John R. Alm; after February 10, 1987, this account became a joint account for Donna Alm and her second husband Lou Hilford;

(c) a chequing account in the name of Donna Alm; this account also became joint with Lou Hilford after February 10, 1987.

6 Entre 1982 et 1987, Donna Alm avait trois comptes bancaires à la succursale de la CIBC de North Vancouver:

a) un compte de chèques au nom de son premier mari, John R. Alm;

b) un compte de chèques conjoint aux noms de Donna et John R. Alm; après le 10 février 1987, ce compte est devenu un compte conjoint pour elle et son deuxième mari Lou Hilford;

c) un compte de chèques à son nom personnel; après le 10 février 1987, ce compte est également devenu un compte conjoint avec Lou Hilford.

Between December 8, 1982 and May 6, 1987, Alm used the appellants' pre-printed cheque forms to create some 155 cheques totalling $91,289.54, payable to a number of persons connected with the appellants, including Boris Mange, Ursula Mange, several employees, and one of the subcontractors, Van Sang Lam. The cheques payable to Lam were, with one exception, made to "J. Lam" or "J. R. Lam", the initials and the last name mimicking the name of Donna Alm's first husband. Alm signed 146 of the cheques on behalf of the appellants, and fraudulently obtained Boris Mange's signature on the other nine. Alm deposited all the cheques into one of her accounts at the CIBC.

7 Entre le 8 décembre 1982 et le 6 mai 1987, Alm s'est servie des formulaires de chèque préimprimés des appelantes pour rédiger quelque 155 chèques dont le montant total s'élevait à 91 289,54 $ et qui étaient payables à un certain nombre de personnes ayant des liens avec les appelantes, y compris Boris Mange, Ursula Mange, plusieurs employés et un sous-traitant, Van Sang Lam. Les chèques payables à Lam étaient faits, sauf un, à l'ordre de «J. Lam» ou «J. R. Lam», les initiales et le nom de famille imitant le nom du premier mari de Donna Alm. Alm a signé 146 des chèques pour le compte des appelantes et a frauduleusement obtenu la signature de Boris Mange pour les neuf autres chèques. Alm a déposé tous les chèques dans l'un de ses comptes à la CIBC.

The appellants had entered into a verification agreement with the Royal Bank in connection with their accounts, which excepted "any payments made on forged or unauthorized endorsements". The fraudulently negotiated cancelled cheques were sent to the appellants, and most of them were removed and destroyed by Alm. Her conduct was not discovered until May 11, 1987, through a new assistant bookkeeper. Alm was immediately dismissed.

8 Les appelantes avaient conclu un accord de vérification avec la Banque Royale relativement à leurs comptes, qui excluait [TRADUCTION] «tout paiement effectué sur la foi d'un endossement falsifié ou non autorisé». Les chèques frauduleusement négociés et oblitérés ont été retournés aux appelantes et la plupart ont été retirés de la circulation et détruits par Alm. Sa conduite n'a été découverte que le 11 mai 1987 par un nouvel aide-comptable adjoint. Alm a été congédiée immédiatement.

In April 1988, written notice with respect to some $74,000 worth of cheques was given to the Royal Bank and to the CIBC. A complete listing of the fraudulent cheques was provided to the Royal

9 En avril 1988, un avis écrit concernant des chèques représentant un montant de quelque 74 000 $ a été donné à la Banque Royale et à la CIBC. À la suite d'une enquête policière, une liste

Bank and the CIBC in May of 1989, following a police investigation.

complète de tous les chèques frauduleux a été remise à la Banque Royale et à la CIBC en mai 1989.

10 The CIBC's policy with respect to a customer wishing to deposit a third party cheque to her account was to require that the cheque be endorsed by the payee. If there was no endorsement by the payee, the teller was to return the cheque to the customer. However, 107 of the cheques payable to "J. Lam" or "J. R. Lam" were accepted by the CIBC for deposit in one or the other of the three accounts without endorsement. The tellers apparently assumed that the payee was "J. Alm" or "J. R. Alm", Donna Alm's first husband, and so accepted the cheques without endorsement, contrary to policy. Donna Alm was a longstanding customer of the CIBC branch in question, and was considered to be reliable. The tellers also assumed, given the large number of transactions involving the appellants' cheques signed by Donna Alm, that Donna Alm owned the appellant companies. Some of the Lam cheques, and all of the cheques payable to other third parties, bore the forged endorsement of the payee, the forgeries having been perpetrated by Donna Alm.

Dans le cas où un client souhaitait déposer à son compte le chèque d'une tierce partie, la CIBC avait comme politique d'exiger l'endossement du chèque par le preneur. Si le chèque n'était pas endossé par le preneur, le caissier ou la caissière devait le retourner au client. Cependant, la CIBC a accepté, sans endossement, 107 des chèques payables à «J. Lam» ou à «J. R. Lam» pour dépôt dans l'un ou l'autre des trois comptes. Les caissiers ou caissières ont apparemment supposé que le preneur était «J. Alm» ou «J. R. Alm», le premier mari de Donna Alm, et ont accepté les chèques sans endossement, contrairement à la politique de la banque. Donna Alm était une cliente de longue date de la succursale en cause de la CIBC et était considérée comme une personne fiable. En raison du grand nombre d'opérations comportant les chèques des appelantes signés par Donna Alm, les caissiers ou caissières ont aussi supposé que Donna Alm était propriétaire des compagnies appelantes. Certains des chèques à l'ordre de Lam et tous les chèques payables à d'autres tierces parties portaient l'endossement falsifié du preneur, l'auteur des faux étant Donna Alm.

11 The appellants were successful at trial, and the Royal Bank was ordered to pay $5,390.12, and the CIBC was ordered to pay $91,289.54: (1993), 81 B.C.L.R. (2d) 197, [1993] 7 W.W.R. 368. CIBC appealed the decision before a five-member panel. A majority of the Court of Appeal allowed the appeal, reducing the judgment so as to reflect only the amount of the nine cheques bearing Boris Mange's signature: (1994), 99 B.C.L.R. (2d) 201, 120 D.L.R. (4th) 250, [1995] 2 W.W.R. 435, 52 B.C.A.C. 161, 86 W.A.C. 161, 19 B.L.R. (2d) 166. A minority of two would have also held the CIBC liable for the amount of the 103 cheques signed by Donna Alm that were not endorsed.

Les appelantes ont eu gain de cause au procès, le tribunal ordonnant à la Banque Royale et à la CIBC de payer, respectivement, les sommes de 5 390, 12 $ et de 91 289,54 $: (1993), 81 B.C.L.R. (2d) 197, [1993] 7 W.W.R. 368. La CIBC en a appelé de cette décision devant une formation de cinq juges. La Cour d'appel à la majorité a accueilli l'appel, réduisant le montant du jugement de façon à ne refléter que les neuf chèques portant la signature de Boris Mange: (1994), 99 B.C.L.R. (2d) 201, 120 D.L.R. (4th) 250, [1995] 2 W.W.R. 435, 52 B.C.A.C. 161, 86 W.A.C. 161, 19 B.L.R. (2d) 166. Deux juges minoritaires auraient aussi statué que la CIBC était responsable du montant des quelque 103 chèques signés par Donna Alm, qui n'avaient pas été endossés.

II. Relevant Statutory Provisions

Bills of Exchange Act, R.S.C., 1985, c. B-4

2. In this Act,

. . .

"bearer" means the person in possession of a bill or note that is payable to bearer;

. . .

"delivery" means transfer of possession, actual or constructive, from one person to another;
"endorsement" means an endorsement completed by delivery;
"holder" means the payee or endorsee of a bill or note who is in possession of it, or the bearer thereof;

20. . . .

(2) A negotiable bill may be payable either to order or to bearer.

(3) A bill is payable to bearer that is expressed to be so payable, or on which the only or last endorsement is an endorsement in blank.

(4) Where a bill is not payable to bearer, the payee must be named or otherwise indicated therein with reasonable certainty.

(5) Where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer.

39. (1) As between immediate parties and as regards a remote party, other than a holder in due course, the delivery of a bill

(*a*) in order to be effectual must be made either by or under the authority of the party drawing, accepting or endorsing, as the case may be. . . .

(2) Where the bill is in the hands of a holder in due course, a valid delivery of the bill by all parties prior to him, so as to make them liable to him, is conclusively presumed.

48. (1) Subject to this Act, where a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorized signature is wholly inoperative, and no right to retain the bill or to give a discharge therefor or

II. Les dispositions législatives pertinentes

12

Loi sur les lettres de change, L.R.C. (1985), ch. B-4

2. Les définitions qui suivent s'appliquent à la présente loi.

. . .

«détenteur» Soit le preneur ou l'endossataire d'une lettre ou d'un billet qui en a la possession, soit le porteur de ces effets.

. . .

«endossement» ou «endos» Endossement complété par livraison.
«livraison» Transfert de possession réelle ou présumée d'une personne à une autre.
«porteur» La personne en possession d'une lettre ou d'un billet payable au porteur.

20. . . .

(2) Une lettre négociable peut être payable à ordre ou au porteur.

(3) La lettre est payable au porteur lorsqu'elle comporte une clause à cet effet ou lorsque l'unique ou le dernier endossement est un endossement en blanc.

(4) La lettre qui n'est pas payable au porteur porte le nom du preneur ou une désignation suffisamment précise de celui-ci.

(5) La lettre dont le preneur est une personne fictive ou qui n'existe pas peut être considérée comme payable au porteur.

39. (1) Entre les parties immédiates et en ce qui concerne toute autre partie qui n'est pas détenteur régulier:

a) la livraison doit, pour produire son effet, être faite par le tireur, l'accepteur ou l'endosseur, selon le cas, ou avec leur autorisation. . .

(2) Le fait que la lettre soit entre les mains d'un détenteur régulier est la présomption irréfragable qu'une livraison valable de l'effet a été effectuée par toutes les parties antérieures de façon à les obliger envers lui.

48. (1) Sous réserve des autres dispositions de la présente loi, toute signature contrefaite, ou apposée sans l'autorisation du présumé signataire, n'a aucun effet et ne confère pas le droit de garder la lettre, d'en donner libération ni d'obliger une partie à celle-ci à en effectuer to enforce payment thereof against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority.

le paiement, sauf dans les cas où la partie visée n'est pas admise à établir le faux ou l'absence d'autorisation.

49. (1) Where a bill bearing a forged or an unauthorized endorsement is paid in good faith and in the ordinary course of business by or on behalf of the drawee or acceptor, the person by whom or on whose behalf the payment is made has the right to recover the amount paid from the person to whom it was paid or from any endorser who has endorsed the bill subsequent to the forged or unauthorized endorsement if notice of the endorsement being a forged or an unauthorized endorsement is given to each such subsequent endorser within the time and in the manner mentioned in this section.

49. (1) Le tiré ou l'accepteur qui paye, ou au nom de qui est payée, de bonne foi et selon l'usage commercial normal, une lettre portant un endossement irrégulier — faux ou non autorisé — a le droit de recouvrer la somme ainsi payée de la personne à qui elle l'a été ou de l'auteur d'un endossement postérieur à l'endossement irrégulier, si chaque endosseur subséquent est avisé de l'irrégularité en cause dans le délai et de la manière prévus au présent article.

55. (1) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely,

(*a*) that he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact; and

(*b*) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

55. (1) Est un détenteur régulier celui qui a pris une lettre, manifestement complète et régulière, dans les conditions suivantes:

a) il en est devenu détenteur avant son échéance et sans avoir été avisé d'un refus d'acceptation ou de paiement;

b) il a pris la lettre de bonne foi et à titre onéreux et, à la date de la négociation, n'avait été avisé d'aucun vice affectant le titre du cédant.

59. (1) A bill is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill.

(2) A bill payable to bearer is negotiated by delivery.

(3) A bill payable to order is negotiated by the endorsement of the holder.

59. (1) Il y a négociation quand le transfert de la lettre constitue le cessionnaire en détenteur de la lettre.

(2) La lettre payable au porteur se négocie par livraison.

(3) La lettre payable à ordre se négocie par endossement du détenteur.

73. The rights and powers of the holder of a bill are as follows:

(*a*) he may sue on the bill in his own name;

(*b*) where he is a holder in due course, he holds the bill free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill;

(*c*) where his title is defective, if he negotiates the bill to a holder in due course, that holder obtains a good and complete title to the bill; and

73. Les droits et pouvoirs du détenteur d'une lettre sont les suivants:

a) il peut intenter en son propre nom une action fondée sur la lettre;

b) le détenteur régulier détient la lettre libérée de tout vice de titre des parties qui le précèdent ainsi que des défenses personnelles que pouvaient faire valoir les parties antérieures entre elles; il peut exiger le paiement de toutes les parties obligées par la lettre;

c) le détenteur dont le titre est défectueux qui négocie la lettre à un détenteur régulier confère à celui-ci un titre valable et parfait sur la lettre;

(*d*) where his title is defective, if he obtains payment of the bill, the person who pays him in due course gets a valid discharge for the bill.

165. . . .

(3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

III. Judgments Appealed From

A. *British Columbia Supreme Court* (1993), 81 B.C.L.R. (2d) 197

Macdonald J. first examined ss. 48(1), 48(3) and 49 of the *Bills of Exchange Act*. He noted that all the cheques involved in this case had been properly issued, as they had all been signed either by Alm or by Mange, both of whom were authorized signing officers.

After considering the claim against the Royal Bank (not in issue in the instant appeal), Macdonald J. turned to the claims against the CIBC. The appellants claimed in negligence, conversion, and under the provisions of the Act itself. The negligence claim was dismissed, Macdonald J. finding that the CIBC owed no duty of care to the appellants. He also stated that the negligent failure of the appellants to detect Alm's fraudulent conduct far outweighed any negligent conduct on the respondent's part.

Macdonald J. found the respondent to be *prima facie* liable for conversion. Accordingly, he considered whether any of the following defences raised by the respondent could defeat the conversion claim: (a) the "worthless paper" defence; (b) the s. 165(3) defence; (c) the "fictitious payee" defence; and (d) the "inadequate notice" defence.

With respect to the worthless paper defence, the trial judge noted that where the signature of the

d) la personne qui paie en temps voulu la lettre au détenteur dont le titre est défectueux est valablement libérée.

165. . . .

(3) Lorsqu'un chèque est livré à une banque en vue de son dépôt au compte d'une personne et que la banque porte au crédit de celle-ci le montant du chèque, la banque acquiert tous les droits et pouvoirs du détenteur régulier du chèque.

III. Les juridictions inférieures

A. *Cour suprême de la Colombie-Britannique* (1993), 81 B.C.L.R. (2d) 197

Le juge Macdonald a commencé par examiner les par. 48(1) et 48(3) ainsi que l'art. 49 de la *Loi sur les lettres de change*. Il a fait remarquer que tous les chèques en cause avaient été régulièrement émis puisqu'ils avaient tous été signés par Alm ou Mange, tous deux signataires autorisés. 13

Après avoir examiné la réclamation contre la Banque Royale (qui n'est pas en cause en l'espèce), le juge Macdonald a examiné celles contre la CIBC. Les appelantes ont fondé leur réclamation sur la négligence, le détournement et les dispositions de la Loi elle-même. La réclamation fondée sur la négligence a été rejetée, le juge Macdonald concluant que la CIBC n'avait aucune obligation de diligence envers les appelantes. Il a aussi affirmé que l'omission négligente des appelantes de déceler la conduite frauduleuse de Alm l'emportait de beaucoup sur toute conduite négligente de la part de l'intimée. 14

Le juge Macdonald a conclu que l'intimée était coupable à première vue de détournement. Il a donc examiné si l'un des moyens de défense suivants, opposés par l'intimée, pouvait faire échouer la réclamation fondée sur le détournement: a) le moyen de défense fondé sur l'«effet sans valeur», b) le moyen de défense fondé sur le par. 165(3), c) le moyen de défense fondé sur le «preneur fictif», et d) le moyen de défense fondé sur l'«avis insuffisant». 15

En ce qui concerne le moyen de défense fondé sur l'effet sans valeur, le juge de première instance 16 maker of the cheque is forged, the cheques are "worthless", and incapable of conversion. However, in this case, Donna Alm and Boris Mange were authorized signing officers. Accordingly, the cheques in question were not worthless paper.

a affirmé qu'un chèque est «sans valeur» et non susceptible de détournement lorsque la signature de son auteur est contrefaite. En l'espèce, cependant, Donna Alm et Boris Mange étaient des signataires autorisés. En conséquence, les chèques en question n'étaient pas des effets sans valeur.

17 With respect to the second defence, s. 165(3), Macdonald J. concluded as follows (at p. 207):

> Where the endorsement is forged, or where the collecting bank neglects to require an endorsement by the payee and its own customer, that result would completely negative the effect of s. 48 of the Act. I accept the response of the [appellants] that "delivery" in s. 165(3) in these circumstances requires the authority of the drawer under s. 39(1)(*a*) of the Act, and that Donna Alm had no such authority. I reject the submission of C.I.B.C. that her authority to sign cheques on behalf of the [appellants] carried with it the authority to deliver the same. In my view, any such authority to deliver is limited to cheques properly drawn payable to creditors of the [appellants].
>
> With regard to those cheques with forged endorsements, there can be no argument that Donna Alm had any authority from the named payees.
>
> I reject the defence to conversion based on s. 165(3).

En ce qui concerne le second moyen de défense, fondé sur le par. 165(3), le juge Macdonald arrive à la conclusion suivante (à la p. 207):

> [TRADUCTION] L'endossement falsifié ou l'omission de la banque d'encaissement d'exiger un endossement du preneur et de son propre client rendraient complètement sans effet l'art. 48 de la Loi. J'accepte la réponse des [appelantes] que, dans ces circonstances, la «livraison» visée au par. 165(3) exige l'autorisation du tireur en vertu de l'al. 39(1)*a*) de la Loi et que Donna Alm n'avait pas cette autorisation. Je rejette l'argument de la C.I.B.C. que son autorisation de signer des chèques pour le compte des [appelantes] comportait celle de les livrer. À mon avis, cette autorisation de livrer ne vise que les chèques régulièrement payables à des créanciers des [appelantes].
>
> En ce qui concerne les chèques avec endossements falsifiés, on ne saurait soutenir que Donna Alm avait l'autorisation des preneurs nommés.
>
> Je rejette le moyen de défense fondé sur le par. 165(3), qui a été opposé au détournement.

18 As a third defence, the CIBC submitted that the cheques in question had been made out to "fictitious payees", within the meaning of s. 20(5) of the Act. Accordingly, the respondent would be able to treat the cheques as payable to bearer, rather than payable to order, and negotiation of the cheques would not require endorsement, but only delivery. Macdonald J. found a complete answer to this issue in *Number 10 Management Ltd. v. Royal Bank of Canada* (1976), 69 D.L.R. (3d) 99, at p. 102, wherein the Manitoba Court of Appeal found that a collecting bank guarantees the endorsement of all properly issued bills of exchange, and that where the bank pays out money on a forged endorsement, the bank will be liable. Macdonald J. found this approach to be consistent with the scheme of the Act. He stated that as the drawer of a cheque owes no duty to its own bank to verify monthly statements, in the absence of a

Comme troisième moyen de défense, la CIBC a soutenu que les chèques en question avaient été émis au nom de «preneurs fictifs» au sens du par. 20(5) de la Loi. En conséquence, l'intimée pourrait considérer que les chèques sont payables au porteur plutôt que payables à ordre, et leur négociation ne nécessiterait pas l'endossement, mais seulement la livraison. Le juge Macdonald a trouvé une réponse exhaustive à cette question dans l'arrêt *Number 10 Management Ltd. c. Royal Bank of Canada* (1976), 69 D.L.R. (3d) 99, à la p. 102, dans lequel la Cour d'appel du Manitoba a conclu qu'une banque d'encaissement garantit l'endossement de toutes les lettres de change régulièrement émises et que sa responsabilité sera engagée si elle verse de l'argent sur la foi d'un endossement falsifié. Le juge Macdonald a conclu que ce point de vue était compatible avec l'économie de la Loi. Il a affirmé que, puisque le tireur d'un chèque n'a verification agreement, then it certainly cannot owe any such duty to a collecting bank. He also noted that under s. 48(1) of the Act, a forged endorsement is wholly inoperative and gives no right either to retain the bill or enforce payment thereof. Macdonald J. agreed with the appellants that the fictitious payee defence is largely irrelevant to an action against a collecting bank for conversion, because in his view (at p. 208):

> . . . a bearer cheque can be converted by a person not authorized to deliver it. Where the C.I.B.C. can be regarded as an agent for its dishonest customer to collect, as would appear to be the case under its practice set out in the Agreed Statement of Facts, it is responsible to the drawer for her conversion.

He concluded that, even if the cheques in question were payable to "fictitious persons" within the meaning of s. 20(5), and the CIBC was entitled to treat them as bearer cheques, the cheques were not "delivered" or "negotiated" and the CIBC did not acquire title to them. Accordingly, the CIBC had no right to obtain payment for the cheques from the appellants' bank accounts.

With respect to the last defence raised, Macdonald J. was of the view that notice had been provided within a reasonable time in this case.

The trial judge ultimately concluded that it was on the third ground advanced by the appellants that the claim should succeed, that is, under s. 49(1) of the Act. Under this section, where a cheque bearing a forged endorsement is paid, there is a right of recovery against any subsequent endorser. In his view, this section makes the CIBC "the guarantor of the validity of the payee's endorsement on the cheques in issue here" (p. 208), as stated in *Number 10 Management*. As for the cheques that were not endorsed, the trial judge stated that they had not been delivered within the meaning of s. 59(2). He also noted that the situation between the plain-

envers sa propre banque aucune obligation de vérifier ses relevés mensuels, en l'absence d'un accord de vérification, il ne peut sûrement pas avoir une telle obligation envers une banque d'encaissement. Il a également souligné qu'en vertu du par. 48(1) de la Loi un endossement falsifié n'a aucun effet et ne confère pas le droit de garder la lettre ou d'obliger une partie à celle-ci à en effectuer le paiement. Le juge Macdonald était d'accord avec les appelantes pour dire que le moyen de défense fondé sur le preneur fictif est en grande partie non pertinent à l'égard d'une action pour détournement intentée contre une banque d'encaissement parce que, selon lui (à la p. 208):

> [TRADUCTION] . . . un chèque au porteur peut être détourné par une personne non autorisée à en faire la livraison. Dans le cas où la C.I.B.C. peut être considérée comme un mandataire de sa cliente malhonnête, comme cela paraîtrait être le cas selon sa pratique exposée dans l'exposé conjoint des faits, elle est responsable envers le tireur du détournement commis par sa cliente.

Il a conclu que, même si les chèques étaient payables à des «personnes fictives» au sens du par. 20(5) et même si la CIBC avait le droit de les considérer comme des chèques au porteur, la CIBC n'en avait pas acquis le titre et qu'ils n'avaient été ni «livrés» ni «négociés». En conséquence, la CIBC n'avait pas le droit d'obtenir paiement de ces chèques sur les comptes bancaires des appelantes.

Quand au dernier moyen de défense invoqué, le juge Macdonald estimait que l'avis avait été donné à l'intérieur d'un délai raisonnable en l'espèce. 19

Le juge de première instance a finalement conclu que c'était en fonction du troisième moyen soulevé par les appelantes, celui fondé sur le par. 49(1) de la Loi, que la réclamation devait réussir. Aux termes de cette disposition, lorsqu'un chèque portant un endossement falsifié est payé, il existe un droit de recouvrement auprès de tout endosseur subséquent. À son avis, cette disposition rend la CIBC [TRADUCTION] «garante de la validité de l'endossement que les preneurs ont apposé sur les chèques ici en cause» (p. 208), tel que déclaré dans l'arrêt *Number 10 Management*. Quand aux chèques non endossés, le juge de première instance 20 tiff and a collecting bank should be different from the situation between the plaintiff and its own bank (at pp. 208-9):

> The drawee bank is entitled to rely upon a person whom the drawer has authorized to conduct banking business on its behalf. There is no such connection between the drawer and the collecting bank, which is dependent upon its own customer for protection.
>
> The system requires the collecting bank to verify the endorsement ahead of its own, and it must rely on its own customer in that regard by ensuring that sufficient funds remain in the customer's account until the cheque has cleared or count on that customer to cover any cheque not honoured by the drawee bank.

For these reasons, the CIBC's negligence in failing to obtain an endorsement on the "Lam" cheques was a bar to the CIBC's reliance upon any estoppel arising from the negligence of the appellants.

21 The trial judge ordered judgment against the Royal Bank for $5,390.12, and judgment against the CIBC for the whole of the $91,289.54 claimed.

B. *British Columbia Court of Appeal* (1994), 99 B.C.L.R. (2d) 201

1. Southin J.A. (for the majority)

22 Southin J.A. emphasized the following four facts, which in her view were critical to the resolution of the appeal: (1) the cheques involved were the drawers' cheques, rather than forgeries thereof; (2) Alm, the signatory of the 146 cheques, intended both to validate the cheques for the bank upon which they were drawn and to receive the proceeds; (3) Mange, the signatory of the nine cheques, intended to validate them for the Royal Bank, but did not intend that anyone other than the named payee should receive the proceeds; and (4), of the 155 cheques, 107 were collected by the CIBC, although they were payable to a third party and had not been endorsed.

a affirmé qu'ils n'avaient pas été livrés au sens du par. 59(2). Il a également souligné que la situation entre le demandeur et une banque d'encaissement devait être différente de celle qui existe entre le demandeur et sa propre banque (aux pp. 208 et 209):

> [TRADUCTION] La banque tirée a le droit de se fier à une personne que le tireur a autorisée à faire des opérations bancaires en son nom. Il n'existe aucun lien de la sorte entre le tireur et la banque d'encaissement, dont la protection dépend de son propre client.
>
> Le système exige que la banque d'encaissement vérifie l'endossement qui précède le sien, et elle doit, à cet égard, se fier à son propre client en s'assurant que celui-ci a, dans son compte, suffisamment de fonds jusqu'à ce que le chèque soit compensé, ou encore compter sur ce client pour couvrir tout chèque refusé par la banque tirée.

Pour ces motifs, la négligence dont la CIBC a fait preuve, en n'obtenant pas un endossement sur les chèques tirés au nom de «Lam», l'empêchait de se fier sur une fin de non-recevoir résultant de la négligence des appelantes.

Le juge de première instance a ordonné à la Banque Royale de payer la somme de 5 390,12 $, et à la CIBC de payer la totalité des 91 289,54 $ réclamés.

B. *Cour d'appel de la Colombie-Britannique* (1994), 99 B.C.L.R. (2d) 201

1. Le juge Southin (au nom de la majorité)

Le juge Southin a fait ressortir les quatre faits suivants qui, à son avis, étaient essentiels au règlement de l'appel: (1) les chèques en cause étaient les chèques des tireurs et non des faux, (2) Alm, la signataire des 146 chèques, avait l'intention de valider les chèques pour la banque sur laquelle ils avaient été tirés et d'en toucher le montant, (3) Mange, le signataire des neuf chèques, avait l'intention de les valider pour la Banque Royale, mais ne voulait pas qu'une personne autre que le preneur nommé en touche le montant, et (4) des 155 chèques, 107 avaient été encaissés par la CIBC, même s'ils étaient payables à une tierce partie et n'avaient pas été endossés.

Southin J.A. concluded that the crux of the action in conversion was that the recipient of the proceeds, Donna Alm, was not the person intended to receive the funds. In this regard, it was important to determine whether it was the company's or the signatory's intention that was of relevance. Southin J.A. concluded that Alm, an authorized signing agent, had the power to bind her principal, and accordingly, it was Alm's intention that should prevail. Consequently, Southin J.A. was of the view that the action in relation to the 146 cheques that Alm had signed could not succeed, as there had been no misdirection of these cheques; Alm intended all along that they be directed to herself. The action in conversion could only succeed with respect to the nine cheques that Mange had signed, as they had truly been diverted from their intended recipient.

23 Le juge Southin a conclu que le fait que Donna Alm, la personne qui a touché le montant des chèques, n'était pas celle à qui les fonds étaient destinés était au cœur de l'action pour détournement. À cet égard, il était important de déterminer si c'était l'intention de la compagnie ou celle de la signataire qui était pertinente. Le juge Southin a conclu que Alm, signataire autorisée, avait le pouvoir de lier son mandant et, par conséquent, que c'était l'intention de Alm qui devait prévaloir. Le juge Southin était donc d'avis que l'action relative aux 146 chèques que Alm avait signés ne pouvait réussir puisqu'il n'y avait pas eu de mauvaise utilisation de ces chèques, Alm ayant toujours voulu en bénéficier. L'action pour détournement ne pouvait réussir que relativement aux neuf chèques que Mange avait signés puisqu'ils avaient été véritablement détournés du bénéficiaire auquel ils étaient destinés.

With respect to the application of s. 20(5) to the nine cheques signed by Mange, Southin J.A. noted that whether someone is "fictitious or non-existing" within the meaning of s. 20(5) of the Act must "depend on the intention of the drawer of the cheque, not the intention of the person who fills in the cheque" (p. 217). The intention of the drawer in this case, that is, the appellants, was that the payees receive payment. Accordingly, the payees were not fictitious persons, and the cheques could not be treated as payable to bearer.

24 En ce qui concerne l'application du par. 20(5) aux neuf chèques signés par Mange, le juge Southin a précisé que la réponse à la question de savoir si une personne est «une personne fictive ou qui n'existe pas» au sens du par. 20(5) de la Loi doit [TRADUCTION] «dépendre de l'intention du tireur du chèque et non de celle de la personne qui le rédige» (p. 217). L'intention du tireur en l'espèce, les appelantes, était que les preneurs reçoivent paiement. En conséquence, les preneurs n'étaient pas des personnes fictives et les chèques ne pouvaient pas être considérés comme payables au porteur.

Southin J.A. rejected the s. 165(3) defence raised by the CIBC. She stated that she was not "persuaded that Parliament intended, by s. 165(3), to give a bank an independent title to a cheque payable to A and intended by the drawer to be paid to A which was deposited to the account of B without any endorsement by A or with an endorsement by A which is forged" (p. 218). Accordingly, Southin J.A. held that the appellants were entitled to recover from the CIBC on the nine cheques signed by Mange. The award given at trial was reduced to the amount of the nine cheques.

25 Le juge Southin a rejeté le moyen de défense de la CIBC, fondé sur le par. 165(3). Elle a affirmé qu'elle n'était pas [TRADUCTION] «convaincue que le Parlement voulait, lorsqu'il a adopté le par. 165(3), conférer à la banque un titre indépendant sur un chèque payable à A, que le tireur voulait payer à A, qui a été déposé dans le compte de B sans endossement de A ou avec endossement falsifié de A» (p. 218). En conséquence, le juge Southin a conclu que les appelantes avaient le droit de recouvrer auprès de la CIBC le montant des neuf chèques signés par Mange. Le montant accordé au procès a été ramené à celui des neuf chèques.

2. Hutcheon J.A. (dissenting in part)

26 Hutcheon J.A. agreed with Southin J.A.'s disposition, "save as to 103 of the 107 cheques on which there was no signature purporting to be an endorsement of the payee" (p. 220). In his view, the cheques accepted by the CIBC without any endorsement were patently irregular on their face. He stated that in order for the provisions of s. 20(5) to be of application, the person claiming to enforce payment of the cheque must be its lawful holder. A holder, pursuant to s. 2 of the Act, is "the payee or endorsee of a bill or note . . . or the bearer thereof", and a bearer is a "person in possession of a bill or note that is payable to bearer". He concluded as follows (at p. 222):

> The Bank was neither the payee nor the endorsee of the cheques in question. Nor was it the person in possession of a cheque that was payable to bearer. All that s. 20(5) provides is that the cheque "may be treated as payable to bearer". On a strict construction of s. 20(5) that is different from a provision that the cheque is payable to bearer. No policy reason exists for extending s. 20(5) beyond its express letter to protect a collecting bank that received and paid the unendorsed cheques contrary to its own internal rules.
>
> For these reasons, s. 20(5) cannot be invoked by the Bank to set up the defence to the claim of conversion that the Bank was justified in ignoring the existence of a named payee on the face of the cheques. With respect I do not think that it is any answer to say that if the Bank had not been internally careless Alm would simply have endorsed the cheques. I do not know what she would have done if she had been challenged.
>
> I would therefore allow the appeal by varying the amount of the judgment to the amount of the nine cheques dealt with by Madam Justice Southin and of the 103 cheques dealt with in these reasons.

2. Le juge Hutcheon (dissident en partie)

Le juge Hutcheon a souscrit au dispositif du juge Southin [TRADUCTION] «sauf en ce qui concerne 103 des 107 chèques sur lesquels n'avait été apposée aucune signature censée être un endossement du preneur» (p. 220). À son avis, les chèques acceptés par la CIBC sans aucun endossement étaient manifestement irréguliers à première vue. Il a affirmé que la personne réclamant l'exécution du paiement du chèque doit en être le détenteur légitime pour que s'applique le par. 20(5). Suivant l'art. 2 de la Loi, le détenteur est «[s]oit le preneur ou l'endossataire d'une lettre ou d'un billet [. . .], soit le porteur de ces effets», et le porteur est «[l]a personne en possession d'une lettre ou d'un billet payable au porteur». Le juge Hutcheon conclut ceci (à la p. 222):

> [TRADUCTION] La banque n'était ni le preneur ni l'endossataire des chèques en question. Elle n'était pas non plus la personne en possession d'un chèque payable au porteur. Le paragraphe 20(5) prévoit seulement que le chèque «peut être considér[é] comme payable au porteur». Suivant une interprétation stricte du par. 20(5), cela est différent d'une disposition voulant que le chèque soit payable au porteur. Il n'existe, en principe, aucune raison d'élargir la portée du par. 20(5) au-delà de ses termes explicites de façon à protéger une banque d'encaissement qui a reçu et payé des chèques non endossés contrairement à ses propres règles internes.
>
> Pour ces motifs, la banque ne saurait invoquer le par. 20(5) pour opposer à l'action pour détournement le moyen de défense selon lequel elle était justifiée d'ignorer l'existence d'un preneur dont le nom figurait sur les chèques. En toute déférence, je ne crois pas que l'on puisse répondre que Alm aurait tout simplement endossé les chèques si la banque n'avait pas été négligente dans l'application de sa procédure interne. Je ne sais pas ce que Alm aurait fait si l'on avait contesté ses actes.
>
> En conséquence, je suis d'avis d'accueillir l'appel et de modifier le montant du jugement pour l'établir à celui des neuf chèques examinés par Madame le juge Southin ainsi qu'à celui des 103 chèques dont il est question dans les présents motifs.

IV. Issues

A. *On Appeal*

1. Were the cheques in question made payable to fictitious or non-existing persons?

2. Were the cheques in question "delivered" to the CIBC?

3. Was the CIBC, as a "collecting" bank, *prima facie* liable to the appellants in conversion so that the cheques in question had to be properly negotiated to the CIBC in order for the CIBC to obtain title to those cheques and thereby escape liability?

4. Is the defence of contributory negligence available to the respondent?

B. *On Cross-Appeal*

1. What is the proper interpretation of s. 165(3), and in particular:

   (a) Must the cheque be deposited to the credit of its payee for the subsection to apply?

   (b) Must the cheque be endorsed before the bank can credit the person with the amount of the cheque?

   (c) Must the cheque be delivered with the authority of the drawer or endorser, or does simply handing it to the bank teller for deposit suffice?

V. Analysis

I have found it helpful to consider this appeal in terms of three broad issues, as follows: the doctrine of conversion with respect to cheques; s. 20(5) as a defence to an action in conversion; and s. 165(3) as a defence to an action in conversion.

A. *Conversion in relation to cheques*

It is a commonly accepted proposition that a bill of exchange is a chattel that can be negotiated from party to party. An individual obtains title to a bill through negotiation. Once an individual has

IV. Les questions en litige

A. *Le pourvoi*

27 1. Les chèques en question étaient-ils payables à des personnes fictives ou qui n'existaient pas?

2. Les chèques en question ont-ils été «livrés» à la CIBC?

3. La CIBC était-elle, en tant que banque «d'encaissement», responsable à première vue de détournement envers les appelantes, de sorte que les chèques en question devaient être régulièrement négociés à la CIBC pour que celle-ci obtienne le titre sur ces chèques et se dégage ainsi de toute responsabilité?

4. L'intimée peut-elle invoquer la négligence contributive comme moyen de défense?

B. *Le pourvoi incident*

28 1. Comment faut-il interpréter le par. 165(3)? Et notamment:

   a) Le chèque doit-il être porté au crédit de son preneur pour que s'applique ce paragraphe?

   b) Le chèque doit-il être endossé pour que la banque puisse en porter le montant au crédit de la personne en question?

   c) Le chèque doit-il être livré avec l'autorisation du tireur ou de l'endosseur, ou suffit-il simplement qu'il soit remis au caissier ou à la caissière pour dépôt?

V. Analyse

29 J'ai jugé utile d'examiner le présent pourvoi en fonction de trois grandes questions: la règle du détournement relatif à des chèques, le par. 20(5) comme moyen de défense à une action pour détournement, et le par. 165(3) comme moyen de défense à une action pour détournement.

A. *Le détournement relatif à des chèques*

30 Il est généralement accepté qu'une lettre de change est un bien qui peut être négocié d'une partie à une autre. Une personne obtient le titre sur une lettre par négociation. Une fois qu'elle a

obtained title, that individual has the right to present the bill to the drawee for payment, as well as a right of recovery against the drawer if the bill is dishonoured by the drawee.

obtenu ce titre, la personne a le droit de présenter la lettre au tiré pour paiement, ainsi que celui de recouvrer cette somme auprès du tireur si la lettre est refusée par le tiré.

31 The tort of conversion involves a wrongful interference with the goods of another, such as taking, using or destroying these goods in a manner inconsistent with the owner's right of possession. The tort is one of strict liability, and accordingly, it is no defence that the wrongful act was committed in all innocence. Diplock L.J. asserted this principle in *Marfani & Co. v. Midland Bank, Ltd.*, [1968] 2 All E.R. 573, at pp. 577-78:

Le délit de détournement comporte une ingérence illégitime dans les objets appartenant à autrui, comme le fait de prendre, utiliser ou détruire ces objets d'une façon incompatible avec le droit de possession de leur propriétaire. Ce délit est de responsabilité stricte et l'on ne peut donc opposer, comme moyen de défense, que l'acte illégitime a été accompli en toute innocence. Le lord juge Diplock a invoqué ce principe dans l'arrêt *Marfani & Co. c. Midland Bank, Ltd.*, [1968] 2 All E.R. 573, aux pp. 577 et 578:

> . . . the moral concept of fault in the sense of either knowledge by the doer of an act that is likely to cause injury, loss or damage to another, or lack of reasonable care to avoid causing injury, loss or damage to another, plays no part.
>
> . . .
>
> If the customer is not entitled to the cheque which he delivers to his banker for collection, the banker, however, innocent and careful he might have been, would at common law be liable to the true owner of the cheque for the amount of which he receives payment, either as damages for conversion or under the cognate cause of action, based historically on assumpsit, for money had and received.

> [TRADUCTION] . . . que ce soit dans le sens de la connaissance par l'auteur d'un acte que cet acte est susceptible de causer un préjudice, une perte ou un dommage à autrui, ou dans le sens de l'omission de faire preuve de diligence raisonnable pour éviter de causer un préjudice, une perte ou un dommage à autrui, le concept moral de la faute ne joue aucun rôle.
>
> . . .
>
> Si le client n'a pas droit au chèque qu'il livre à son banquier pour encaissement, ce banquier, peu importe l'innocence ou la prudence dont il peut avoir fait preuve, serait en common law responsable envers le véritable propriétaire du chèque du montant dont il reçoit paiement, que ce soit sous forme de dommages-intérêts pour détournement ou, en vertu de la cause d'action apparentée, historiquement fondée sur l'*assumpsit*, de l'enrichissement sans cause.

32 The fact that liability for the tort of conversion is strict suggests that the respondent's submission that the appellants were contributorily negligent must fail. The matter was raised before the Court of Appeal, and was dismissed without reasons. While this argument would be available in an action for negligence, the notion of strict liability involved in an action for conversion is *prima facie* antithetical to the concept of contributory negligence.

Le fait que le délit de détournement soit une infraction de responsabilité stricte laisse entendre que l'argument de l'intimée, voulant que les appelantes aient fait preuve de négligence contributive, doit échouer. Cette question a été soulevée devant la Cour d'appel et a été rejetée sans motif à l'appui. Même si cet argument pourrait être avancé dans une action pour négligence, la notion de responsabilité stricte dont il est question dans une action pour détournement est, à première vue, contraire au concept de négligence contributive.

33 It is true that the comments of Professor Ogilvie in *Canadian Banking Law* (1991), at pp. 593-94,

Il est vrai que les commentaires de la professeure Ogilvie, dans *Canadian Banking Law* provide some support for the respondent's position:

Contributory negligence would require courts to apportion liability in accordance with negligence as between the true owner and the bank in cases of conversion. The availability of contributory negligence as a defence in an action for conversion was originally doubtful because the defence was at first only thought to be available in actions for negligence. But in a 1950 decision from New Zealand, the defence was permitted where conversion was found [*Helson v. McKensies (Cuba Street) Ltd.*, [1950] N.Z.L.R. 878 (C.A.)], and this approach was adopted in *Lumsden & Co.* v. *London Trustee Savings Bank* [[1971] 1 Lloyd's Rep. 114 (Ch. D.). See also: *Southrada* v. *Bank of New South Wales*, [1976] 2 Lloyd's Rep. 444 (P.C.)] by Donaldson J. who held that damages may be received where the plaintiff was also negligent.

. . . This decision has been doubted in Australia on the ground that the defence of contributory negligence is only available under the Act in situations where it could have been pleaded as a defence at common law, or in negligence cases only. In England, any doubts about the availability of contributory negligence as a defence were removed by section 47 of the Banking Act, 1979, which is one of the few sections of that Act still in force. In Canada, however, the situation is unknown. Most provinces have similar contributory negligence legislation to that in England and Australia, but there would appear to be no case law to date considering such a defence in an action against a collecting bank in conversion.

It is arguable that the defence of contributory negligence should be available. In most situations in which conversion occurs in relation to cheques, there are varying degrees of innocence and carelessness on both sides. It is more equitable to apportion liability in accordance with the actual facts as found by a court, than to expect banks to be the insurers of the "true owner" of a cheque whose carelessness has contributed to the conversion. As total insurers, banks would simply pass the costs on to all its customers, who played no role in the conversion whatsoever.

(1991), aux pp. 593 et 594, appuient dans une certaine mesure le point de vue de l'intimée:

[TRADUCTION] Dans les affaires de détournement, la négligence contributive exigerait que les tribunaux répartissent la responsabilité suivant la négligence entre le véritable propriétaire et la banque. La possibilité d'opposer la négligence contributive comme moyen de défense dans une action pour détournement était douteuse à l'origine parce que l'on croyait alors que ce moyen ne pouvait être invoqué que dans des actions pour négligence. Cependant, dans une décision rendue en 1950, en Nouvelle-Zélande, le moyen de défense a été autorisé lorsqu'on a conclu à l'existence d'un détournement [*Helson c. McKensies (Cuba Street) Ltd.*, [1950] N.Z.L.R. 878 (C.A.)], et ce point de vue a été adopté dans *Lumsden & Co.* c. *London Trustee Savings Bank* [[1971] 1 Lloyd's Rep. 114 (Ch. D.). Voir aussi: *Southrada* c. *Bank of New South Wales*, [1976] 2 Lloyd's Rep. 444 (C.P.)] par le juge Donaldson qui a statué que des dommages-intérêts peuvent être touchés lorsque le demandeur a aussi fait preuve de négligence.

. . . Cette décision a été mise en doute en Australie pour le motif que la Loi n'autorise le recours au moyen de défense fondé sur la négligence contributive que dans les cas où il aurait pu être invoqué en vertu de la common law, ou encore dans les cas de négligence seulement. En Angleterre, l'article 47 de la Banking Act, 1979, qui est l'un des rares articles de cette loi qui soient encore en vigueur, a dissipé tout doute relativement à la possibilité d'invoquer la négligence contributive comme moyen de défense. Cependant, au Canada, la situation est inconnue. La plupart des provinces ont des lois semblables à l'Angleterre et à l'Australie en matière de négligence contributive, mais jusqu'à ce jour, il ne semblerait pas y avoir eu de jurisprudence dans laquelle on a examiné ce moyen de défense dans le cadre d'une action pour détournement intentée contre une banque d'encaissement.

On peut soutenir qu'il devrait être possible d'invoquer le moyen de défense fondé sur la négligence contributive. Dans la plupart des cas où il y a détournement relatif à des chèques, il existe divers degrés d'innocence et d'imprudence de part et d'autre. Il est plus équitable de répartir la responsabilité conformément aux conclusions de fait d'un tribunal que de s'attendre à ce que les banques soient les assureurs du «véritable propriétaire» d'un chèque, dont l'imprudence a contribué au détournement. En tant qu'assureurs de la totalité des pertes, les banques feraient simplement assumer les coûts par l'ensemble de leurs clients qui n'ont joué aucun rôle dans le détournement.

See also Professor Ogilvie's case comment, "Should the Collecting Banker Be the Drawer's Insurer?: *Boma Manufacturing Ltd.* v. *Canadian Imperial Bank of Commerce*" (1994), 9 *B.F.L.R.* 227, in which she expresses her view that this case should not be decided in reference to the Act, but rather on the common law tort of negligence, and that the courts should impose a duty of account verification on bank customers.

Voir aussi le commentaire d'arrêt de la professeure Ogilvie, intitulé: «Should the Collecting Banker Be the Drawer's Insurer?: *Boma Manufacturing Ltd.* v. *Canadian Imperial Bank of Commerce*» (1994), 9 *B.F.L.R.* 227, dans lequel elle exprime l'opinion que le présent pourvoi devrait être tranché non pas en fonction de la Loi, mais plutôt en fonction du délit de négligence en common law, et que les tribunaux devraient imposer aux clients d'une banque un devoir de vérification de comptes.

34 The respondent argues that it would have been easier for the appellants to detect the fraud than for the respondent: even if the unendorsed third party cheques had been questioned by the respondent, it is submitted that Alm would have forged the endorsements and continued with her scheme. In the respondent's view, the appellants should have at least adopted the "elementary precaution" of having someone else check the bank statements, or requiring a second signature on cheques, or having the books audited.

L'intimée prétend qu'il aurait été plus facile pour les appelantes que pour l'intimée de déceler la fraude: on fait valoir que, même si les chèques non endossés d'une tierce partie avaient été contestés par l'intimée, Alm aurait contrefait les endossements et poursuivi son manège. De l'avis de l'intimée, les appelantes auraient tout au moins dû prendre la «précaution élémentaire» de faire examiner les relevés bancaires par quelqu'un d'autre, d'exiger une deuxième signature sur les chèques ou de faire vérifier les registres.

35 As I stated above, however, it seems as a matter of principle that contributory negligence would not be available in the context of a strict liability tort. If the contributory negligence approach is to be introduced into this area of the law, I would leave that innovation to Parliament because such a change would be more appropriate for the legislative branch to make. As I see it, the strict liability feature of conversion is well engrained in the jurisprudence concerning bills of exchange.

Cependant, comme je l'ai déjà mentionné, il semble en principe que la négligence contributive ne pourrait pas être invoquée dans le contexte d'un délit de responsabilité stricte. S'il faut introduire la notion de négligence contributive dans ce domaine du droit, je laisserais au Parlement le soin de procéder à une telle innovation parce qu'il serait plus approprié que ce soit le législateur qui le fasse. Selon moi, l'aspect «responsabilité stricte» du détournement est bien ancré dans la jurisprudence relative aux lettres de change.

36 The seminal discussion of conversion of cheques is found in Crawford and Falconbridge, *Banking and Bills of Exchange* (8th ed. 1986), vol. 2, at p. 1386:

> Conversion is the remedy of the lawful possessor of chattels to have their value paid to him by a wrongful dispossessor. It is normally applied to goods and there might appear to be some difficulty in holding that a bank that has paid part of what it owes to a customer to some other person not entitled to receive it is guilty of a conversion of the customer's chattel. But any such apparent difficulty has been surmounted by treating the conversion as being of the instrument itself, that is, of the piece of paper in respect of which the payment is

On trouve dans Crawford et Falconbridge, *Banking and Bills of Exchange* (8^e^ éd. 1986), vol. 2, à la p. 1386, l'analyse fondamentale du détournement de chèques:

> [TRADUCTION] L'action pour détournement est le recours que le possesseur légitime de biens peut exercer pour s'en faire payer la valeur par la personne qui l'en a dépossédé illégitimement. Elle s'applique normalement à des objets, et il pourrait paraître quelque peu difficile de conclure qu'une banque, qui a payé une partie de ce qu'elle doit à un client à une autre personne qui n'y a pas droit, est coupable de détournement du bien du client. Cependant, on a surmonté cette difficulté apparente en assimilant le détournement à l'effet lui-même,

made. Similarly a bank that collects a sum of money under an instrument for a person not entitled to it is treated as having converted the instrument. It has been repeatedly held that a bank converts an instrument by dealing with it under the direction of one not authorized, either by collecting it or, *semble* (although this has not yet actually been decided) by paying it and in either case, making the proceeds available to someone other than the person rightfully entitled to possession.

c'est-à-dire au document sur la foi duquel est effectué le paiement. De même, on considère qu'une banque détourne un effet si, sur la foi de cet effet, elle perçoit une somme d'argent pour le compte d'une personne qui n'y a pas droit. On a conclu, à maintes reprises, qu'une banque détourne un effet si elle le négocie sur l'ordre d'une personne non autorisée, en l'encaissant ou, semble-t-il (quoique cela n'ait pas été encore tranché) en le payant et, dans un cas comme dans l'autre, en en remettant le montant à une personne autre que celle qui y a légitimement droit.

The drawer, the payee or the endorsee can bring an action for conversion of a cheque. To make the claim for damages for conversion, the plaintiff must prove that he or she was either in actual possession or entitled to immediate possession of the chattel. As Rafferty states in "Forged Cheques: A Consideration of the Rights and Obligations of Banks and Their Customers" (1979-1980), 4 *C.B.L.J.* 208, at p. 228, "[t]he conversion action, however, will lie only if the drawer is still the true owner of the cheque. It must not have been issued to the payee" (*Jervis B. Webb Co. v. Bank of Nova Scotia* (1965), 49 D.L.R. (2d) 692 (Ont. H.C.), and see for example *Ontario Woodsworth Memorial Foundation v. Grozbord*, [1969] S.C.R. 622). The defendant's liability extends to the face value of the converted instrument, and is not limited to the value of the instrument as paper and ink (*Norwich Union Fire Insurance Society Ltd. v. Banque Canadienne Nationale*, [1934] S.C.R. 596).

37 Le tireur, le preneur ou l'endossataire peuvent intenter une action pour détournement d'un chèque. Pour établir la réclamation en dommages-intérêts pour détournement, le demandeur doit prouver qu'il était en possession réelle du bien, ou encore qu'il avait droit à sa possession immédiate. Comme l'affirme Rafferty dans «Forged Cheques: A Consideration of the Rights and Obligations of Banks and Their Customers» (1979-80), 4 *C.B.L.J.* 208, à la p. 228, [TRADUCTION] «[c]ependant, l'action pour détournement ne peut être intentée que si le tireur est encore le véritable propriétaire du chèque. Il ne doit pas avoir été émis au preneur» (*Jervis B. Webb Co. c. Bank of Nova Scotia* (1965), 49 D.L.R. (2d) 692 (H.C. Ont.), et voir, par exemple, *Ontario Woodsworth Memorial Foundation c. Grozbord*, [1969] R.C.S. 622). La responsabilité du défendeur s'étend à la valeur nominale de l'effet détourné et n'est pas limitée à la valeur du papier et de l'encre qui le constituent (*Norwich Union Fire Insurance Society Ltd. c. Banque Canadienne Nationale*, [1934] R.C.S. 596).

In this case, it is common ground that the payees of the cheques in question had no right of possession to the cheques, as they were not created in respect of legitimate debts owed to them by the appellants. It is also agreed that Alm had no right to immediate possession of the cheques. However, it remains to be determined whether the respondent may have had a right of possession over and against the appellants; this issue will be canvassed below, in the context of fictitious or non-existing persons under s. 20(5) of the Act.

38 En l'espèce, il est reconnu que les preneurs n'avaient pas droit à la possession des chèques en cause, car ces chèques n'avaient pas été rédigés pour payer des dettes légitimes des appelantes envers ces preneurs. Il est également reconnu que Alm n'avait pas droit à la possession immédiate des chèques. Cependant, il reste à déterminer si l'intimée peut avoir eu un droit de possession qui l'emportait sur celui des appelantes et qui leur était opposable; cette question sera examinée plus loin dans le contexte des personnes fictives ou qui n'existent pas au sens du par. 20(5) de la Loi.

39 The respondent agrees that in this case, it is *prima facie* liable to the drawer for conversion. The trial judge, in finding the respondent liable for conversion, correctly affirmed, in my view, that where a collecting bank pays out on a forged endorsement, the collecting bank will be liable for conversion. The Court of Appeal, by contrast, found that the action in conversion must fail with respect to the 146 cheques signed by Alm, for the reason that Alm had authority to sign the cheques as well as to deliver them. Further, the Court of Appeal found significance in the fact that Alm fully intended to receive the proceeds herself. Accordingly, in the majority's view, the payment was not diverted from its intended recipient.

L'intimée reconnaît qu'elle est, en l'espèce, responsable à première vue de détournement envers le tireur. En concluant que l'intimée était responsable du détournement, le juge de première instance a, selon moi, confirmé à juste titre que la banque d'encaissement est responsable de détournement si elle fait un paiement sur la foi d'un endossement falsifié. Par contre, la Cour d'appel a conclu que l'action pour détournement doit échouer relativement aux 146 chèques signés par Alm puisque celle-ci était autorisée à signer les chèques et à les livrer. De plus, la Cour d'appel a jugé important le fait que Alm ait parfaitement eu l'intention de toucher personnellement le montant des chèques. En conséquence, de l'avis de la majorité, le paiement n'avait pas été détourné du bénéficiaire auquel il était destiné.

40 In my view, the Court of Appeal's approach, with respect, misses the point. It is the intention of the drawer, not the signatory of the cheque, that is relevant, as will be discussed in greater detail below. Alm is not the drawer because she cannot be said to be the directing mind of the corporate appellants; she simply had signing authority within limited circumstances. The relevant intention in this case is that of the drawer, the appellant companies. In the absence of Alm's fraud, they would have been liable, not Alm, if the cheques had been validly issued and were subsequently dishonoured by the drawee.

J'estime, en toute déférence, que le point de vue de la Cour d'appel passe à côté de la question. C'est l'intention du tireur et non celle du signataire du chèque qui est pertinente, comme nous le verrons plus en détail ultérieurement. Alm n'est pas le tireur parce que l'on ne peut dire qu'elle est l'âme dirigeante des compagnies appelantes; elle était tout simplement autorisée à signer dans certaines circonstances. En l'espèce, l'intention pertinente est celle du tireur, les compagnies appelantes. Dans le cas où il n'y aurait pas eu fraude de la part de Alm, ce sont les compagnies qui auraient été responsables, et non Alm, si les chèques avaient été émis validement et subséquemment refusés par le tiré.

41 The money on deposit in the appellants' Royal Bank accounts was owed to the lawful holder of those accounts, the appellants. Through the CIBC's actions, money owed to the appellants was paid to Alm, who was not entitled to the money. She was not a payee, and none of the cheques was endorsed by any of the named payees. The forged endorsements were "wholly inoperative" pursuant to s. 48 of the Act. The CIBC presented fraudulent cheques for payment to the Royal Bank, and collected the proceeds therefrom. The CIBC then accounted for the proceeds to Ms. Alm, one not "rightfully entitled" to the funds. Thus, the CIBC is *prima facie* liable in conversion to the appel-

Les sommes en dépôt dans les comptes des appelantes à la Banque Royale étaient des sommes dues au détenteur légitime de ces comptes, à savoir les appelantes. Par les actes de la CIBC, des sommes dues aux appelantes ont été payées à Alm qui n'y avait pas droit. Elle n'était pas un preneur et aucun des chèques n'avait été endossé par l'un ou l'autre des preneurs nommés. Les endossements falsifiés n'avaient «aucun effet», conformément à l'art. 48 de la Loi. La CIBC a présenté pour paiement à la Banque Royale des chèques frauduleux et les a encaissés. La CIBC en a ensuite porté le montant au crédit de Alm, une personne qui n'avait pas «légitimement droit» à ces fonds. La lants. However, it remains to be seen whether the CIBC can avail itself of a defence.

B. *Unauthorized signatures and the fictitious payee defence*

As noted above, Alm created some 155 cheques payable to a number of persons connected with the appellants. One hundred and seven of the cheques were payable to "J. Lam" or "J. R. Lam", and were accepted for deposit without endorsement. The remaining Lam cheques, and all of the cheques payable to other third parties, bore the forged endorsement of the payee, the forgeries having been perpetrated by Donna Alm.

I note in passing that in this case, we are not within the realm of *Number 10 Management*, *supra*, where the Manitoba Court of Appeal held that a cheque with a forged signature is not a bill of exchange. In this case, the cheques were signed by authorized signatories, albeit for non-existent obligations, and were bills of exchange.

As Professor Benjamin Geva notes in his commentary, "The Fictitious Payee and Payroll Padding: Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd." (1977-78), 2 *C.B.L.J.* 418, the general rule with respect to a forged or an unauthorized signature on a bill is contained in s. 48(1) (formerly s. 49(1)) of the Act. Such a signature is "wholly inoperative, and no right to retain the bill or to give a discharge therefor or to enforce payment thereof against any party thereto can be acquired through or under that signature". As Geva states at pp. 418-19, "the effect of this section is to force a bank that has paid a cheque and debited the account of the drawee, based on a forged or unauthorized endorsement, to re-credit the account and to bear the loss".

An exception to this rule is set out in s. 20(5) of the Act, the fictitious payee provision. The section

CIBC est donc responsable à première vue de détournement envers les appelantes. Cependant, il reste à voir si la CIBC dispose d'un moyen de défense.

B. *Les signatures non autorisées et le moyen de défense fondé sur le preneur fictif*

Comme je l'ai déjà fait remarquer, Alm a rédigé quelque 155 chèques payables à un certain nombre de personnes ayant des liens avec les appelantes. Cent sept de ces chèques étaient payables à «J. Lam» ou à «J. R. Lam», et ont été acceptés pour dépôt sans endossement. Les autres chèques au nom de Lam et tous les chèques payables à d'autres tierces parties portaient l'endossement falsifié du preneur, l'auteur des faux étant Donna Alm. 42

En passant, je tiens à préciser que la situation, en l'espèce, ne relève pas de l'arrêt *Number 10 Management*, précité, dans lequel la Cour d'appel du Manitoba a conclu qu'un chèque portant une signature contrefaite n'est pas une lettre de change. En l'espèce, les chèques ont été signés par des signataires autorisés, quoique pour des obligations inexistantes, et constituaient des lettres de change. 43

Comme le professeur Benjamin Geva l'affirme dans son commentaire intitulé «The Fictitious Payee and Payroll Padding: Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd.» (1977-78), 2 *C.B.L.J.* 418, la règle générale applicable à une signature contrefaite ou non autorisée figurant sur une lettre de change est exposée au par. 48(1) (auparavant 49(1)) de la Loi. Une telle signature «n'a aucun effet et ne confère pas le droit de garder la lettre, d'en donner libération ni d'obliger une partie à celle-ci à en effectuer le paiement». Comme l'affirme Geva, aux pp. 418 et 419, [TRADUCTION] «cette disposition a pour effet de contraindre une banque qui a payé un chèque et débité de cette somme le compte du tiré, sur la foi d'un endossement falsifié ou non autorisé, à créditer de nouveau le compte de cette somme et à assumer la perte». 44

Une exception à cette règle est prévue au par. 20(5) de la Loi, qui traite des preneurs fictifs. Aux 45 provides that, where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer. The significance of a cheque that is payable to bearer, rather than to order, is that it can be negotiated by simple "delivery" to the bank; endorsement is not required. The presence or absence of a legitimate or forged endorsement is irrelevant to a bearer cheque. A bank becomes the lawful holder of a bearer cheque simply through delivery. By contrast, in order for a bank to become the lawful holder of a cheque that is payable to order, not only must the cheque be delivered to effect negotiation, but the cheque must also be endorsed. If the cheques in question were payable to fictitious persons, and could accordingly be treated as bearer cheques, the bank would become a "holder in due course" pursuant to s. 73 of the Act despite the forged endorsements and the missing endorsements; to repeat, negotiation of a bearer cheque is achieved simply by delivery. In this way, an exception to the usual rule of *nemo dat quod non habet* is created. Through the fictitious payee defence, the loss, as Geva states at p. 419, "is thrown upon the drawer". (See also Rafferty, *supra*, at pp. 210-11.)

46 Falconbridge, in *Banking and Bills of Exchange* (6th ed. 1956), put forward the following four propositions with respect to fictitious payees (at pp. 468-69):

> Whether a named payee is non-existing is a simple question of fact, not depending on anyone's intention. The question whether the payee is fictitious depends upon the intention of the creator of the instrument, that is, the drawer of a bill or cheque or the maker of a note.
>
> In the case of a bill drawn by Adam Bede upon John Alden payable to Martin Chuzzlewit, the payee may or may not be fictitious or non-existing according to the circumstances:
>
> (1) If Martin Chuzzlewit is not the name of any real person known to Bede, but is merely that of a creature of the imagination, the payee is non-existing, and is probably also fictitious.

termes de ce paragraphe, la lettre dont le preneur est une personne fictive ou qui n'existe pas peut être considérée comme payable au porteur. Le fait qu'un chèque soit payable au porteur plutôt qu'à ordre signifie qu'il peut être négocié par simple «livraison» à la banque; il n'a pas besoin d'être endossé. Dans le cas d'un chèque au porteur, la présence ou l'absence d'endossement légitime ou falsifié est sans importance. Une banque devient détentrice légitime d'un chèque au porteur par simple livraison. Par contre, pour qu'une banque devienne détentrice légitime d'un chèque payable à ordre, le chèque doit non seulement être livré, mais encore il doit être endossé, pour qu'il y ait négociation. Si les chèques en question étaient payables à des personnes fictives et pouvaient donc être considérés comme des chèques payables au porteur, la banque deviendrait un «détenteur régulier», conformément à l'art. 73 de la Loi, même s'il y avait falsification ou absence d'endossement; je répète que la négociation d'un chèque au porteur se fait par simple livraison. On crée ainsi une exception à la règle habituelle *nemo dat quod non habet*. Par le moyen de défense fondé sur le preneur fictif, la perte, comme l'affirme Gèva, à la p. 419, [TRADUCTION] «est reportée sur le tireur». (Voir aussi Rafferty, *loc. cit.*, aux pp. 210 et 211.)

Dans *Banking and Bills of Exchange* (6e éd. 1956), Falconbridge formule les quatre propositions qui suivent relativement aux preneurs fictifs (aux pp. 468 et 469):

> [TRADUCTION] La question de savoir si un preneur nommé est une personne qui n'existe pas est une simple question de fait qui ne dépend de l'intention de personne. Celle de savoir si le preneur est une personne fictive dépend de l'intention de l'auteur de l'effet, à savoir le tireur d'une lettre de change ou d'un chèque, ou encore l'auteur d'un billet.
>
> Dans le cas d'une lettre de change dont le tireur est Adam Bede, le tiré John Alden et le preneur Martin Chuzzlewit, ce dernier est fictif ou inexistant ou ne l'est pas selon les circonstances:
>
> (1) Si Martin Chuzzlewit n'est pas le nom d'une personne existante que Bede connaît, mais seulement le fruit de l'imagination de ce dernier, le preneur est inexistant et, vraisemblablement aussi, fictif.

(2) If Bede for some purpose of his own inserts as payee the name of Martin Chuzzlewit, a real person who was known to him but whom he knows to be dead, the payee is non-existing, but is not fictitious.

(3) If Martin Chuzzlewit is the name of a real person known to Bede, but Bede names him as payee by way of pretence, not intending that he should receive payment, the payee is fictitious, but is not non-existing.

(4) If Martin Chuzzlewit is the name of a real person, intended by Bede to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that Bede has been induced to draw the bill by the fraud of some other person who has falsely represented to Bede that there is a transaction in respect of which Chuzzlewit is entitled to the sum mentioned in the bill.

The policy underlying the fictitious person rule seems to be that if a drawer has drawn a cheque payable to order, not intending that the payee receive payment, the drawer loses, by his or her conduct, the right to the protections afforded to a bill payable to order.

47 The fictitious payee rule was considered by this Court in *Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd.*, [1977] 2 S.C.R. 456, and in *Fok Cheong Shing Investments Co. v. Bank of Nova Scotia*, [1982] 2 S.C.R. 488. In *Concrete Column Clamps*, a payroll clerk perpetrated a fraud by including among the cheques presented to the authorized signing officer of the company a number of cheques payable to persons who were not owed any wages, some being former employees and the others having names which may or may not have been those of existing persons. The fraudulent employee took the cheques and received the amounts on forged endorsements. With regard to the named payees who were not former employees, it was held both by the trial judge and the Court of Appeal that they were "non-existing", and so fell within the s. 21(5) (now s. 20(5)). No issue in this respect was raised on appeal to the Supreme Court. With respect to the cheques made payable to former employees, both the trial judge and the Court of Appeal applied the fourth proposition put forward by Falconbridge, namely, that:

(2) Si Bede, pour ses fins propres, inscrit comme preneur le nom de Martin Chuzzlewit, une personne ayant déjà existé, qu'il connaissait et sait être décédée, le preneur est inexistant mais il n'est pas fictif.

(3) Si Martin Chuzzlewit est le nom d'une personne existante que Bede connaît, mais qu'il inscrit comme preneur dans un but frauduleux n'ayant pas l'intention d'avantager monétairement ce preneur, le preneur est une personne fictive mais non inexistante.

(4) Si Martin Chuzzlewit est le nom d'une personne existante à qui Bede destine le paiement, le preneur n'est ni fictif, ni inexistant, quoique Bede ait été amené à rédiger la lettre de change par des manœuvres frauduleuses d'une autre personne qui a fait croire à Bede qu'il y a une transaction au regard de laquelle Chuzzlewit a droit au montant spécifié dans la lettre de change.

Le principe sous-jacent à la règle de la personne fictive semble être le suivant: si une personne a tiré un chèque payable à ordre, sans vouloir que le preneur reçoive paiement, elle perd, en raison de sa conduite, le droit aux mesures de protection dont bénéficie une lettre de change payable à ordre.

La règle du preneur fictif a été examinée dans les arrêts *Banque Royale du Canada c. Concrete Column Clamps (1961) Ltd.*, [1977] 2 R.C.S. 456, et *Fok Cheong Shing Investments Co. c. Banque de Nouvelle-Écosse*, [1982] 2 R.C.S. 488. Dans l'arrêt *Concrete Column Clamps*, un préposé à la paie avait commis une fraude en glissant parmi les chèques présentés au signataire autorisé de la compagnie un certain nombre de chèques payables à des personnes à qui aucun salaire n'était dû, certaines d'entre elles étant d'anciens employés, d'autres étant fictives ou inconnues. L'employé malhonnête s'emparait des chèques et en touchait le montant sur la foi d'endossements falsifiés. En ce qui concerne les preneurs nommés qui n'étaient pas d'anciens employés, le juge de première instance et la Cour d'appel ont tous deux conclu que c'étaient des personnes «qui n'existaient pas» et qui étaient donc visées par le par. 21(5) (maintenant le par. 20(5)). Lors du pourvoi devant notre Cour, aucune question à ce sujet n'a été soulevée. Quant aux chèques payables à d'anciens employés, le juge de première instance et la Cour d'appel ont tous deux appliqué la quatrième proposition formulée par Falconbridge, à savoir:

If Martin Chuzzlewit is the name of a real person, intended by Bede to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that Bede has been induced to draw the bill by the fraud of some other person who has falsely represented to Bede that there is a transaction in respect of which Chuzzlewit is entitled to the sum mentioned in the bill.

Si Martin Chuzzlewit est le nom d'une personne existante à qui Bede destine le paiement, le preneur n'est ni fictif, ni inexistant, quoique Bede ait été amené à rédiger la lettre de change par des manœuvres frauduleuses d'une autre personne qui a fait croire à Bede qu'il y a une transaction au regard de laquelle Chuzzlewit a droit au montant spécifié dans la lettre de change.

48 The majority of the Court in *Concrete Column Clamps, supra*, agreed that the fourth proposition was of application, and noted that a considerable line of Canadian and English authority had adopted the same approach in similar circumstances. The appellant in that case had suggested that where the person authorized to sign the cheques did so mechanically, without knowing any of the payees personally, it was not possible to apply the same rule as when a cheque is signed relying on an explicit false declaration. However, Pigeon J. for the majority commented as follows (at p. 484):

On the contrary, in an age when cheques are processed by computer, it is even more necessary to avoid facilitating fraudulent operations.

By making banks responsible for cheques cashed on a false endorsement, our *Bills of Exchange Act* certainly has the effect of making it more difficult to cash a cheque fraudulently. It is common knowledge that as a result, public agencies and private enterprises rely heavily on the responsibility of those who pay the cheques they issue, to counteract all kinds of fraud and at the same time to protect those for whom the payments are intended. The argument of counsel for the appellant, based on references to legislation in other countries relieving banks of this responsibility, is unconvincing. It is not for this Court to judge the results of such legislation, no attempt was even made to show that they were favourable. If appellant believes they were, it is to Parliament that it should apply to have the *Bills of Exchange Act* amended. I can see no justification for changing the interpretation of this Act, because a different rule has been established by legislation elsewhere.

It is to be noted that in the United Kingdom the drawee bank which pays cheques in good faith but on forged endorsements is protected by s. 60 of its

Dans l'arrêt *Concrete Column Clamps*, précité, notre Cour à la majorité a reconnu que c'était la quatrième proposition qui s'appliquait, et elle a fait remarquer que ce point de vue avait, dans des circonstances similaires, été adopté dans un grand nombre de décisions canadiennes et britanniques. Dans cette affaire, l'appelante soutenait que dans le cas où la personne autorisée à signer les chèques les avait signés machinalement, sans connaître personnellement aucun des preneurs, il n'était pas possible d'appliquer la même règle que lorsqu'un chèque était signé sur la foi d'une fausse déclaration explicite. Cependant, le juge Pigeon a fait les commentaires suivants, au nom de la Cour à la majorité (à la p. 484):

Au contraire, à l'ère des chèques faits par ordinateur, il me semble encore plus désirable de ne pas faciliter l'entreprise des fraudeurs.

En rendant les banques responsables des chèques encaissés sur un endossement faux, notre *Loi sur les lettres de change* tend indubitablement à rendre l'encaissement frauduleux plus difficile. Il est notoire qu'en conséquence les administrations publiques comme les entreprises privées comptent beaucoup sur la responsabilité de ceux qui paient les chèques qu'elles émettent, pour contrecarrer toutes sortes de fraudes en même temps que pour protéger ceux auxquels les paiements sont destinés. Je ne puis accepter l'argument que l'avocat de l'appelante nous a présenté en citant d'autres législations qui affranchissent les banques de cette responsabilité. Il ne nous appartient pas d'en apprécier les résultats, mais on n'a même pas tenté de nous démontrer qu'ils étaient favorables. Si l'appelante le croit, c'est au Parlement qu'elle doit s'adresser pour demander la modification de notre *Loi sur les lettres de change*. Rien ne saurait nous justifier d'en changer l'interprétation parce qu'une règle différente a été législativement décrétée ailleurs.

Il faut signaler qu'au Royaume-Uni la banque tirée qui paie les chèques de bonne foi, mais sur la foi d'endossements falsifiés, est protégée par l'art. 60

Bills of Exchange Act, 1882, (U.K.), 45 & 46 Vict., c. 61, which has no parallel in Canada.

Laskin C.J. took a view different from that of the majority. In his opinion, the intention of the dishonest clerk should be attributed to the drawer/employer. In this way, he concluded that the named former employees were fictitious persons. The Chief Justice considered principles of agency law and vicarious liability (at pp. 480-81):

There is a fine line, too fine in my opinion, between the case where the authorized signer of a cheque perpetrates a payroll fraud and the case where the fraud is perpetrated by a payroll clerk upon whose integrity the authorized signer generally must rely in making out the payroll cheques. The *Restatement of Agency Second* (1958) accepts this distinction, holding that a drawee bank which acts in good faith is protected in the first situation and liable to suffer the loss in the second situation: see s. 173, *Comment b*; s. 280, *Comment b*. The Reporter's notes to s. 280 point out, *inter alia*, that "imputing knowledge to the principal is a fictitious way of stating that the principal is liable for the conduct of the agent, and the fiction should be used only where it would be equitable to do so" (at p. 482 of *Restatement of Agency Second*, Appendix).

The distinction taken in the *Restatement of Agency Second* appears to be based on a line of cases different from the line that led to the development of the present law on vicarious liability in tort. That line is concerned with the question of how far notice to or knowledge of an agent of facts relating to a transaction which he is carrying out for the principal will be imputed to the latter. The general rule of imputation on such a case (and I state the matter broadly without the distinctions thrown up by the cases: see Powell, *Agency* (2nd ed. 1961) at pp. 236 ff.) has been held to be subject to an exception where the agent for his own purposes engages in a fraud against the principal: see, for example, Bowstead, *Agency* (13th ed. 1968), at pp. 356-57; *Corporation Agencies Ltd. v. Home Bank of Canada* [[1925] S.C.R. 706], at p. 718. I do not think that this line of cases, concerned as they are with what a third party communicates to an agent and *vice versa*, or with what an agent knows or should know when acting for a principal, are applicable here. It seems to me that the tort cases offer a better analogy by posing the question as to when an employee's or an agent's interest adverse to the

du *Bills of Exchange Act, 1882* (R.-U.), 45 & 46 Vict., ch. 61, qui n'a pas d'équivalent au Canada.

Le juge en chef Laskin a adopté un point de vue différent de celui de la majorité. À son avis, l'intention du commis malhonnête devrait être attribuée à l'employeur-tireur. C'est ainsi qu'il a conclu que les anciens employés nommés étaient des personnes fictives. Le Juge en chef a examiné les principes du droit des mandats et de responsabilité du fait d'autrui ou responsabilité patronale (aux pp. 480 et 481): 49

Il existe une distinction subtile, trop subtile à mon avis, entre le cas où une fraude du présent type est commise par le préposé autorisé à signer les chèques et le cas où la fraude est perpétrée par le commis chargé de préparer les feuilles de paie sur qui le signataire autorisé doit généralement se fier lorsqu'il émet les chèques de paie. Le *Restatement of Agency Second* (1958) accepte cette distinction et estime que la banque tirée qui agit de bonne foi est protégée dans le premier cas et responsable de la perte dans le second cas: voir art. 173, *Comment b*; art. 280, *Comment b*. Sous l'art. 280, le rédacteur souligne, entre autres, que [TRADUCTION] «attribuer au mandant la connaissance que l'agent a des faits est une façon détournée de dire que le mandant est responsable du comportement du mandataire, et ce détour ne doit être admis que lorsqu'il est équitable» (à la p. 482 du *Restatement of Agency Second*, Annexe).

La distinction établie au *Restatement of Agency Second* semble fondée sur une jurisprudence différente de celle qui a mené au développement du droit actuel sur la responsabilité patronale en matière délictuelle. Elle recherche jusqu'à quel point la connaissance propre au mandataire des faits relatifs à une transaction qu'il exécute pour le mandant, va être attribuée à ce dernier. La règle générale d'attribution dans un tel cas (et je l'expose carrément sans tenir compte des distinctions apportées par la jurisprudence: voir Powell, *Agency* (2^e éd. 1961) aux pp. 236 et s.) admet une exception, le cas où pour ses fins propres, le mandataire fraude son mandat: voir, par exemple Bowstead, *Agency* (13^e éd. 1968), aux pp. 356-57; *Corporation Agencies Ltd. v. Home Bank of Canada* [[1925] R.C.S. 706], à la p. 718. J'estime inapplicable en l'espèce cette jurisprudence où l'on considère essentiellement ce qu'un tiers a communiqué au mandataire et vice versa, ou ce qu'un mandataire connaît ou devrait connaître lorsqu'il agit pour le mandant. Il me semble que les affaires délictuelles offrent une meilleure analogie en ce qu'on s'y demande quand exactement l'activité d'un employé ou mandataire dans employer or principal takes him outside of the scope of his employment.

Laskin C.J. concluded that it would be more equitable for the drawer/employer to bear the loss, given that the drawee bank had not been negligent in any way. In his view, there was no basis for a distinction between cheques payable to imaginary persons or persons who were not former employees and those who were formerly employees. For a view in support of this position, see Geva's commentary, *supra*.

50 In *Fok Cheong*, *supra*, the president of the appellant company drew a cheque upon the company's account payable to one Looing Weir, one of the company's creditors. The president fraudulently endorsed Weir's name, and received the proceeds. It was found that the cheque was never intended by the drawer to be paid to the payee. The appellant contended that as the payee was a real person to whom the appellant company was indeed indebted, the payee could not be characterized as a fictitious or non-existing person. However, Ritchie J., writing for the Court, concluded as follows (at p. 490):

> It is obvious that the question of whether or not the payee is to be treated as a fictitious person lies at the very heart of this appeal and in my opinion this is to be determined in accordance with the reasoning expressed by Lord Herschell in *Bank of England v. Vagliano Brothers*, [1891] A.C. 107 at p. 153 where he said:
>
> > For the reasons with which I have troubled your Lordships at some length, I have arrived at the conclusion that, whenever the name inserted as that of the payee is so inserted by way of pretence merely, without any intention that payment shall only be made in conformity therewith, the payee is a fictitious person within the meaning of the statute, whether the name be that of an existing person, or of one who has no existence, and that the bill may, in each case, be treated by a lawful holder as payable to bearer.
>
> In my opinion this passage accurately expresses the effect of the accepted authorities and I agree with the Court of Appeal that the finding of fraudulent intent on the part of Chan in drawing the instrument in question makes the payee of this cheque a fictitious person within

un intérêt contraire à celui de son employeur ou mandant a pour effet de le faire sortir de l'exercice de ses fonctions.

Le juge en chef Laskin a conclu qu'il serait plus équitable que l'employeur-tireur assume la perte puisque la banque tirée n'avait absolument pas été négligente. À son avis, rien ne justifiait d'établir une distinction entre les chèques payables à des personnes fictives ou à des personnes qui n'étaient pas d'anciens employés, et ceux payables à des personnes qui étaient d'anciens employés. À l'appui de cette position, voir le commentaire de Geva, *loc. cit.*

Dans l'arrêt *Fok Cheong*, précité, le président de la compagnie appelante avait tiré, sur le compte de la compagnie, un chèque payable à Looing Weir, l'un des créanciers de celle-ci. Le président avait frauduleusement endossé le chèque au nom de Weir et en avait touché le montant. On a conclu que le tireur n'avait jamais voulu que le chèque soit payé à la preneuse. L'appelante a fait valoir que, puisque la preneuse était une personne réelle dont la compagnie appelante était effectivement la débitrice, on ne saurait la qualifier de personne fictive ou qui n'existe pas. Cependant, le juge Ritchie conclut ceci, au nom de notre Cour (à la p. 490):

> Il est évident que la question de savoir si la preneuse doit être considérée comme une personne fictive constitue le cœur même de ce pourvoi et, à mon avis, elle est à trancher suivant le raisonnement de lord Herschell dans l'arrêt *Bank of England v. Vagliano Brothers*, [1891] A.C. 107, à la p. 153, où il dit:
>
> > [TRADUCTION] Pour les motifs que j'ai exposés assez longuement à Vos Seigneuries, je suis arrivé à la conclusion que, premièrement, chaque fois que le nom inscrit comme le nom du preneur n'est qu'un simulacre et qu'il n'y a aucune intention de payer uniquement le preneur nommé, celui-ci est une personne fictive au sens de la loi, peu importe que le nom soit celui d'une personne qui existe ou d'une personne qui n'existe pas, et deuxièmement, que dans l'un et l'autre cas, un détenteur légitime peut considérer la lettre de change comme payable au porteur.
>
> Selon moi, ce passage exprime avec exactitude le sens de la jurisprudence applicable et je suis d'accord avec la Cour d'appel qu'étant donné la conclusion d'intention frauduleuse de la part de Chan lorsqu'il a tiré l'effet en cause, la preneuse de celui-ci est une personne

the meaning of the authorities, (see also the third illustration cited in *Falconbridge on Banking and Bills of Exchange*, 7th ed., 1969, at p. 486), and the bank was accordingly entitled to treat the cheque as payable to bearer and therefore to treat it as chargeable against the account of the appellant.

fictive au sens de la jurisprudence (voir aussi le troisième exemple cité dans l'ouvrage de Falconbridge, *Banking and Bills of Exchange*, 7e éd., 1969, à la p. 486), et que la banque était donc en droit de considérer le chèque comme payable au porteur et, en conséquence, de débiter le compte de l'appelante du montant y figurant.

The appellants in the instant appeal submitted at the outset that the fictitious payee defence should not be available to collecting banks. The appellants argued that unlike a drawee bank, a collecting bank places no reliance on and has no knowledge of the drawer. The collecting bank relies solely upon the creditworthiness of its own customer. The respondent, however, points out that there is no support for this proposition in the Act, in the case law, or in the academic texts. The respondent notes that when the intention of the Act is that it should apply only to a particular class, this intention is made express, citing for example s. 39 of the Act, dealing with delivery of a bill.

Dans le présent pourvoi, les appelantes ont soutenu, au départ, qu'une banque d'encaissement ne devrait pas pouvoir invoquer le moyen de défense fondé sur le preneur fictif. Elles ont fait valoir que, contrairement à une banque tirée, une banque d'encaissement ne se fie aucunement au tireur et ne le connaît pas. La banque d'encaissement ne se fonde que sur la solvabilité de son propre client. L'intimée fait cependant remarquer que cette proposition ne trouve aucun appui dans la Loi, dans la jurisprudence ou dans la doctrine. Elle précise que lorsque la Loi a pour but de s'appliquer à une catégorie particulière seulement, ce but est exprimé clairement, citant comme exemple l'art. 39 de la Loi qui porte sur la livraison d'une lettre de change. 51

I agree with the respondent that there is no precedent for holding that s. 20(5) is not available to a collecting bank. In any event, the appellants agreed in reply that rather than taking the position that the fictitious person defence does not apply to collecting banks, the better argument was that there is a distinction between cases where the cheque is slipped in front of a signing officer, and a situation where the dishonest person is the signing officer.

Je suis d'accord avec l'intimée pour dire que rien dans la jurisprudence ne permet de conclure qu'une banque d'encaissement ne peut invoquer le par. 20(5). Quoi qu'il en soit, les appelantes ont reconnu, dans leur réplique, qu'au lieu de soutenir que la défense du preneur fictif ne s'applique pas aux banques d'encaissement, il vaut mieux affirmer qu'il existe une différence entre les cas où un chèque est glissé sous la plume d'un signataire et celui où la personne malhonnête est le signataire. 52

In the instant appeal, the appellants submit that the facts fall within the fourth proposition set forth by Falconbridge, *supra*, as adopted by this Court in *Concrete Column Clamps*, *supra*. By contrast, the respondent submits that the circumstances of this case fall within the third proposition. The key issue is whether the drawer intended the payees to receive payment, which itself raises the question of who the drawer is. Can Donna Alm's intention be imputed to the appellants?

En l'espèce, les appelantes soutiennent que les faits correspondent à la quatrième proposition formulée par Falconbridge, *op. cit.*, que notre Cour a adoptée dans l'arrêt *Concrete Column Clamps*, précité. Par contre, l'intimée soutient que les circonstances de l'affaire relèvent plutôt de la troisième proposition. Il s'agit principalement de savoir si le tireur voulait que les preneurs reçoivent paiement, ce qui en soi soulève la question de savoir qui est le tireur. L'intention de Donna Alm peut-elle être imputée aux appelantes? 53

Many of the cheques in question were payable to "real" persons, albeit persons to whom no

Bon nombre des chèques en cause étaient payables à des personnes «réelles», quoique ce fus- 54 money was owed by the companies. Donna Alm, the writer of the cheques, did not intend for these payees to receive the proceeds of the cheques. This led the Court of Appeal to conclude that the drawer of the cheques intended them to be payable to bearer, based on the third proposition set out above, which was first stated in *Bank of England v. Vagliano Brothers*, [1891] A.C. 107 (H.L.), at p. 153, as follows, and adopted by this Court in *Fok Cheong*, *supra*, at p. 490:

> For the reasons with which I have troubled your Lordships at some length, I have arrived at the conclusion that, whenever the name inserted as that of the payee is so inserted by way of pretence merely, without any intention that payment shall only be made in conformity therewith, the payee is a fictitious person within the meaning of the statute, whether the name be that of an existing person, or of one who has no existence, and that the bill may, in each case, be treated by a lawful holder as payable to bearer.

55 With respect, it seems to me that the Court of Appeal erred in focusing on Alm's intention. It is the intention of the drawer that is significant for the purpose of s. 20(5), not the intention of the signatory of the cheque. While a "drawer" is often defined to mean "[t]he person who signs or makes a bill of exchange" (cf. *The Dictionary of Canadian Law* (2nd ed. 1995)), in my view, it is important in the circumstances of this case to distinguish between the signatory and the drawer. The drawer, in this case, is the entity out of whose bank account the cheques were drawn, that is, the appellant companies. Alm was not the drawer, but was simply the signatory. Thus, it is the intention of the appellant companies, as the drawer, that must be determined. In my view, it is wrong to conclude that Alm, as an authorized signing officer of the appellants, could somehow be taken as expressing the intention of the appellant drawer.

56 Accordingly, the instant appeal is to be distinguished from the situation in *Fok Cheong*, *supra*. In that case, the drawer of the cheques was a company, and the signatory of the cheques was the

sent des personnes à qui les compagnies ne devaient pas d'argent. Donna Alm, l'auteur des chèques, ne voulait pas que ces preneurs reçoivent les montants en question. C'est ce qui a amené la Cour d'appel à conclure que le tireur des chèques voulait qu'ils soient payables au porteur, selon la troisième proposition énoncée ci-dessus, qui a été formulée pour la première fois dans l'arrêt *Bank of England c. Vagliano Brothers*, [1891] A.C. 107 (H.L.), à la p. 153, et qui a été adoptée par notre Cour dans l'arrêt *Fok Cheong*, précité, à la p. 490:

> [TRADUCTION] Pour les motifs que j'ai exposés assez longuement à Vos Seigneuries, je suis arrivé à la conclusion que, premièrement, chaque fois que le nom inscrit comme le nom du preneur n'est qu'un simulacre et qu'il n'y a aucune intention de payer uniquement le preneur nommé, celui-ci est une personne fictive au sens de la loi, peu importe que le nom soit celui d'une personne qui existe ou d'une personne qui n'existe pas, et deuxièmement, que dans l'un et l'autre cas, un détenteur légitime peut considérer la lettre de change comme payable au porteur.

En toute déférence, il me semble que la Cour d'appel a commis une erreur en se concentrant sur l'intention de Alm. C'est l'intention du tireur qui est importante pour les fins du par. 20(5) et non celle du signataire du chèque. Bien qu'un «tireur» soit souvent défini comme [TRADUCTION] «[l]a personne qui signe ou émet une lettre de change» (voir *The Dictionary of Canadian Law* (2e éd. 1995)), il est, à mon avis, important dans les circonstances de la présente affaire d'établir une distinction entre le signataire et le tireur. En l'espèce, le tireur est l'entité sur le compte bancaire de laquelle les chèques ont été tirés, c'est-à-dire les compagnies appelantes. Alm n'était pas le tireur, mais simplement la signataire. En conséquence, c'est l'intention des compagnies appelantes, en tant que tireur, qui doit être déterminée. À mon avis, il est erroné de conclure qu'il était possible en quelque sorte de considérer que Alm, en tant que signataire autorisée des appelantes, exprimait l'intention du tireur appelant.

En conséquence, il faut établir une distinction entre le présent pourvoi et la situation dans l'affaire *Fok Cheong*, précitée. Dans cette affaire, le tireur des chèques était une compagnie et le signapresident of that company. The actions of the signatory, who was the president and the guiding mind of the company, could be taken to express the intention of the drawer company itself. This is not the case before us now. There is no basis for holding that the intentions of the signatory Donna Alm could be imputed to the appellant companies. The only directors, officers and shareholders of the appellants were Boris Mange and Ursula Mange. Alm was authorized to sign cheques for the appellants only for the purpose of discharging lawful obligations of the appellants, and only when the Manges were not available.

The validity of the cheques is not challenged; therefore, it must be presumed that the drawer intended the payees to receive the proceeds of the cheques. Clearly, the appellants had no intention of transferring over $90,000 to Alm, rather than the payees, for no reason and via the circuitous route of third party cheques.

The respondent submits that the decision of this Court in *Concrete Column Clamps*, *supra*, should be overruled, and the approach taken by Laskin C.J. in dissent adopted. As I noted above, Laskin C.J. would have imputed the fraudulent intention of the employee to the employer/drawer. However, in my view, it is neither necessary nor desirable to import notions of agency and vicarious liability into the analysis. As I understand the applicable provisions of the Act, they do not invite the courts to consider whether the drawer, as principal, is vicariously liable for the acts of the agent. To my mind, it is quite evident that it is the intention of the drawer, in the sense of the entity from whose account the cheques will be drawn, that is of relevance. In some cases, it may be that the signatory is effectively also the drawer. But in this case, however, this is not so.

Pursuant to *Concrete Column Clamps*, *supra*, and the fourth proposition put forward by Falconbridge, *supra*, where a drawer is fraudulently induced by another person into issuing a cheque for the benefit of a real person to whom no obligation is owed, the cheque is to be considered payable to the payee, and not to a fictitious person. Such cheques will, accordingly, still be considered

taire était président de la compagnie. On pouvait considérer que les gestes du signataire, président et âme dirigeante de la compagnie, exprimaient l'intention de la compagnie tireuse. Ce qui n'est pas le cas en l'espèce. Rien ne permet de conclure que l'intention de la signataire Donna Alm pouvait être imputée aux compagnies appelantes. Les seuls administrateurs, dirigeants et actionnaires des appelantes étaient Boris Mange et Ursula Mange. Alm n'était autorisée à signer les chèques au nom des appelantes que pour acquitter des obligations légitimes des appelantes, et seulement lorsque les Mange ne pouvaient pas le faire eux-mêmes.

La validité des chèques n'est pas contestée; en conséquence, il faut présumer que le tireur voulait que les preneurs touchent le montant des chèques. De toute évidence, les appelantes n'avaient pas l'intention de transférer plus de 90 000 $ à Alm plutôt qu'aux preneurs, et ce, sans aucun motif et par le biais de chèques au nom de tierces parties. 57

L'intimée soutient qu'il faudrait renverser l'arrêt de notre Cour *Concrete Column Clamps*, précité, et adopter le point de vue formulé par le juge en chef Laskin, dissident. Comme je l'ai déjà fait remarquer, le juge en chef Laskin aurait imputé l'intention frauduleuse de l'employé à l'employeur-tireur. Cependant, j'estime qu'il n'est ni nécessaire ni souhaitable d'introduire dans l'analyse des notions de mandat et de responsabilité du fait d'autrui. Si je comprends bien, les dispositions applicables de la Loi n'invitent pas les tribunaux à examiner si le tireur, en tant que mandant, est responsable des actes du mandataire. À mon avis, il est fort évident que c'est l'intention du tireur, au sens de l'entité sur le compte de laquelle les chèques sont tirés, qui est pertinente. Dans certains cas, il se peut qu'en réalité le signataire soit aussi le tireur. Cependant, ce n'est pas le cas en l'espèce. 58

Selon l'arrêt *Concrete Column Clamps*, précité, et la quatrième proposition formulée par Falconbridge, *op. cit.*, lorsqu'un tireur est amené frauduleusement par une autre personne à émettre un chèque au profit d'une personne existante envers qui il n'existe aucune obligation, le chèque doit être considéré comme payable au preneur et non à une personne fictive. En conséquence, ces chèques 59 payable to order rather than to bearer. In this case, as in *Concrete Column Clamps*, *supra*, the drawer was fraudulently induced by an employee into issuing cheques for the benefit of real persons to whom no obligation was owed. In this case, then, the cheques payable to actual persons associated with the appellants were not payable to fictitious persons, and could not be treated by the CIBC as payable to bearer.

seront quand même considérés comme étant payables à ordre plutôt qu'au porteur. Dans la présente affaire, comme dans l'arrêt *Concrete Column Clamps*, précité, le tireur a été frauduleusement amené par un employé à émettre des chèques au profit de personnes existantes envers qui il n'existait aucune obligation. En l'espèce, les chèques payables à des personnes existantes ayant des liens avec les appelantes n'étaient donc pas payables à des personnes fictives, et la CIBC ne pouvait pas les considérer comme payables au porteur.

60 Many of the cheques, however, were made payable not to actual persons associated with the companies, but to "J. Lam" and "J. R. Lam". The appellants had no dealings with any persons of such names. According to the criteria set out in Falconbridge, *supra*, such a person would be categorized as "non-existing", and hence, fictitious. But in my view, it seems that Boris Mange was reasonably mistaken in thinking that "J. Lam" or "J. R. Lam" was an individual associated with his companies. Mange knew that one of the subcontractors retained by the companies was a "Mr. Lam". He did not specifically recall Lam's first name, which, incidentally, was Van Sang. However, when Mange approved the cheques to "J. Lam" and "J. R. Lam", he honestly believed that the cheques were being made out for an existing obligation to a real person known to the companies. The trial judge's comments in this regard were tantamount to a finding of fact, and were not disturbed on appeal; as these are concurrent findings of fact, this Court should not intervene.

Cependant, de nombreux chèques étaient payables non pas à des personnes existantes ayant des liens avec les compagnies, mais plutôt à «J. Lam» et à «J. R. Lam». Les appelantes ne faisaient affaire avec personne de ce nom. Selon les critères énoncés dans Falconbridge, *op. cit*, une telle personne serait qualifiée d'«inexistante» et, en conséquence, de personne fictive. Cependant, il me semble que Boris Mange a raisonnablement cru à tort que «J. Lam» ou «J. R. Lam» était une personne ayant des liens avec ses compagnies. Mange savait que les compagnies avaient retenu les services d'un sous-traitant du nom de «M. Lam». Il ne se rappelait pas précisément du prénom de Lam qui, incidemment, était Van Sang. Cependant, lorsque Mange a approuvé les chèques tirés au nom de «J. Lam» et de «J. R. Lam», il croyait sincèrement qu'ils avaient été tirés relativement à une obligation réelle envers une personne existante connue des compagnies. Les commentaires du juge de première instance à ce sujet équivalaient à une conclusion de fait et n'ont pas été modifiés en appel; comme ce sont des conclusions de fait concordantes, notre Cour ne devrait pas intervenir.

61 Accordingly, the cheques made out to "J. Lam" and "J. R. Lam" also fall within the fourth category, and could not be treated by the CIBC as payable to bearer. Rather, the cheques were payable to order, and in order to be negotiable to the bank, delivery alone was not sufficient. Valid, nonforged endorsements were required.

En conséquence, les chèques tirés au nom de «J. Lam» et de «J. R. Lam» tombent également dans la quatrième catégorie, et ne pouvaient pas être considérés par la CIBC comme payables au porteur. Ces chèques étaient payables à ordre et leur livraison n'était pas à elle seule suffisante pour qu'ils soient négociables à la banque. Des endossements valides et non falsifiés étaient requis.

62 The appellants also submitted that, even if the cheques in question could be considered to be pay-

Les appelantes soutiennent également que, même si les chèques en cause pouvaient être consiable to bearer (which, as I have stated, they cannot be), the cheques should not be considered to have been "delivered" within the meaning of the Act. Accordingly, they could not have been negotiated. Upon closer scrutiny, this submission relied upon a rather tortured reading of the Act, which I should like to address.

dérés comme payables au porteur (ce qui est impossible comme je l'ai affirmé), ils ne devraient pas être considérés comme «livrés» au sens de la Loi. En conséquence, ils ne pouvaient pas avoir été négociés. Lorsqu'on l'examine de plus près, on se rend compte que cet argument repose sur une interprétation plutôt fausse de la Loi, et c'est le point que j'aimerais maintenant examiner.

Section 2 of the Act states that "delivery" means transfer of possession, actual or constructive, from one person to another. Delivery, within the meaning of this section, was certainly effected in this case with respect to all the cheques in question, as Donna Alm transferred possession of them to the CIBC.

L'article 2 de la Loi prévoit que la «livraison» est un transfert de possession réelle ou présumée d'une personne à une autre. En l'espèce, tous les chèques en question ont sûrement été livrés au sens de cette disposition puisque Donna Alm en a transféré la possession à la CIBC. 63

The appellants, however, submit that a cheque is not delivered by the mere handing of the cheque to a bank teller, but that the transfer of possession is merely part of a legal process, relying on *Gough Electric Ltd. v. Canadian Imperial Bank of Commerce* (1986), 34 B.L.R. 17 (B.C.C.A.). According to the court in *Gough*, the delivery must be made by the authority of the drawer or the acceptor or the endorsee, as the case may be, referring to the language set out in s. 39 of the Act.

Toutefois, se fondant sur l'arrêt *Gough Electric Ltd. c. Canadian Imperial Bank of Commerce* (1986), 34 B.L.R. 17 (C.A.C.-B.), les appelantes soutiennent qu'un chèque n'est pas livré par sa simple remise à un caissier de la banque, mais que le transfert de possession fait simplement partie d'un processus juridique. Dans l'arrêt *Gough*, la cour, renvoyant aux termes utilisés à l'art. 39 de la Loi, a affirmé que la livraison doit être effectuée avec l'autorisation du tireur, de l'accepteur ou de l'endossataire, selon le cas. 64

I agree with the respondent's submission that it is incorrect to read s. 39 as if it defined "delivery" for all sections of the Act. The language of s. 39 necessarily refers back to the provisions of s. 38. Parliament has defined the term "delivery" in the interpretation section of the statute, a definition that is presumably to apply throughout the statute. In defining the term "delivery" differently in the later section, the clear inference is that this special definition is not intended to apply throughout the statute, but only in the circumstances contemplated by s. 38 because s. 39 cannot be read in isolation from s. 38. Where the delivery is taking place for the purposes of s. 38, there must be more than the transfer of possession, actual or constructive, from one person to another; it must also be made either by or under the authority of the party drawing, accepting or endorsing, as the case may be. Section 39 deals with the completion of a contract on a bill, not the delivery of every bill of exchange for

Je suis d'accord avec l'intimée pour dire qu'il est incorrect d'interpréter l'art. 39 comme s'il définissait le terme «livraison» pour toutes les dispositions de la Loi. Le texte de l'art. 39 renvoie nécessairement à l'art. 38. Le législateur a défini le terme «livraison» dans la partie de la Loi réservée aux définitions, et il faut présumer que cette définition s'applique à l'ensemble de la Loi. On ne peut que déduire que, lorsqu'il a défini le terme «livraison» différemment dans la dernière disposition, le législateur a voulu que cette définition spéciale s'applique non pas à l'ensemble de la Loi, mais seulement aux circonstances envisagées à l'art. 38 du fait que l'art. 39 ne peut être interprété indépendamment de l'art. 38. Lorsqu'il y a livraison pour les fins de l'art. 38, il doit y avoir plus qu'un transfert de possession réelle ou présumée d'une personne à une autre; la livraison doit aussi être faite par le tireur, l'accepteur ou l'endosseur, selon le cas, ou avec leur autorisation. L'article 39 65 simple deposit or negotiation. As further support for this interpretation, I note that the first incarnation of the Act incorporated the present ss. 38 and 39 in one section (see S.C. 1890, c. 33, s. 21).

traite de l'irrévocabilité de la conclusion d'un contrat sur une lettre de change, et non de la livraison de toute lettre de change pour simple dépôt ou négociation. Pour appuyer davantage cette interprétation, je souligne que, dans la première version de la Loi, les art. 38 et 39 actuels ne formaient qu'une seule et même disposition (voir S.C. 1890, ch. 33, art. 21).

66 If s. 39 applied beyond the situations encompassed in s. 38, s. 2 would be rendered meaningless, as delivery would never mean the simple transfer of possession. Such a result would be an absurdity. It is true that the Manitoba Court of Appeal has held that "delivery" must always be more than mere transfer of possession, in *Toronto-Dominion Bank v. Dauphin Plains Credit Union Ltd.* (1992), 98 D.L.R. (4th) 736. I expressly disagree with this approach, however, as it renders s. 2 meaningless, and also essentially renders s. 20(5) nugatory. It must be remembered that a cheque payable to bearer, including a cheque payable to a fictitious person, is negotiated by simple delivery (s. 59(2)). To adopt the s. 39 definition of delivery for all purposes would mean that something more than simple delivery would be required, contrary to the very intent of s. 20(5) and s. 59(2). This result defies the maxim *ut res magis valeat quam pereat*, "it is better for a thing to go well than to come to nothing", that is, legislation should be interpreted to give it effect, rather than to render it a nullity.

Si l'article 39 s'appliquait à d'autres situations que celles visées à l'art. 38, l'art. 2 serait dénué de tout sens puisque la livraison ne signifierait jamais le simple transfert de possession. Un tel résultat serait absurde. Il est vrai que, dans l'arrêt *Toronto-Dominion Bank c. Dauphin Plains Credit Union Ltd.* (1992), 98 D.L.R. (4th) 736, la Cour d'appel du Manitoba a statué que la «livraison» doit toujours être plus qu'un simple transfert de possession. Cependant, je suis explicitement en désaccord avec ce point de vue étant donné qu'il fait perdre tout son sens à l'art. 2 et qu'il rend essentiellement inopérant le par. 20(5). Il faut se rappeler qu'un chèque payable au porteur, y compris un chèque payable à une personne fictive, se négocie par simple livraison (par. 59(2)). Adopter à toutes fins la définition de «livraison» à l'art. 39 signifierait que quelque chose de plus qu'une simple livraison serait requis, contrairement à l'intention exprimée aux par. 20(5) et 59(2). Ce résultat va à l'encontre de la maxime *ut res magis valeat quam pereat*, «il vaut mieux qu'une chose soit valide plutôt qu'elle périsse», c'est-à-dire qu'une loi devrait être interprétée de manière à la rendre opérante plutôt que de la rendre nulle.

67 For these reasons, it is my conclusion that the cheques in question certainly were "delivered" by Alm to the CIBC within the meaning of s. 2 of the Act. However, the cheques were not bearer cheques, but were payable to order. Accordingly, for negotiation to be effected, endorsement by the payee was required in order for the CIBC to acquire valid title to the cheques.

Pour ces motifs, je conclus que Alm a sûrement livré les chèques en question à la CIBC, au sens de l'art. 2 de la Loi. Cependant, les chèques étaient non pas payables au porteur, mais payables à ordre. En conséquence, pour être négociés, ils devaient porter l'endossement du preneur pour que la CIBC acquière un titre valide.

68 It remains to be seen, however, whether s. 165(3) of the Act is of application in this situation so as to give the CIBC the rights of a holder in due course, including immunity against a claim in conversion.

Il reste cependant à examiner si le par. 165(3) de la Loi s'applique en l'espèce de façon à conférer à la CIBC les droits d'un détenteur régulier, y compris l'immunité contre les réclamations fondées sur le détournement.

C. *Section 165(3)*

It should be noted at the outset that the CIBC in this case cannot be an actual holder in due course under the Act, because it is not a valid "holder" of the cheques in question. A bill must be negotiated to an individual in order for him or her to be a holder. As set out above, the cheques in this case were not validly negotiated, since they were payable to order, and bore no endorsement, or bore forged endorsements which amounted to a nullity under s. 48 of the Act.

However, it is argued that the CIBC acquired the rights of a holder in due course pursuant to s. 165(3), which provides that:

> Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

At this point, it should be noted that this section has attracted considerable commentary; see, for example, Professor Sheilah Martin's article "Section 165(3) of the Bills of Exchange Act" (1985), 11 *C.B.L.J.* 23, and Professor Stephen A. Scott's article "The Bank is Always Right: Section 165(3) of the Bills of Exchange Act and its Curious Parliamentary History" (1973), 19 *McGill L.J.* 78.

Section 165(3) was introduced in 1966; Professor Martin summarizes the subsequent reaction to the new provision as highly critical by giving too wide a protection to banks (at p. 23). She describes the significant advantage that the section affords to a depositing bank as follows, at p. 47:

> While some innovations have been made, in the case of a good faith requirement and the deposit proviso, most cases have technically applied s. 165(3) to give the bank the wide protection it promotes. When one realizes that s. 165(3) is now being used as a defence to common law actions and that the bank remains free to pursue the drawer or endorsers at its option and regardless of its relationship with the endorser, it is easy to understand

C. *Le paragraphe 165(3)*

Il y a lieu de souligner, au départ, que la CIBC ne peut être un véritable détenteur régulier au sens de la Loi parce qu'elle n'est pas un «détenteur» valide des chèques en question. Une lettre de change doit être négociée en faveur d'une personne pour qu'elle en devienne détentrice. Comme je l'ai déjà exposé, les chèques en l'espèce n'ont pas été validement négociés puisqu'ils étaient payables à ordre et ne portaient aucun endossement ou portaient un endossement falsifié constituant nullité en vertu de l'art. 48 de la Loi. 69

Cependant, on soutient que la CIBC a acquis les droits d'un détenteur régulier conformément au par. 165(3), qui prévoit ceci: 70

> Lorsqu'un chèque est livré à une banque en vue de son dépôt au compte d'une personne et que la banque porte au crédit de celle-ci le montant du chèque, la banque acquiert tous les droits et pouvoirs du détenteur régulier du chèque.

Il y a lieu ici de souligner que cette disposition a fait couler beaucoup d'encre; voir, par exemple, l'article de la professeure Sheilah Martin, intitulé «Section 165(3) of the Bills of Exchange Act» (1985), 11 *C.B.L.J.* 23, et celui du professeur Stephen A. Scott, intitulé «The Bank is Always Right: Section 165(3) of the Bills of Exchange Act and its Curious Parliamentary History» (1973), 19 *R.D. McGill* 78. 71

Le paragraphe 165(3) a été introduit en 1966; la professeure Martin affirme succinctement que la nouvelle disposition a été fort critiquée parce qu'elle accorde une protection trop grande aux banques (à la p. 23). Voici comment elle décrit le grand avantage que cette disposition confère à une banque déposante (à la p. 47): 72

> [TRADUCTION] Bien que certaines innovations aient été réalisées, dans le cas d'une exigence de bonne foi et de la clause de dépôt, on a, la plupart du temps, appliqué littéralement le par. 165(3) de façon à conférer aux banques la protection générale qu'il favorise. Lorsque l'on se rend compte que le par. 165(3) est maintenant opposé comme moyen de défense à des actions fondées sur la common law et que la banque continue de pouvoir

the fear that the section has done much to strengthen the legal position of a depositing bank.

Professor Martin explores in her article whether the breadth of s. 165(3) can be narrowed by strictly construing its threshold requirements but concludes that it would be difficult to narrow the scope of the subsection.

73 Professor Scott goes so far as to state that s. 165(3) "must be summarily repealed", as "[i]ts continued presence on the Canadian statute book is completely unjustified" (p. 97). In his view, it would not be necessary to replace the section with a new provision, but he suggests specific changes (at p. 97).

74 The respondent submits that, within the plain meaning of s. 165(3), it has acquired the rights of a holder in due course, since the cheques in question were indeed "delivered to a bank for deposit to the credit of a person", and since the CIBC credited the person "with the amount of the cheque". At first blush, this interpretation seems to be attractive. However, the consequence of this approach would be far-reaching and overly broad.

75 If the respondent's interpretation were adopted, a bank would never need to require an endorsement, and the distinction between cheques payable to order and payable to bearer would be insignificant. A bank would always be immune from the consequences of having accepted unendorsed cheques into third party accounts. This result cannot be supported.

76 In my view, the "person" in s. 165(3) must mean a person who is entitled to the cheque. This means that only the payee or the legitimate endorsee of the payee would qualify as a "person" for the purposes of s. 165(3). The purpose of s. 165(3), in my view, is to deal with, among others, situations like the one that arose in *Royal Bank of Canada v. Wild* (1974), 51 D.L.R. (3d) 188 (Ont. C.A.), that is, where a payee deposits a cheque to his or her own account without endorsement, and to deal with restrictive endorsements. In that case, a cheque

poursuivre, comme elle l'entend, le tireur ou les endosseurs, et ce, quel que soit son lien avec l'endosseur, on comprend facilement pourquoi l'on craint que la disposition ait contribué énormément à renforcer la situation en droit des banques déposantes.

La professeure Martin examine, dans son article, si l'on peut restreindre la portée du par. 165(3) en donnant une interprétation stricte à ses exigences préliminaires; cependant, elle conclut qu'il serait difficile d'en restreindre la portée.

Le professeur Scott va même jusqu'à dire que le par. 165(3) [TRADUCTION] «doit être abrogé sommairement» étant donné que «[s]on maintien dans les recueils de lois canadiennes est totalement injustifié» (p. 97). À son avis, il ne serait pas nécessaire de remplacer cette disposition, mais il propose certaines modifications (à la p. 97).

L'intimée soutient que, suivant le sens ordinaire du par. 165(3), elle a acquis les droits d'un détenteur régulier puisque les chèques en question ont vraiment été «livré[s] à une banque en vue de son dépôt au compte d'une personne», et que la CIBC a porté au crédit de cette personne «le montant du chèque». À prime abord, cette interprétation semble intéressante. Cependant, elle aurait des conséquences profondes et d'une portée excessive.

Si l'on adoptait l'interprétation préconisée par l'intimée, une banque n'aurait jamais besoin d'exiger un endossement et la distinction entre les chèques payables à ordre et ceux payables au porteur serait sans importance. Une banque serait toujours à l'abri des conséquences de l'acceptation de chèques non endossés pour dépôt dans le compte d'une tierce partie. Ce résultat est insoutenable.

À mon avis, la «personne» visée au par. 165(3) doit être une personne ayant droit au chèque. Cela signifie que seul le preneur ou l'endossataire légitime du preneur pourrait être qualifié de «personne» pour les fins du par. 165(3). J'estime que le par. 165(3) vise notamment des situations comme celle qui existait dans l'arrêt *Royal Bank of Canada c. Wild* (1974), 51 D.L.R. (3d) 188 (C.A. Ont.), c'est-à-dire celle où un preneur dépose un chèque dans son compte sans endossement, et qu'il vise aussi l'endossement restrictif. Dans l'arrêt drawn by Wild and payable to Interlocking Building Systems Limited was delivered to the bank by the payee, to be deposited to the credit of his account. The words "for deposit only to the credit of Interlocking Building Systems Limited, dealer's account" were typed on the back of the cheque. There was no actual signature by way of endorsement on the cheque. The cheque was credited to the payee's account. When the cheque was presented by the collecting bank to the drawee, it was dishonoured, and charged back to the account of the payee. However, the funds in the payee's account were insufficient, there being an overdraft of $1,550. Several months later, the collecting bank demanded payment from the drawer of the cheque, Wild. The defendant conceded that the collecting bank had acquired the rights of a holder in due course by virtue of s. 165(3) of the Act.

In *Wild*, the bank, but for s. 165(3), could not have taken title to the cheque, since a cheque that is payable to order must be endorsed to be negotiated (s. 59(3)). The bank could not then be a holder in due course, and would be exposed to any equities between the payee and the drawer of the cheque. Section 165(3) remedies this situation. As long as a payee or endorsee is entitled to the proceeds of the cheque, the cheque can be deposited without endorsement without harming the position of the bank.

Section 165(3) represents a policy decision with respect to the allocation of risk. When a collecting bank is presented with a cheque for deposit to the credit of the payee, the bank is entitled, essentially, to assume that it was truly the intention of the drawer that the payee receive the proceeds of the cheque. It is more difficult for a fraudulent employee to manage to have cheques wrongfully made out in their own name; the likelihood with respect to cheques presented by the payee is that they are genuine. Accordingly, a policy decision has been made to overlook the lack of endorsement with respect to these cheques, to prevent the bank from being exposed to personal defences and defects in title should the cheque be dishonoured. The collecting bank is permitted to overlook endorsement with respect to these cheques,

Wild, un chèque tiré par Wild et payable à Interlocking Building Systems Limited avait été livré à la banque par le preneur pour être déposé dans son compte. À l'endos du chèque était dactylographiée la phrase suivante: [TRADUCTION] «pour dépôt seulement au crédit d'Interlocking Building Systems Limited, compte du marchand». Le chèque n'avait pas été endossé. Il a été déposé au compte du preneur. Lorsque la banque d'encaissement a présenté ce chèque au tiré, il a été refusé et débité du compte du preneur. Cependant, le compte du preneur ne contenait pas suffisamment de fonds, présentant un découvert de 1 550 $. Plusieurs mois plus tard, la banque d'encaissement a exigé le paiement du tireur du chèque, Wild. Le défendeur a reconnu que la banque d'encaissement avait acquis les droits d'un détenteur régulier en application du par. 165(3) de la Loi.

Dans l'arrêt *Wild*, n'eût été le par. 165(3), la banque n'aurait pu obtenir le titre sur le chèque puisqu'un chèque payable à ordre se négocie par endossement (par. 59(3)). La banque ne pouvait alors être un détenteur régulier, et était sujette à tout droit susceptible d'exister en *equity* entre le preneur et le tireur du chèque. Le paragraphe 165(3) remédie à cette situation. Dans la mesure où un preneur ou un endossataire a droit au montant du chèque, le chèque peut être déposé sans endossement sans nuire à la situation de la banque. 77

Le paragraphe 165(3) représente une décision de principe relative à la répartition du risque. Lorsqu'une banque d'encaissement se voit présenter un chèque pour dépôt au crédit du preneur, elle a essentiellement le droit de supposer que le tireur voulait réellement que le preneur reçoive le montant du chèque. Il est plus difficile pour un employé fraudeur de faire illicitement tirer des chèques à son nom; il est probable que les chèques présentés par le preneur seront authentiques. En conséquence, on a pris la décision de principe d'ignorer l'absence d'endossement sur ces chèques de façon à empêcher que la banque se voie opposer des moyens de défense personnels et qu'elle se trouve en possession de titres défectueux, au cas où ces chèques seraient refusés. La banque d'encaissement est autorisée à ignorer l'absence d'en- 78 because it is very likely that they are indeed genuine.

79 However, the likelihood of fraud is dramatically higher when a person presents a third party cheque, particularly when it bears no endorsement. A collecting bank is not permitted to assume that the transaction is genuine in the face of circumstances that are so clearly prone to fraud. This is why the collecting bank is required, in the case of third party cheques, to ensure that they have been endorsed. It should be remembered that it was the respondent's own internal policy that third party cheques were not to be accepted without endorsement.

80 To some, the allocation of risk in the bills of exchange system may seem arbitrary, but in my view a necessary and coherent rationale sustains this allocation. With respect to forged endorsements, for example, no party in particular is in any better position to detect the fraud than any other. It is a risk that all parties must bear, including collecting banks. It is a price that must be paid if one wishes to enjoy the significant benefits of the bills of exchange scheme, not the least of which is, from the bank's perspective, the facilitation of huge numbers of financial dealings conducted rapidly, and without overwhelming transaction costs. While the banks are accorded the important advantage of holder in due course status in many situations, it would not be appropriate, as the respondent would have it, to exempt any party, including collecting banks, from all exposure to the risk and consequence of fraud.

81 In my view, s. 165(3) does not apply to the facts of this case. Alm was not the payee or a legitimate endorsee of the cheques in question. Accordingly, she was not a "person" within the meaning of s. 165(3). Absent valid endorsements, the cheques were not validly negotiated to the bank. As a result, CIBC took the cheques subject to the equities of the situation. Alm was not entitled to the cheques, but CIBC credited her with the amount of those cheques. This constitutes conversion, for which CIBC is strictly liable.

dossement sur ces chèques étant donné qu'il est fort probable qu'ils sont vraiment authentiques.

Cependant, le risque de fraude est sensiblement plus grand lorsqu'une personne présente un chèque d'une tierce partie, et plus particulièrement s'il n'est pas endossé. Une banque d'encaissement ne peut pas présumer que l'opération est authentique dans des circonstances qui se prêtent aussi clairement à la fraude. C'est pourquoi la banque d'encaissement doit veiller à ce que les chèques de tierces parties soient endossés. Il faudrait se rappeler que l'intimée avait comme politique interne de ne pas accepter les chèques de tierces parties non endossés.

Pour certains, la répartition du risque à l'intérieur du régime des lettres de change peut sembler arbitraire; cependant, j'estime que cette répartition a une raison d'être logique et nécessaire. Par exemple, en ce qui concerne les endossements falsifiés, une partie n'est jamais mieux placée qu'une autre pour déceler la fraude. C'est un risque qui doit être assumé par toutes les parties, y compris les banques d'encaissement. C'est le prix à payer si l'on désire bénéficier des avantages considérables qu'offre le régime des lettres de change, dont n'est pas le moindre celui, du point de vue des banques, de faciliter l'exécution rapide d'une multitude d'opérations financières, sans frais exorbitants. Même si, dans bien des cas, les banques ont l'avantage important de posséder le statut de détenteur régulier, il ne conviendrait pas de mettre toute partie, y compris les banques d'encaissement, à l'abri du risque et des conséquences de la fraude, comme le préconise l'intimée.

À mon avis, le par. 165(3) ne s'applique pas aux faits de la présente affaire. Alm n'était ni le preneur ni un endossataire légitime des chèques en question. En conséquence, elle n'était pas une «personne» au sens du par. 165(3). Sans endossement valide, les chèques n'ont pas été validement négociés à la banque. En conséquence, la CIBC a accepté les chèques sous réserve des droits susceptibles d'exister en *equity*. Alm n'avait pas droit aux chèques, mais la CIBC lui en a crédité le montant. Cela constitue un détournement dont la CIBC a la responsabilité stricte.

VI. Conclusions and Disposition

A bill of exchange is a chattel that can be negotiated from party to party. Title to a bill, such as a cheque, is obtained through negotiation. Once an individual has obtained title, that individual has the right to present the bill to the drawee for payment, as well as a right of recovery against the drawer if the bill is dishonoured by the drawee.

A bank converts an instrument, including a cheque, by dealing with it under the direction of one not authorized, by collecting it and making the proceeds available to someone other than the person rightfully entitled to possession. It should be noted that the tort of conversion is one of strict liability.

The respondent has agreed that it is *prima facie* liable to the drawer for conversion, and focuses instead on possible defences. I have concluded that the Court of Appeal was in error in holding that the action for conversion must fail with respect to the 146 cheques signed by Alm, having focused incorrectly on the intention of Alm, rather than the intention of the drawer. The respondent is indeed *prima facie* liable for conversion with respect to all of the cheques in question.

It is my further conclusion that s. 20(5) offers no defence to the respondent in the circumstances of this case. None of the cheques in question was payable to a fictitious person, in my view. Again, it is the intention of the drawer, in the sense of the one from whose account the cheques are drawn, that is of relevance, rather than the intention of the signatory. The drawer and the signatory may be one and the same in some instances, but this is not the situation in the instant appeal. As none of the cheques was payable to a fictitious person, the cheques could not be treated as payable to bearer by the CIBC. Accordingly, in order to be negotiated, the cheques had to be validly endorsed as well as delivered.

VI. Conclusions et dispositif

82 Une lettre de change est un bien qui peut être négocié d'une partie à une autre. Le titre sur une lettre de change, comme un chèque, s'obtient par négociation. La personne qui obtient ce titre a le droit de présenter la lettre de change au tiré pour paiement ainsi que celui de recouvrer cette somme auprès du tireur si la lettre est refusée par le tiré.

83 Une banque détourne un effet, y compris un chèque, en le traitant sur l'ordre d'une personne non autorisée, en l'encaissant et en en remettant le montant à une personne autre que celle qui y a légitimement droit. Il y a lieu de souligner que le délit de détournement est un délit de responsabilité stricte.

84 L'intimée a reconnu qu'elle était responsable à première vue de détournement envers le tireur, et a plutôt mis l'accent sur des moyens de défense possibles. J'ai conclu que la Cour d'appel a commis une erreur en statuant que l'action pour détournement devait échouer relativement aux 146 chèques signés par Alm, du fait qu'elle s'était concentrée à tort sur l'intention de Alm plutôt que sur celle du tireur. L'intimée est, en fait, responsable à première vue de détournement à l'égard de tous les chèques en cause.

85 Je conclus également que le par. 20(5) n'offre à l'intimée aucun moyen de défense dans les circonstances de l'espèce. À mon avis, aucun des chèques en question n'était payable à une personne fictive. Je répète que c'est l'intention du tireur, au sens de celui sur le compte duquel les chèques sont tirés, qui est pertinente et non celle du signataire. Il se peut, dans certains cas, que le tireur et le signataire soient une seule et même personne, mais ce n'est pas le cas en l'espèce. Puisque aucun des chèques n'était payable à une personne fictive, la CIBC ne pouvait les considérer comme payables au porteur. En conséquence, pour être négociés, les chèques devaient être validement endossés et livrés.

86 I have also concluded that the CIBC did not acquire the rights of a holder in due course pursuant to s. 165(3), for the reason that the person to whose account the cheques were deposited was not a legitimate payee or endorsee, but a third party. Absent valid endorsements, Alm could not validly negotiate the cheques to the bank. As a result, the CIBC took the cheques subject to the equities of the situation, and is liable for conversion with respect to those cheques.

J'ai aussi conclu que la CIBC n'avait pas acquis les droits d'un détenteur régulier conformément au par. 165(3), parce que la personne au compte de laquelle les chèques ont été déposés était non pas un preneur ou un endossataire légitime, mais une tierce partie. Sans endossement valide, Alm ne pouvait pas négocier validement les chèques à la banque. En conséquence, la CIBC a accepté les chèques sous réserve des droits susceptibles d'exister en *equity* et elle est responsable de détournement à l'égard de ces chèques.

87 Accordingly, I would allow the appeal with costs throughout, dismiss the cross-appeal with costs, set aside the judgment of the Court of Appeal, and restore the trial judgment against the CIBC for the full amount of the cheques in question, that is $91,289.54 plus interest.

En conséquence, je suis d'avis d'accueillir le pourvoi principal avec dépens dans toutes les cours, de rejeter le pourvoi incident avec dépens, d'infirmer l'arrêt de la Cour d'appel et de rétablir le jugement du juge de première instance ordonnant à la CIBC de payer le plein montant des chèques en cause, soit la somme de 91 289,54 $ plus les intérêts.

The reasons of La Forest and McLachlin JJ. were delivered by

Version française des motifs des juges La Forest et McLachlin rendus par

88 LA FOREST J. (dissenting on the appeal) — I have had the advantage of reading the reasons of my colleague, Justice Iacobucci, but, with respect, I am unable to agree with the result he has arrived at and with much of his reasoning. While we are at one in concluding that, absent any applicable defences, the respondent bank is liable to the appellants for conversion, our paths diverge as regards the application of one of those defences. As I see it, s. 20(5) of the *Bills of Exchange Act*, R.S.C., 1985, c. B-4 (the "Act"), provides a defence to the respondent for all but $1,655.17 of the total amount claimed by the appellants. However, for somewhat different reasons, I agree with the interpretation of s. 165(3) arrived at by my colleague and that it is not available to the respondent on the facts of this case.

LE JUGE LA FOREST (dissident quant au pourvoi principal) — J'ai pris connaissance des motifs de mon collègue le juge Iacobucci mais, en toute déférence, je ne puis souscrire au résultat auquel il est arrivé ni à une grande partie de son raisonnement. Bien que nous soyons d'accord pour conclure que, en l'absence de moyens de défense applicables, la banque intimée est responsable de détournement envers les appelantes, nos points de vue divergent sur l'application de l'un de ces moyens de défense. À mon sens, le par. 20(5) de la *Loi sur les lettres de change*, L.R.C. (1985), ch. B-4 (la «Loi»), fournit à l'intimée un moyen de défense relativement au total réclamé par les appelantes, sauf en ce qui concerne la somme de 1 655,17 $. Toutefois, pour des raisons quelque peu différentes, je souscris à la façon dont mon collègue interprète le par. 165(3) et je suis d'accord avec lui pour dire que, d'après les faits du présent pourvoi, il ne peut être invoqué par l'intimée.

89 My colleague has summarized the facts and the judicial history of the case. I find it unnecessary to repeat the latter, but I do feel it is necessary to

Mon collègue a résumé les faits et l'historique judiciaire de l'affaire. J'estime inutile de reprendre cet historique, mais je considère nécessaire de briefly review the facts. The appellants, Boma Manufacturing Ltd. and Panabo Sales Ltd., are two small, family-owned, manufacturing companies whose only shareholders and officers are Boris Mange and his wife Ursula Mange. From 1967 to 1987 the appellants employed a bookkeeper, Donna Alm, who, along with Boris and Ursula Mange, was an authorized signing officer for both companies with respect to the appellants' accounts at the Royal Bank of Canada. Cheques drawn on these accounts required the signature of only one authorized signing officer. Over a five-year period, from 1982 to 1987, Ms. Alm defrauded the appellants of $91,289.54 by issuing and depositing to her own accounts with the respondent a total of 155 cheques drawn on the account of the appellants and fraudulently made out to third parties. Of the 155 cheques, 146 were signed personally by Ms. Alm in her capacity as signing officer; the remaining nine were prepared by Ms. Alm but signed by the president of the appellants, Boris Mange. The cheques were presented for deposit by Ms. Alm at her regular branch of the respondent CIBC. Ms. Alm had forged endorsements on some of the cheques but not on others. In any event, all of the cheques were accepted by the bank and Ms. Alm was credited with the face amount in each case.

In addition to grouping the 155 cheques depending on who signed them, it is also possible to group the cheques depending on the nature of the payee. Forty-one of the cheques were made out to existing employees of the appellants, including 34 which were variously made out to Boris Mange, Ursula Mange, and their son Michael Mange. Of the 41 cheques made out to existing employees of the appellants, 38 were signed by Ms. Alm herself and three by Boris Mange. The remaining 114 cheques were variously made out to "J. Lam", "J. R. Lam", or "D. Lam". The appellants had previously engaged a subcontractor by the name of Van Sang Lam but had never employed or had dealings with anyone by the name of J. Lam, J. R. Lam, or D. Lam. Of these 114 cheques, six were signed by Boris Mange and the remaining 108 by Ms. Alm.

revoir brièvement les faits. Les appelantes, Boma Manufacturing Ltd. et Panabo Sales Ltd., sont deux petites entreprises familiales de fabrication dont les seuls actionnaires et dirigeants sont Boris Mange et son épouse Ursula Mange. De 1967 à 1987, les appelantes ont employé comme aide-comptable Donna Alm qui, à l'instar de Boris et d'Ursula Mange, était une signataire autorisée des deux sociétés relativement aux comptes des appelantes à la Banque Royale du Canada. Les chèques tirés sur ces comptes n'exigeaient qu'une signature autorisée. Au cours d'une période de cinq ans, de 1982 à 1987, M^{me} Alm a escroqué aux appelantes la somme de 91 289,54 $, en émettant et en déposant, dans ses propres comptes chez l'intimée, 155 chèques au total, tirés sur les comptes des appelantes et émis frauduleusement au nom de tierces parties. Parmi ces 155 chèques, 146 avaient été signés personnellement par M^{me} Alm en sa qualité de signataire autorisée; les neuf autres chèques avaient été rédigés par M^{me} Alm, mais signés par le président des appelantes, Boris Mange. Les chèques ont été présentés pour dépôt par M^{me} Alm à sa succursale habituelle de l'intimée la CIBC. Madame Alm avait contrefait l'endossement sur certains des chèques seulement. De toute façon, tous les chèques ont été acceptés par la banque et la somme inscrite sur chacun a été portée au crédit de M^{me} Alm.

En plus de grouper les 155 chèques selon l'identité de leur signataire, il est aussi possible de les grouper selon l'identité du preneur. Quarante et un chèques étaient payables à des employés existants des appelantes, dont 34 à Boris Mange, à Ursula Mange ou encore à leur fils Michael Mange. Parmi les 41 chèques payables à des employés existants des appelantes, 38 avaient été signés par M^{me} Alm elle-même, et trois par Boris Mange. Les 114 autres chèques étaient payables à « J. Lam», à «J. R. Lam» ou encore à «D. Lam». Les appelantes avaient antérieurement retenu les services d'un sous-traitant appelé Van Sang Lam, mais n'avaient jamais employé quelqu'un qui s'appelait J. Lam, J. R. Lam ou D. Lam, ni fait affaire avec une personne de ce nom. Parmi ces 114 chèques, six avaient été signés par Boris Mange, et les 108 autres par M^{me} Alm. 90

Fictitious and Non-Existing Payees

91 As noted by my colleague, s. 20(5) of the Act provides a defence to the respondent bank against an action for conversion in that a bill that is payable to a fictitious or non-existing person may be treated as payable to bearer. In so far as this section applies to any of the cheques which are the subject of the present appeal, the respondent stands in the position of a holder in due course of such cheques and cannot be sued for conversion by the drawer. On the facts of this case two different issues must be addressed under this section. First, are the 41 cheques which Ms. Alm made out to existing employees payable to fictitious persons? Second, are the 114 cheques with "J. Lam", "J. R. Lam", or "D. Lam" as the payee cheques made out to non-existent payees within the meaning of s. 20(5)? In addressing these questions it is necessary to remember that the cheque system is but one part of the bills of exchange system and that the underlying principles of the Act, including those of negotiability, certainty, and finality respecting commercial paper and commercial paper transactions, must be respected.

92 In addressing the first of these questions my colleague relies on the rules enunciated by Dean Falconbridge in the sixth edition of his textbook, *Banking and Bills of Exchange* (1956), at pp. 468-69, which read:

> Whether a named payee is non-existing is a simple question of fact, not depending on anyone's intention. The question whether the payee is fictitious depends upon the intention of the creator of the instrument, that is, the drawer of a bill or cheque or the maker of a note.
>
> In the case of a bill drawn by Adam Bede upon John Alden payable to Martin Chuzzlewit, the payee may or may not be fictitious or non-existing according to the circumstances:
>
> (1) If Martin Chuzzlewit is not the name of any real person known to Bede, but is merely that of a creature of the imagination, the payee is non-existing, and is probably also fictitious.

Preneurs fictifs ou qui n'existent pas

Comme l'a souligné mon collègue, le par. 20(5) de la Loi fournit à la banque intimée un moyen de défense contre toute action pour détournement en ce sens qu'une lettre de change payable à une personne fictive ou qui n'existe pas peut être considérée comme payable au porteur. Dans la mesure où cette disposition s'applique à l'un ou l'autre des chèques qui font l'objet du présent pourvoi, l'intimée est le détenteur régulier de ces chèques et ne peut pas être poursuivie pour détournement par le tireur. D'après les faits de la présente affaire, cette disposition soulève deux questions distinctes. Premièrement, les 41 chèques que M^me^ Alm a tirés au nom d'employés existants sont-ils payables à des personnes fictives? Deuxièmement, les 114 chèques dont le preneur est «J. Lam», «J. R. Lam» ou «D. Lam» sont-ils payables à des preneurs qui n'existent pas au sens du par. 20(5)? Pour répondre à ces questions, il faut se rappeler que le régime des chèques n'est qu'un élément du régime des lettres de change et qu'il faut respecter les principes sous-jacents de la Loi, dont ceux de la négociabilité, de la certitude et de l'irrévocabilité des effets de commerce et des transactions en matière d'effets de commerce.

En abordant la première question, mon collègue s'appuie sur les règles énoncées par le doyen Falconbridge dans la sixième édition de son traité intitulé *Banking and Bills of Exchange* (1956), aux pp. 468 et 469:

> [TRADUCTION] La question de savoir si un preneur nommé est une personne qui n'existe pas est une simple question de fait qui ne dépend de l'intention de personne. Celle de savoir si le preneur est une personne fictive dépend de l'intention de l'auteur de l'effet, à savoir le tireur d'une lettre de change ou d'un chèque, ou encore l'auteur d'un billet.
>
> Dans le cas d'une lettre de change dont le tireur est Adam Bede, le tiré John Alden et le preneur Martin Chuzzlewit, ce dernier est fictif ou inexistant ou ne l'est pas selon les circonstances:
>
> (1) Si Martin Chuzzlewit n'est pas le nom d'une personne existante que Bede connaît, mais seulement le fruit de l'imagination de ce dernier, le preneur est inexistant et, vraisemblablement aussi, fictif.

(2) If Bede for some purpose of his own inserts as payee the name of Martin Chuzzlewit, a real person who was known to him but whom he knows to be dead, the payee is non-existing, but is not fictitious.

(3) If Martin Chuzzlewit is the name of a real person known to Bede, but Bede names him as payee by way of pretence, not intending that he should receive payment, the payee is fictitious, but is not non-existing.

(4) If Martin Chuzzlewit is the name of a real person, intended by Bede to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that Bede has been induced to draw the bill by the fraud of some other person who has falsely represented to Bede that there is a transaction in respect of which Chuzzlewit is entitled to the sum mentioned in the bill.

In his reasons, my colleague accepts these rules and interprets them as standing for the proposition that where a drawer does not intend a named payee to receive payment, the payee is fictitious and the bill must be read as payable to bearer. Applying this proposition to the facts of the case he states that the intention of the signor, Ms. Alm, cannot be equated to that of the drawer, the appellant companies, as Ms. Alm is not a guiding mind of the corporations. In consequence, the fourth rule applies and the payees are not fictitious within the meaning of s. 20(5).

The proposition embodied by s. 20(5) as it relates to the actions of fraudulent employees has been the subject of considerable judicial attention, starting with the House of Lords' decision in *Bank of England v. Vagliano Brothers*, [1891] A.C. 107, and continuing up until this Court's decisions in *Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd.*, [1977] 2 S.C.R. 456, and *Fok Cheong Shing Investments Co. v. Bank of Nova Scotia*, [1982] 2 S.C.R. 488. It is fair to say that Dean Falconbridge's fourth rule, which encompasses the situation of the fraudulent employee, merely reflects one line of reasoning within the jurisprudence (see *Vinden v. Hughes*, [1905] 1 K.B. 795, and *Harley v. Bank of Toronto*, [1938] 2 D.L.R. 135 (Ont. C.A.)), and does not take into account various decisions that have gone the other way (see *London Life Insurance Co. v. Molsons Bank* (1904), 8 O.L.R. 238 (C.A.), and *Metropoli-*

(2) Si Bede, pour ses fins propres, inscrit comme preneur le nom de Martin Chuzzlewit, une personne ayant déjà existé, qu'il connaissait et sait être décédée, le preneur est inexistant mais il n'est pas fictif.

(3) Si Martin Chuzzlewit est le nom d'une personne existante que Bede connaît, mais qu'il inscrit comme preneur dans un but frauduleux n'ayant pas l'intention d'avantager monétairement ce preneur, le preneur est une personne fictive mais non inexistante.

(4) Si Martin Chuzzlewit est le nom d'une personne existante à qui Bede destine le paiement, le preneur n'est ni fictif, ni inexistant, quoique Bede ait été amené à rédiger la lettre de change par des manœuvres frauduleuses d'une autre personne qui a fait croire à Bede qu'il y a une transaction au regard de laquelle Chuzzlewit a droit au montant spécifié dans la lettre de change.

Dans ses motifs, mon collègue accepte ces règles et les interprète comme établissant que, lorsque le tireur ne veut pas que le preneur nommé reçoive paiement, le preneur est fictif et la lettre doit être interprétée comme payable au porteur. Appliquant cette proposition aux faits de la présente affaire, il affirme que l'intention de la signataire, M[me] Alm, ne peut pas être assimilée à celle du tireur, les compagnies appelantes, étant donné qu'elle n'est pas l'âme dirigeante de ces compagnies. En conséquence, la quatrième règle s'applique et les preneurs ne sont pas fictifs au sens du par. 20(5).

La proposition contenue au par. 20(5) en ce qui a trait aux actes d'employés malhonnêtes a abondamment retenu l'attention des tribunaux, à commencer par l'arrêt de la Chambre des lords *Bank of England c. Vagliano Brothers*, [1891] A.C. 107, jusqu'aux arrêts de notre Cour *Banque Royale du Canada c. Concrete Column Clamps (1961) Ltd.*, [1977] 2 R.C.S. 456, et *Fok Cheong Shing Investments Co. c. Banque de Nouvelle-Écosse*, [1982] 2 R.C.S. 488. Il est juste de dire que la quatrième règle du doyen Falconbridge, qui vise le cas de l'employé malhonnête, ne reflète qu'un raisonnement dans la jurisprudence (voir *Vinden c. Hughes*, [1905] 1 K.B. 795, et *Harley c. Bank of Toronto*, [1938] 2 D.L.R. 135 (C.A. Ont.)), et ne tient pas compte des diverses décisions qui sont allées dans le sens contraire (voir *London Life Insurance Co. c. Molsons Bank* (1904), 8 O.L.R. 238 (C.A.), et *Metropolitan Life Insurance Co. c.* 93

tan Life Insurance Co. v. Quebec Bank (1916), 50 C.S. 214). This fact has been acknowledged in the latest edition of the textbook (Crawford and Falconbridge, *Banking and Bills of Exchange* (8th ed. 1986), vol. 2), where the editor, Bradley Crawford, is critical both of the fourth rule and the cases that have produced it (at pp. 1259 and 1261):

> The Canadian courts have been led into error by Warrington J. in *Vinden v. Hughes* and Dean Falconbridge's endorsement of that judgment in early editions of this treatise.
>
> . . .
>
> It is probably of no use to point out that Falconbridge's fourth proposition never was in accord with the actual result in *Vagliano's* case where, it may be recalled, the acceptor was deceived by his clerk into signing bills he thought represented real transactions with real persons.

94 The problem with any black letter rule of law is that it offers no insight into the competing interests that underlie the conflict it allegedly resolves. Unfortunately, the cases that led to the formulation of Falconbridge's fourth rule, and those that have applied it, have by and large also failed to consider these competing interests as well as the policy considerations inherent in the conflict. In the case of s. 20(5), the underlying conflict that arises when trying to decide its scope and application is that of the allocation of loss as between the accepting bank and the drawer of a fraudulent cheque. This conflict becomes ripe when it is an employee of the drawer, or a third person, that perpetrates the fraud and the loss must be borne by one of two innocent parties: the employer/drawer or the accepting bank.

95 As between the employer/drawer and the accepting bank, the questions are who should bear the risk of any loss and who is in the best position to minimize that risk. The answer to both these questions must, I suggest, be the employer/drawer. In cases such as the one at bar the accepting bank usually receives the fraudulent cheques from the hands of one of its customers who passes himself or herself off as the endorsee or holder of the

Quebec Bank (1916), 50 C.S. 214). Ce fait a été reconnu dans la dernière édition de Crawford et Falconbridge, *Banking and Bills of Exchange* (8e éd. 1986), vol. 2, où le directeur, Bradley Crawford, critique à la fois la quatrième règle et la jurisprudence dont elle émane (aux pp. 1259 et 1261):

> [TRADUCTION] Les tribunaux canadiens ont été induits en erreur par le juge Warrington dans *Vinden c. Hughes* et par l'approbation de cet arrêt que le doyen Falconbridge a donnée dans les premières éditions du présent traité.
>
> . . .
>
> Il est probablement inutile de souligner que la quatrième proposition de Falconbridge n'a jamais été conforme au résultat réel de l'arrêt *Vagliano*, dans lequel, on s'en souviendra, l'accepteur a été amené par son commis à signer des effets qui, croyait-il, représentaient des transactions réelles avec des personnes réelles.

Le problème que pose toute règle de droit immuable réside dans le fait qu'elle ne donne aucun aperçu des intérêts opposés qui sous-tendent le conflit qu'elle est censée résoudre. Malheureusement, la jurisprudence qui a conduit à la formulation de la quatrième règle de Falconbridge et celle qui l'a appliquée n'ont pas non plus, de façon générale, tenu compte de ces intérêts opposés, ni des considérations de principe inhérentes au conflit. Dans le cas du par. 20(5), le conflit sous-jacent à toute tentative d'en déterminer la portée et l'application réside dans la répartition de la perte entre la banque qui a accepté un chèque frauduleux, et le tireur de ce chèque. Ce conflit atteint son paroxysme quand c'est un employé du tireur, ou un tiers, qui commet la fraude et que la perte doit être assumée par l'une de deux parties innocentes: l'employeur-tireur ou la banque-accepteur.

En ce qui concerne l'employeur-tireur et la banque-accepteur, il faut se demander qui doit assumer le risque de perte et qui est le mieux placé pour réduire au minimum ce risque. À ces deux questions, il faut, selon moi, répondre: l'employeur-tireur. Dans un cas comme celui qui nous occupe, la banque-accepteur reçoit habituellement les chèques frauduleux de l'un de ses clients qui se fait passer pour l'endossataire ou le détenteur du cheque. Since the named payee is generally a stranger to the bank, the requirement of an endorsement on the cheque will more often than not be ineffective in protecting against fraud. As demonstrated by the facts of this case, it is easy enough for the perpetrator to forge the endorsement of the named payee and there is no way for the bank to verify the authenticity of the signature. On the other hand, the drawer/employer is in a much better position to put a stop to fraud of this type and is at least in an equal position to bear any loss. As a matter of course, any risk of loss on the part of a large corporation is generally covered by fidelity insurance. It is also possible for large scale fraud to be discovered through audits or other protective measures. If the drawer is a small company, as in the case at bar, then it is in an excellent position to detect the fraud at an early stage and in that way minimize the loss. From the facts of the present case it is clear that the only reason Ms. Alm was able to continue her illegal activities for such a long time was because no internal or independent audit was ever conducted by the appellants; nor was there a routine inspection of the cheque register or monthly bank statements. In short, the party in the best position to stop the fraudulent activity was, and generally is, the drawer/employer. In such a situation it makes sense to allocate the risk of loss to the drawer so that the proper steps can be taken to minimize such losses.

The problem with allocating the loss to the accepting bank is that it removes all incentive from a corporation to pursue business practices that will minimize such losses. Furthermore it has the effect of putting the accepting bank in the position of fidelity insurer for the appellants. I can see no justification for such a step. There is no doubt that the chartered banks, and trust companies for that matter, benefit from the existence of the chequing system. However it is also true that the business community in general also depends on the same

chèque. Puisque le preneur nommé est généralement un étranger pour la banque, l'exigence d'endossement du chèque s'avère le plus souvent un moyen inefficace de la protéger contre la fraude. Comme le montrent les faits de la présente affaire, le fraudeur peut assez aisément falsifier l'endossement du preneur nommé et la banque n'a aucun moyen de vérifier l'authenticité de la signature. En revanche, l'employeur-tireur est beaucoup mieux placé pour mettre fin à ce genre de fraude et est au moins aussi bien placé pour assumer toute perte subie. Il va sans dire que tout risque de perte auquel est exposée une grande entreprise est généralement couvert par une assurance contre les détournements. Il est également possible de déceler la fraude sur grande échelle par des vérifications et d'autres mesures de protection. Si le tireur est une petite entreprise, comme c'est le cas en l'espèce, il est alors très bien placé pour déceler rapidement la fraude et pour réduire ainsi au minimum la perte. Il ressort clairement des faits de la présente affaire que si M[me] Alm a été en mesure de poursuivre ses activités illégales pendant aussi longtemps, c'est uniquement parce que les appelantes n'ont jamais effectué de vérification interne ou indépendante, et qu'il n'y a eu aucune inspection systématique du registre des chèques ou des relevés bancaires mensuels. Bref, la partie la mieux placée pour mettre fin à l'activité frauduleuse était, et est en règle générale, l'employeur-tireur. En pareil cas, il est logique de faire assumer le risque de perte par le tireur de manière à pouvoir prendre les mesures appropriées pour réduire au minimum ces pertes.

Le problème qui se pose en faisant assumer la perte par la banque-accepteur, c'est que cela enlève à une société toute incitation à poursuivre des pratiques commerciales propres à réduire au minimum ces pertes. De plus, la banque-accepteur se voit ainsi obligée de jouer le rôle d'assureur des appelantes contre les détournements. Je ne vois rien qui justifie une telle mesure. Il n'y a pas de doute que les banques à charte, tout comme les sociétés de fiducie, tirent profit de l'existence du régime de chèques. Toutefois, il est également vrai 96 chequing system to facilitate the function of commerce.

que le milieu des affaires en général compte lui aussi sur le même régime de chèques pour faciliter le commerce.

97 A second problem with allocating the loss to the accepting bank is that it does not fit in well with the general scheme of bills of exchange. The essence of a bill of exchange is its negotiability and the finality of payment inherent to such a negotiation. Imposing liability on the accepting bank rather than upon the party in the position to stop the fraud is inconsistent with these policies. Whether one is talking about the situation where a signing officer has acted fraudulently, or the situation where a payroll clerk induces an innocent signing officer to sign a fraudulent cheque, allocating the loss to the accepting bank would create a situation where the bank would be required to verify the validity of every single cheque it receives involving a corporate drawer. Applying such a scheme to the facts of the present case would have demanded that every time the respondent received a cheque drawn by the appellants it should have called the president of the appellants, Boris Mange, and verified with him that the appellants had truly intended to issue the cheque to the payee. Besides being impractical, such a procedure is simply not in keeping with the purpose or the scheme of the Act.

Le deuxième problème qui se pose en faisant assumer la perte par la banque-accepteur, c'est que cela ne cadre pas bien avec l'économie du régime des lettres de change. L'essence d'une lettre de change est sa négociabilité et l'irrévocabilité du paiement inhérent à la négociation de cette lettre. Imposer la responsabilité à la banque-accepteur plutôt qu'à la partie qui est en mesure de mettre fin à la fraude est incompatible avec ces principes. Peu importe qu'il soit question du cas où un signataire autorisé a agi frauduleusement, ou de celui où un préposé à la paie amène un signataire autorisé innocent à signer un chèque frauduleux, faire assumer la perte par la banque-accepteur engendrerait une situation où cette dernière serait tenue de vérifier la validité de chaque chèque tiré par une personne morale qui lui serait présenté. Si pareil régime avait été appliqué aux faits de la présente affaire, l'intimée aurait été tenue, chaque fois qu'elle aurait reçu un chèque des appelantes, de communiquer avec leur président, Boris Mange, pour s'assurer que les appelantes avaient vraiment eu l'intention d'émettre le chèque au preneur. En plus de ne pas être pratique, cette façon de procéder est simplement contraire à l'objet ou à l'économie de la Loi.

98 Notwithstanding what I see as the convincing policy arguments in favour of imposing the loss on the drawer/employer, I remain bound by this Court's decision in *Concrete Column*, *supra*. In that case a majority of the Court held that where a payroll clerk had fraudulently filled out company cheques, and then fraudulently induced a signing officer to sign those cheques, they did not fall within the scope of s. 20(5). The intent of the payroll clerk was not the intent of the drawer; when he signed the cheques the latter had actually intended the named payees to receive payment. On its face the majority judgment endorses the fourth of Falconbridge's rules, but as Laskin C.J. noted in

Malgré ce que je considère comme des arguments de principe convaincants qui justifient de faire assumer la perte par l'employeur-tireur, je demeure lié par l'arrêt de notre Cour *Concrete Column*, précité. Dans cet arrêt, notre Cour à la majorité a décidé que, lorsqu'un préposé à la paie a tiré frauduleusement des chèques d'une compagnie, pour ensuite amener frauduleusement un signataire autorisé à les signer, ces chèques ne sont pas visés par le par. 20(5). L'intention du préposé à la paie n'était pas l'intention du tireur; quand il a signé les chèques, ce dernier voulait vraiment que les preneurs nommés reçoivent paiement. À première vue, l'arrêt majoritaire sanctionne la quatrième règle de Falconbridge, mais, comme le fait observer le juge en chef Laskin dissident, cette dissent, this rule encompasses at least three different fact scenarios. At pp. 477-78, he stated:

> In approaching this issue, I would distinguish three situations which have been treated in the case law and in the leading textbook in this country, Falconbridge, *Banking and Bills of Exchange*, *supra*, as not warranting differentiation. Thus, in the fourth proposition quoted above from that textbook, the author speaks of the fraud of "some other person", that is, other than the drawer, which induced the drawing of the bill in the illustration there given. That person may, however, be a third person, as he was in the *Agricultural Savings and Loan Association* case, as he was in the *Macbeth* case, as he was in *Bank of Toronto v. Smith* and as he was in the *Barbeau* case; or he may be an employee who has been authorized to issue negotiable instruments, as in the *Bromont* case; or he may be an employee who has no authority to issue negotiable instruments but, on the other hand, is charged with the duty of making up the payroll for presentation to those authorized to issue cheques in the name of the drawer.

I agree with this distinction, though again for policy reasons I do not believe that the second and third scenarios should lead to different conclusions. However the fact situation in *Concrete Column* fell squarely within the third scenario. Similarly, the three cheques out of the 41 which Ms. Alm fraudulently produced and then induced Boris Mange to sign are also examples of the third scenario. Therefore, with respect to these three cheques only, having a combined face value of $1,655.17, the respondent's defence under this section must fail in light of the majority's decision in *Concrete Column*. However the remaining 38 cheques which Ms. Alm made out to existing employees, and which she herself signed in her capacity as a signing officer, are examples of the second scenario set out by Laskin C.J. in *Concrete Column* and do not fall within the scope of the majority's decision in that case.

With respect I must disagree with my colleague's conclusion that Ms. Alm's fraudulent intent as the signing officer cannot be equated to

règle englobe au moins trois scénarios différents. Aux pages 477 et 478, il dit ceci:

> Sur ce point, je dois distinguer trois situations que la jurisprudence et l'ouvrage qui fait autorité en ce pays, Falconbridge, *Banking and Bills of Exchange*, précité, ont traité sur le même pied. Dans la quatrième proposition citée précédemment et extraite de Falconbridge, celui-ci parle des manœuvres frauduleuses «d'une autre personne», c'est-à-dire une personne autre que le tireur qui, dans l'exemple donné, a provoqué l'émission de la lettre de change. Cette personne peut être un tiers comme ce fut le cas dans l'affaire *Agricultural Savings and Loan Association*, dans l'affaire *Macbeth*, dans l'affaire *Bank of Toronto v. Smith* ainsi que dans l'affaire *Barbeau*; elle peut être un employé autorisé à émettre des effets de commerce négociables comme dans l'affaire *Bromont* ou, encore, elle peut être un employé qui n'est pas autorisé à émettre des effets de commerce négociables mais qui, d'autre part, est chargé de préparer les feuilles de paie qui seront présentées aux personnes autorisées à émettre les chèques au nom du tireur.

Je souscris à cette distinction, quoique, encore une fois pour des raisons de principe, je ne crois pas que les deuxième et troisième scénarios devraient mener à des conclusions différentes. Toutefois, la situation factuelle dans *Concrete Column* correspondait exactement au troisième scénario. De même, les trois chèques, sur les 41, que M^me^ Alm a rédigés frauduleusement, pour ensuite inciter Boris Mange à les signer, constituent également des exemples du troisième scénario. Par conséquent, en ce qui concerne ces trois chèques seulement, dont la valeur nominale totale s'élève à 1 655,17 $, le moyen de défense que l'intimée a invoqué en vertu de cette disposition doit échouer, compte tenu de l'arrêt majoritaire rendu dans l'affaire *Concrete Column*. Cependant, les 38 autres chèques payables à des employés existants, que M^me^ Alm a rédigés et qu'elle a elle-même signés en sa qualité de signataire autorisée, sont des exemples du deuxième scénario énoncé par le juge en chef Laskin dans *Concrete Column* et ne sont pas visés par l'arrêt majoritaire rendu dans cette affaire. 99

En toute déférence, je me dois d'exprimer mon désaccord avec la conclusion de mon collègue que l'intention frauduleuse de M^me^ Alm, à titre de 100 the intent of the drawer, the appellant companies. As I understand it, the application of the law of agency leads to the inevitable conclusion that where the fraudulent employee is a signing officer of the drawer, then his or her intent must be taken as being the intent of the drawer. This issue was canvassed by Laskin C.J. in *Concrete Column*, where he reviewed the law of agency and of vicarious liability in tort. In particular, he thus addressed those situations where in the course of employment an employee defrauds a third party, at pp. 478-79:

> Agency law, especially as it relates to vicarious liability in tort, has long ago departed from strict conceptions of authority (see, for example, *Limpus v. London General Omnibus Co.* [(1862), 1 H. & C. 526, aff'd 9 Jur. N.S. 333]) and has, similarly, departed from notions of benefit or detriment so that an employer may be held vicariously liable to a person injured by his employee's negligence, even though the employee has, while acting within the scope of his employment, carried out his duties in a way expressly prohibited by the employer: see, for example, *Lockhart v. Stinson and C.P.R.* [[1941] S.C.R. 278, aff'd [1942] A.C. 591]; and *cf. Rose v. Plenty* [[1976] 1 All E.R. 97].
>
> Again, even where the employee defrauds a third person, his employer may have to answer for the fraud, as was the case in *Lloyd v. Grace, Smith & Co.* [[1912] A.C. 716], where a solicitor's clerk, acting in the course of his employment, and held out as authorized to deal with clients of the solicitor, defrauded a client of her property. The principle underlying this and other cases is an old one, based on a broad rule of policy, stated for England nearly three hundred years ago in *Hern v. Nichols* [(1708), 1 Salk. 289, 91 E.R. 256] and restated in fuller terms by the House of Lords in *Lloyd v. Grace, Smith & Co., supra*. There, Lord Shaw of Dunfermline put it as follows (at pp. 739-40):
>
> > The case is in one respect the not infrequent one of a situation in which each of two parties has been betrayed or injured by the fraudulent conduct of a third. I look upon it as a familiar doctrine as well as a safe general rule, and one making for security instead of uncertainty and insecurity in mercantile dealings, that the loss occasioned by the fault of a third person in such circumstances ought to fall upon the one of the two parties who clothed that third person as agent

signataire autorisée, ne saurait être assimilée à l'intention du tireur, les compagnies appelantes. Si je comprends bien, l'application du droit des mandats nous amène inévitablement à conclure que, lorsque l'employé malhonnête est un signataire autorisé du tireur, son intention doit alors être considérée comme étant celle du tireur. Le juge en chef Laskin a étudié cette question dans l'arrêt *Concrete Column*, quand il a examiné le droit des mandats et les principes de la responsabilité du fait d'autrui ou responsabilité patronale. Il a notamment examiné les situations où, dans l'exercice de ses fonctions, un employé fraude une tierce partie (aux pp. 478 et 479):

> Le droit du mandat s'est depuis longtemps écarté du concept restrictif du pouvoir, surtout en ce qui a trait à la responsabilité patronale en matière délictuelle (voir, par exemple, *Limpus v. London General Omnibus Co.* [(1862), 1 H. & C. 526, conf. 9 Jur. N.S. 333]). On a semblablement écarté les notions d'avantage ou de préjudice, de sorte qu'un employeur peut être tenu responsable envers une personne blessée par la négligence de son employé même si ce dernier, agissant dans le cadre de son emploi, a accompli sa tâche d'une façon expressément interdite par l'employeur: voir, par exemple, *Lockhart c. Stinson et la Compagnie du chemin de fer canadien du Pacifique* [[1941] R.C.S. 278, conf. [1942] A.C. 591]; et *cf. Rose v. Plenty* [1976] 1 All E.R. 97].
>
> De plus, l'employeur peut avoir à répondre de la fraude commise par son employé envers un tiers, comme ce fut le cas dans *Lloyd v. Grace, Smith & Co.* [[1912] A.C. 716], où le commis d'un avocat a escroqué deux immeubles à une cliente alors qu'il agissait dans le cadre de son emploi et se déclarait autorisé à négocier avec les clients de l'avocat. Cette décision-là ainsi que plusieurs autres sont fondées sur un vieux principe général énoncé en Angleterre il y a près de trois siècles dans *Hern v. Nichols* [(1708), 1 Salk. 289, 91 E.R. 256] et que lord Shaw of Dunfermline a reformulé de façon plus complète dans *Lloyd v. Grace, Smith & Co.*, précité (aux pp. 739-740):
>
> > [TRADUCTION] Sous un rapport, cette cause nous présente la situation assez fréquente où chacune des deux parties a été trahie ou lésée par les manœuvres frauduleuses d'un tiers. Je considère comme une doctrine connue, comme une bonne règle générale, facteur de sécurité plutôt que d'incertitude et de risque dans les relations commerciales, le principe que la perte causée par la faute du tiers en de telles circonstances doive être supportée par celle des deux parties

with the authority by which he was enabled to commit the fraud . . . .

This Court too has recognized the principle, as witness *The Queen v. Levy Bros. Ltd.* [[1961] S.C.R. 189], at p. 192, where Ritchie J. quoted with approval the following passage from *Story on Agency* (7th ed.) para. 452:

> . . . he (the principal) is held liable to third persons in a civil suit for the frauds, deceits, concealments, misrepresentations, torts, negligences, and other malfeasances, or misfeasances, and omissions of duty, of his agent, in the course of his employment, although the principal did not authorize, or justify, or participate in, or, indeed, know of such misconduct, or even if he forbade the acts, or disapproved of them.

In the present case there is no question that Ms. Alm acted beyond the ambit of what the appellants had in mind when she prepared and signed cheques made out to payees who were not their creditors. However it is equally clear that to the eyes of a third party she would have had the apparent authority to sign the cheques as she was an acknowledged signing officer of both Boma Manufacturing Ltd. and Panabo Sales Ltd. The general rule of agency is that a principal is bound by the acts of an agent when that agent is acting within the scope of his or her ordinary or apparent authority. The agent does not cease to bind the principal when he or she acts fraudulently in furtherance of his or her own purposes. That this is the law in Canada was acknowledged in *Canadian Laboratory Supplies Ltd. v. Engelhard Industries of Canada Ltd.*, [1979] 2 S.C.R. 787, where Laskin C.J., speaking for the Court on this point, stated at p. 797:

> There is, of course, no doubt in my mind that if an agent, in the exercise of an admitted authority in him in respect of his ordinary duties acts for his own benefit, his principal cannot deny liability for contracts he purports to make on behalf of the principal. It is only in such circumstances or where there is a representation from the principal that puts the agent in a position to act beyond the authority reposed in him that the principal can be bound.

In light of this principle, I am unable to see how the intent of Ms. Alm is not also the intent of the

qui a mandaté ce tiers et l'a investi du pouvoir dont il s'est servi pour commettre la fraude . . . .

Cette Cour a également reconnu ce principe, comme en témoigne l'arrêt *La Reine c. Levy Bros. Ltd.* [[1961] R.C.S. 189], à la p. 192 où le juge Ritchie a cité approbativement le passage suivant de *Story on Agency* (7e éd.) par. 452:

> [TRADUCTION] . . . dans une poursuite civile, il (le mandant) est responsable envers le tiers des fraudes, des supercheries, des réticences, des fausses déclarations, des délits, des négligences, des méfaits ou omissions de son mandataire, dans l'exercice de ses fonctions, même si le mandant n'a pas autorisé, légitimé ou couvert ces actes, même s'il ne les connaissait pas ou même s'il les avait interdits ou désapprouvés.

En l'espèce, il n'y a aucun doute que Mme Alm est allée au-delà de ce que les appelantes avaient à l'esprit quand elle a rédigé et signé les chèques payables à des preneurs qui n'étaient pas leurs créanciers. Toutefois, il est également clair qu'aux yeux d'une tierce partie elle était apparemment autorisée à signer les chèques, car elle était une signataire reconnue de Boma Manufacturing Ltd. et de Panabo Sales Ltd. Selon la règle générale du mandat, le mandant est lié par les actes du mandataire si ce dernier agit dans les limites de ses pouvoirs ordinaires ou apparents. Le mandataire ne cesse pas de lier le mandant s'il agit frauduleusement pour ses propres fins. On a reconnu que c'était là l'état du droit au Canada, dans *Canadian Laboratory Supplies Ltd. c. Engelhard Industries of Canada Ltd.*, [1979] 2 R.C.S. 787, où le juge en chef Laskin affirme, au nom de la Cour sur ce point, à la p. 797: 101

> Il est à mon avis incontestable que si, dans l'exercice de pouvoirs conférés dans le cadre de ses fonctions ordinaires, un mandataire agit dans son propre intérêt, son commettant ne peut se dégager de toute responsabilité à l'égard des contrats que le mandataire a prétendu faire en son nom. C'est uniquement dans de telles circonstances que le commettant est lié ou encore lorsqu'il a donné lieu de croire que le mandataire avait le pouvoir de faire ce qui excède son mandat.

Vu ce principe, je ne puis voir pourquoi l'intention de Mme Alm n'est pas non plus celle des appe- 102 appellants, the drawer of the cheques. Ms. Alm was held out by the appellants as a signing officer and the very essence of this representation of agency was that to the outside world the intent of Ms. Alm was the intent of the appellants when it came to the issuing of cheques. Interestingly enough, this position is implicit in the majority's decision in *Concrete Column* where it was the intent of a signing officer that was held to be the intent of the respondent corporation/drawer, even though there was no indication that the signing officer in that case was a guiding mind of the corporation. There is simply no authority for the position adopted by my colleague on this point. Nor should there be, given the principles of the law of agency stated above. As a result, I find that the 38 cheques prepared and signed by Ms. Alm, and payable by way of pretence to employees of the appellants, are payable to fictitious persons within the meaning of s. 20(5) of the Act and in consequence must be treated as payable to bearer. As such the respondent is a holder in due course of these cheques and cannot be liable to the appellants for conversion.

103 The above discussion is based on the premise that the loss must be borne in its entirety by one party or the other. However, I am not yet prepared to discount the possibility that in a proper case the loss should be apportioned between the employer/drawer and the accepting bank. There is much to be said for the view that this would be the fairer course. One, but possibly not the only, vehicle that would allow this to occur would be a suit in negligence. In a suit in negligence apportionment is specifically provided for through the mechanism of contributory negligence. The principal difficulty with such an approach is that the courts in both England and Canada have traditionally been unwilling to find that a duty of care exists between the rightful owner of a cheque and an accepting bank (see Crawford and Falconbridge, *supra*, at p. 1040). However, that type of reasoning is reminiscent of the time before the law could take contributory negligence into account by virtue of either legislation or judicial development.

lantes qui sont le tireur des chèques. Madame Alm était considérée comme une signataire autorisée par les appelantes et l'essence même de ce mandat faisait en sorte que, pour le monde extérieur, l'intention de M^me^ Alm était l'intention des appelantes lorsqu'il s'agissait d'émettre des chèques. Fait assez intéressant, ce point de vue est implicite dans l'arrêt majoritaire rendu dans l'affaire *Concrete Column*, où c'est l'intention d'un signataire qui a été considérée comme celle de la société-tireur intimée, bien que rien n'ait indiqué, dans cette affaire, que le signataire était une âme dirigeante de la société. Il n'y a simplement rien qui appuie la position de mon collègue sur ce point, et rien ne devrait l'appuyer, compte tenu des principes du droit des mandats énoncés plus haut. En définitive, je conclus que les 38 chèques rédigés et signés par M^me^ Alm, et apparemment payables à des employés des appelantes, sont payables à des personnes fictives au sens du par. 20(5) de la Loi et qu'ils doivent donc être tenus pour payables au porteur. L'intimée est donc le détenteur régulier de ces chèques et ne saurait être responsable de détournement envers les appelantes.

L'analyse qui précède est basée sur la prémisse que la perte doit être assumée entièrement par l'une ou l'autre des parties. Toutefois, je ne suis pas encore disposé à écarter la possibilité que, si les circonstances s'y prêtent, la perte soit répartie entre l'employeur-tireur et la banque-accepteur. Il y a bien des raisons de soutenir que cette solution serait la plus juste. Une solution, peut-être pas la seule, qui permettrait de réaliser cela serait d'intenter une action pour négligence. Dans une telle action, la répartition est expressément prévue grâce au mécanisme de la négligence contributive. La principale difficulté que pose cette solution réside dans le fait que, traditionnellement, les tribunaux, tant anglais que canadiens, ont refusé de conclure à l'existence d'une obligation de diligence entre le propriétaire légitime d'un chèque et la banque qui accepte ce chèque (voir Crawford et Falconbridge, *op. cit.*, à la p. 1040). Toutefois, ce type de raisonnement nous rappelle la situation qui existait avant que le droit puisse tenir compte de la négligence contributive en vertu de la loi écrite ou de l'évolution de la jurisprudence.

Though the appellants in the present case originally alleged both conversion and negligence, and contributory negligence was pleaded by the respondent in turn, I need not enter further into the issue. The negligence action was dismissed by the trial judge and not pursued on appeal. Even if the negligence action were before us, or contributory negligence could otherwise be raised, the worst that can be said about the respondent is that it failed to follow its internal policy in accepting cheques for deposit that had not been endorsed. However the evidence is clear that the requirement for an endorsement was no obstacle to Ms. Alm's activities and thus any negligence on the part of the respondent was not causally linked to the appellants' loss. In short, assuming it is possible to do so, this is not an appropriate case for apportionment.

104 Quoique les appelantes, en l'espèce, aient d'abord allégué tant le détournement que la négligence, et que l'intimée ait, à son tour, plaidé la négligence contributive, je n'ai pas à m'étendre davantage sur la question. L'action pour négligence a été rejetée par le juge de première instance et n'a pas été continuée en appel. Même si l'action pour négligence nous avait été soumise, ou si la négligence contributive pouvait être invoquée par ailleurs, la pire chose qu'on pourrait dire au sujet de l'intimée est qu'elle n'a pas suivi sa politique interne en acceptant pour dépôt des chèques non endossés. Toutefois, il ressort clairement de la preuve que l'exigence d'endossement n'a pas fait obstacle aux activités de Mme Alm et que, par conséquent, il n'y avait aucun lien de causalité entre une quelconque négligence de la part de l'intimée et la perte des appelantes. Bref, à supposer que ce soit possible, la présente affaire ne se prête pas à une répartition de la perte.

Non-Existent Persons

The majority of the cheques in this case, 114 in total, are not cheques to an existing person at all but rather to an imaginary person created by Ms. Alm for her own purposes. Unlike the debate surrounding the interpretation of a fictitious person, the concept of a non-existent person within the meaning of s. 20(5) is well settled: if the payee on a cheque is a matter of pure invention and not a real person then the payee is non-existent. There is no support for the position that this is a subjective test based on what the signor of a cheque believes is true; rather it is an objective question of fact — is the payee an invention of the employee? (see Crawford and Falconbridge, *supra*, at p. 1264, and *Clutton v. George Attenborough & Son*, [1897] A.C. 90 (H.L.)). This question was never addressed by either the trial judge or the Court of Appeal. In the reasons of both these courts there is no more than the recitation from paragraph 45 of the Agreed Statement of Facts that Boris Mange knew that the appellants engaged a subcontractor named Lam, "but had either forgotten, or never knew, his first name or initials". In this light I can-

Personnes qui n'existent pas

105 En l'espèce, la majorité des chèques, soit 114 au total, ne sont absolument pas des chèques à l'ordre d'une personne existante, mais sont plutôt des chèques payables à une personne fictive créée par Mme Alm pour ses propres fins. Contrairement au débat qui entoure l'interprétation de ce qu'est une personne fictive, la notion de personne qui n'existe pas au sens du par. 20(5) est bien arrêtée: si le preneur d'un chèque relève de la pure invention et n'est pas une personne réelle, ce preneur n'existe pas. Rien ne permet d'affirmer qu'il s'agit d'un critère subjectif fondé sur ce que le signataire du chèque croit vrai; il s'agit plutôt d'une question de fait objective — le preneur a-t-il été inventé par l'employé? (voir Crawford et Falconbridge, *op. cit.*, à la p. 1264, et *Clutton c. George Attenborough & Son*, [1897] A.C. 90 (H.L.)). Cette question n'a été abordée ni par le juge de première instance, ni par la Cour d'appel. Dans les motifs de ces deux tribunaux, on s'est contenté de citer le paragraphe 45 de l'exposé conjoint des faits qui précise que Boris Mange savait que les appelantes avaient retenu les services d'un sous-traitant du nom de «Lam», [TRADUCTION] «mais [qu'il] avait oublié ou n'avait jamais su son prénom ou ses ini-

not agree that the trial judge's comments on this point were tantamount to a finding of fact.

106 On the basis of the Agreed Statement of Facts, there is no doubt that Boris Mange did not know a D. Lam, J. Lam, or J. R. Lam. It may well be that he thought they were the same person as his contractor Van Sang Lam, but that is not the question that needs to be asked. What is determinative is that on an objective standard the payees were non-existent to the knowledge of the signor, whether that be Ms. Alm or Boris Mange. I note that paragraph 43 of the Agreed Statement of Facts states that no person with the name D. Lam, J. Lam or J. R. Lam was known to the appellants, while paragraph 46 of the Agreed Statement of Facts says that Boris Mange simply assumed that the cheques payable to J. Lam and J. R. Lam were payable to the appellants' subcontractor with the last name of Lam. As a result, the remaining 114 cheques clearly fall within the scope of s. 20(5) of the Act and are to be treated as payable to bearer. Therefore the respondent is a holder in due course of these cheques and has a complete defence against the action of the appellants.

Section 165(3) — The Bank as a Holder in Due Course

107 The second ground of defence raised by the respondent bank is that it has the rights of a holder in due course of the subject cheques via the operation of s. 165(3) of the Act, which reads as follows:

> **165.** . . .
>
> (3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

At first sight, this provision appears to remove from an accepting bank the obligation of satisfying the general requirements for becoming a holder in due course set out in s. 55 of the Act: namely that the cheque must be taken by negotiation, for value,

tiales». Compte tenu de cela, je ne puis convenir que les observations du juge de première instance sur ce point représentaient une conclusion de fait.

Compte tenu de l'exposé conjoint des faits, il n'y a pas de doute que Boris Mange ne connaissait aucun D. Lam, J. Lam ou J. R. Lam. Il se peut bien qu'il ait cru qu'il s'agissait de son sous-traitant Van Sang Lam, mais ce n'est pas la question qu'il faut se poser. Ce qui est déterminant, c'est que, selon une norme objective, les preneurs n'existaient pas à la connaissance du signataire, peu importe que ce fût M^me^ Alm ou Boris Mange. Je remarque que le paragraphe 43 de l'exposé conjoint des faits précise que les appelantes ne connaissaient personne du nom de D. Lam, J. Lam ou J. R. Lam, alors que le paragraphe 46 du même exposé dit que Boris Mange a simplement supposé que les chèques payables à J. Lam et à J. R. Lam étaient payables au sous-traitant des appelantes, dont le nom de famille était «Lam». En définitive, les 114 autres chèques sont clairement visés par le par. 20(5) de la Loi et doivent être considérés comme payables au porteur. Par conséquent, l'intimée est le détenteur régulier de ces chèques et jouit d'un moyen de défense complet contre l'action des appelantes.

Le paragraphe 165(3) — La banque en tant que détenteur régulier

Le second moyen de défense invoqué par la banque intimée est qu'elle possède les droits d'un détenteur régulier des chèques en cause, en vertu du par. 165(3) de la Loi, qui est ainsi conçu:

> **165.** . . .
>
> (3) Lorsqu'un chèque est livré à une banque en vue de son dépôt au compte d'une personne et que la banque porte au crédit de celle-ci le montant du chèque, la banque acquiert tous les droits et pouvoirs du détenteur régulier du chèque.

À première vue, cette disposition semble soustraire une banque-accepteur à l'obligation de remplir les conditions générales fixées, à l'art. 55 de la Loi, pour devenir un détenteur régulier: savoir que le chèque doit être pris par négociation, à titre onéand in good faith. In the case of a cheque payable to order, negotiation would require the valid endorsement of the payee or endorsee. By removing the need for these requirements, it may be said that s. 165(3) effectively removes any difference between a cheque payable to order and one payable to bearer; as long as the cheque is delivered to the accepting bank, and the depositor's account is credited with the amount of the cheque, the bank has the rights of a holder in due course of the cheque and takes the cheque free of any defect of title.

So interpreted, s. 165(3) would amount to a sweeping grant of powers to the banks, a possibility that has received almost unanimous condemnation and persistent calls for reform since its introduction into the Act in 1966 (see S. Scott, "The Bank is Always Right: Section 165(3) of the Bills of Exchange Act and its Curious Parliamentary History" (1973), 19 *McGill L.J.* 78; S. Martin, "Section 165(3) of the Bills of Exchange Act" (1985), 11 *C.B.L.J.* 23; Law Reform Commission of Canada, *The Cheque: Some Modernization* (1979)).

My colleague has attempted to restrict the scope of the section by interpreting the word "person" as being limited to the payee or the legitimate endorsee of the payee of the cheque only, with the result that the provision would be of no help to the respondent in the present case. The word "person" is clearly capable of diverse meanings depending on the circumstance in which it is used. Where a court is faced with the situation where there is more than one possible construction of the statutory provision before it, and the result of one construction would lead to manifest absurdity or injustice (see E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 47, and *Grey v. Pearson* (1857), 6 H.L.C. 60), it is well established that a court will adopt the construction that does not lead to that result, even though the words used would strongly favour the alternative construction; see, for example, *Caledonian Railway Co. v. North British Railway Co.* (1881), 6 App. Cas. 114 (H.L.). The situation here militates in favour of this approach. There is no question that if s. 165(3)

reux et de bonne foi. Dans le cas d'un chèque payable à ordre, la négociation requiert l'endossement valide du preneur ou de l'endossataire. On peut dire qu'en supprimant la nécessité de remplir ces conditions, le par. 165(3) supprime effectivement toute différence entre un chèque payable à ordre et un chèque payable au porteur; dans la mesure où le chèque est livré à la banque-accepteur et où le montant du chèque est porté au crédit du déposant, la banque jouit des droits d'un détenteur régulier du chèque et prend le chèque exempt de tout vice de titre.

Interprété ainsi, le par. 165(3) représenterait une 108
attribution générale de pouvoirs aux banques, une possibilité qui fait l'objet de réprobation quasi unanime et d'appels répétés à la réforme depuis son insertion dans la Loi en 1966 (voir S. Scott, «The Bank is Always Right: Section 165(3) of the Bills of Exchange Act and its Curious Parliamentary History» (1973), 19 *R.D. McGill* 78; S. Martin, «Section 165(3) of the Bills of Exchange Act» (1985), 11 *C.B.L.J.* 23; Commission de réforme du droit du Canada, *Le chèque: un peu plus moderne* (1979)).

Mon collègue a tenté de limiter la portée de la 109
disposition en interprétant le mot «personne» comme s'entendant uniquement du preneur ou de l'endossataire légitime du preneur du chèque, de sorte que la disposition serait inutile à l'intimée en l'espèce. Le mot «personne» est nettement susceptible d'avoir plusieurs sens selon le contexte dans lequel il est utilisé. Si un tribunal se trouve dans une situation où la disposition législative dont il est saisi peut être interprétée de plus d'une façon, et qu'une interprétation donnée conduirait à une absurdité ou à une injustice flagrante (voir E. A. Driedger, *Construction of Statutes* (2e éd. 1983), à la p. 47, et l'arrêt *Grey c. Pearson* (1857), 6 H.L.C. 60), il est bien établi qu'il adoptera celle qui ne produit pas ce résultat, même si les mots employés militeraient fortement en faveur de l'autre interprétation; voir, par exemple, *Caledonian Railway Co. c. North British Railway Co.* (1881), 6 App. Cas. 114 (H.L.). La situation en l'espèce milite en faveur de cette solution. Il n'y a pas de doute que, si l'on attribue au par. 165(3) la portée que préco-

is given the scope advanced by the respondent it will both be in disharmony with the general scheme for cheques set out in the Act, and has the potential for inflicting considerable injustice on the drawers of cheques. On the other hand, the interpretation adopted by my colleague avoids these results and is in keeping with the apparent intent of Parliament in introducing the section: the desire to protect banks in those situations where a cheque is restrictively endorsed or where the payee fails to endorse a cheque upon presenting it to an accepting bank for deposit. Neither of these situations is present in the case at bar.

110 Accordingly I would dismiss the appeal and the cross-appeal, both with costs. Based on my findings with respect to the application of s. 20(5) I would have reduced the judgment of the Court of Appeal in favour of the appellants from $5,390.12 to $1,655.17, this amount being the face value of the three cheques fraudulently prepared by Ms. Alm but signed by Boris Mange in favour of existing employees. However the respondent did not cross-appeal on this issue and the judgment of the Court of Appeal shall stand as is.

Appeal allowed, LA FOREST *and* MCLACHLIN JJ. *dissenting, and cross-appeal dismissed.*

Solicitors for the appellants: Baumgartel Gould, New Westminster, B.C.

Solicitors for the respondent: Davis & Company, Vancouver.

nise l'intimée, il sera à la fois incompatible avec l'économie du régime des chèques établi dans la Loi et susceptible de causer une grave injustice aux tireurs de chèques. Par ailleurs, l'interprétation adoptée par mon collègue permet d'éviter ces résultats et est conforme à l'intention apparente que le législateur avait lorsqu'il a adopté cette disposition, c'est-à-dire protéger les banques en cas d'endossement restrictif d'un chèque ou en cas d'omission de la part du preneur d'endosser un chèque lorsqu'il le présente pour dépôt à la banque-accepteur. Ni l'une ni l'autre de ces situations n'existe en l'espèce.

En conséquence, je suis d'avis de rejeter le pourvoi principal et le pourvoi incident, avec dépens dans les deux cas. Vu mes conclusions quant à l'application du par. 20(5), j'aurais réduit, de 5 390,12 $ à 1 655,17 $, le montant accordé aux appelantes par la Cour d'appel, lequel montant représente la valeur nominale des trois chèques rédigés frauduleusement par Mme Alm, mais signés par Boris Mange au profit d'employés existants. Toutefois, l'intimée n'a pas formé de pourvoi incident relativement à cette question et l'arrêt de la Cour d'appel doit demeurer inchangé.

Pourvoi principal accueilli, les juges LA FOREST *et* MCLACHLIN *sont dissidents, et pourvoi incident rejeté.*

Procureurs des appelantes: Baumgartel Gould, New Westminster (C.-B.).

Procureurs de l'intimée: Davis & Company, Vancouver.

Case Name:

3869130 Canada Inc. (c.o.b. I.C.B. Distribution 2001) v. I.C.B. Distribution Inc.

Between
3869130 Canada Inc. c.o.b. as I.C.B. Distribution 2001, and 2794201 Canada Inc. c.o.b. as C.Y.R. Distributions, and Pierre Cyr, personally, Plaintiffs/Appellants, and
I.C.B. Distribution Inc., Robert Chenier, and Ottawa Freezer Services Inc., Defendants/Respondents
And between
Robert Chenier, Plaintiff/Respondent, and
3869130 Canada Inc. c.o.b. as I.C.B. Distribution 2001, Defendant/Appellant
And between
I.C.B. Distribution Inc., Plaintiff/Respondent, and
3869130 Canada Inc. c.o.b. as I.C.B. Distribution 2001, and 2794201 Canada Inc. c.o.b. as C.Y.R. Distributions, Defendants/Appellants

[2008] O.J. No. 1947

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66 C.C.E.L. (3d) 89

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167 A.C.W.S. (3d) 82

45 B.L.R. (4th) 1

239 O.A.C. 137

Dockets: C43970, C43971 and C43972

Ontario Court of Appeal
Toronto, Ontario

R.A. Blair, R.G. Juriansz and H.S. LaForme JJ.A.

Heard: November 26-27, 2007.
Judgment: May 20, 2008.

(93 paras.)

Contracts -- Formation -- Form of contract -- Expressed orally -- Appeal by Cyr from dismissal of his action for damages and from Chenier's successful action against him for damages arising from two agreements involving the *purchase by Cyr's companies of shares of one of Chenier's companies and assets of another dismissed -- Ample evidence for trial judge findings of credibility in Chenier's favour -- Trial judge correctly interpreted contractual documentation entered into by parties -- Trial judge properly dismissed all of Cyr's allegations that Chenier had acted in bad faith.*

Corporations and associations law -- Sale of a business -- Asset purchase agreement -- Share purchase agreement -- Appeal by Cyr from dismissal of his action for damages and from Chenier's successful action against him for damages arising from two agreements involving the purchase by Cyr's companies of shares of one of Chenier's companies and assets of another dismissed -- Ample evidence for trial judge findings of credibility in Chenier's favour -- Trial judge correctly interpreted contractual documentation entered into by parties -- Trial judge properly dismissed all of Cyr's allegations that Chenier had acted in bad faith.

Employment law -- Termination of employment -- Wrongful dismissal -- Appeal by Cyr from dismissal of his action for damages and from Chenier's successful action against him for damages arising from two agreements involving the purchase by Cyr's companies of shares of one of Chenier's companies and assets of another dismissed -- Ample evidence for trial judge findings of credibility in Chenier's favour -- Trial judge made did not err in making findings in favour of Chenier in wrongful dismissal action -- Trial judge properly dismissed all of Cyr's allegations that Chenier had acted in bad faith.

Tort law -- Interference with economic relations -- Breach of fiduciary obligation -- Appeal by Cyr from dismissal of his action for damages and from Chenier's successful action against him for damages arising from two agreements involving the purchase by Cyr's companies of shares of one of Chenier's companies and assets of another dismissed -- Ample evidence for trial judge findings of credibility in Chenier's favour -- Trial judge correctly interpreted contractual documentation entered into by parties -- Trial judge properly dismissed all of Cyr's allegations that Chenier had acted in bad faith.

Appeal by Cyr from the dismissal of his action for damages and from Chenier's successful action against him for damages arising from two agreements involving the purchase by Cyr's companies of the shares of one of Chenier's companies and the assets of another. Chenier owned and operated ICB Distribution and Ottawa Freezer Services. ICB was a food distribution company and Ottawa Freezer operated a modest refrigerated cooler and warehouse facility located on premises leased from Loeb Canada. Cyr owned and operated CYR Distributions. CYR moved into the same business premises as Chenier's companies. Chenier discussed with Cyr the possibility of his purchasing his businesses. Cyr incorporated a new company, ICB 2001, to purchase the assets of ICB. A non-competition clause was included in the asset purchase agreement. The asset purchase closed after intense negotiations, as Chenier did not want the sale to go through without an executed share purchase agreement between CYR and Ottawa Freezer. This was finally executed containing several conditions precedent, including disclosure of financial statements by Cyr to Chenier, and the securing of an extension of the lease for the premises from Loeb. Chenier did not receive the disclosure in the time frame contemplated by the agreement. Cyr began doing business as ICB, and advanced the purchase monies for the assets to Chenier. Part of the purchase price was satisfied by a vendor take back loan under which Chenier retained rights to oversee the day-to-day operations of the business. Chenier continued to work for ICB as a management consultant. The parties sought an extension of the lease of the premises from Loeb, however the extension was not granted and the share transaction agreement failed to close. The relationship between Cyr and Chenier began to break down. Cyr, feeling he was not given enough space in his current location, sought a new warehouse facility and signed a draft agreement to move ICB 2001 and CYR to the other space. Chenier was terminated without notice. Chenier brought an action for wrongful dismissal and for breach of the vendor take back loan contract. Cyr countered with claims against Chenier for breach of contract for failing to close the share transaction, misrepresentation regarding ICB's customers and accounts, and for breach of fiduciary obligations in negotiating contracts for Chenier's benefit to the detriment of ICB 2001. In dispute was the existence of a gentleman's agreement between Chenier and Cyr under which Cyr was to pay $500,000 to Chenier for Ottawa Freezer's shares. The trial judge allowed Chenier's actions and dismissed Cyr's action. Cyr's failure to testify about the gentleman's agreement gave rise to an adverse inference. The trial judge found that Chenier was terminated without cause, as Cyr failed to demonstrate Chenier had not performed his duties as a management consultant and failed to show he provided Chenier with adequate notice. Cyr formed an intention to move his businesses out of the original premises before any problems started with overcrowding, and tried to mislead the court to believe it was the overcrowding that made him want to move. This constituted a breach of the terms of the vendor take-back agreement. Regarding Cyr's claims, misrepresentation was not made out as Cyr never raised the issue prior to being sued by Chenier. His evidence that he relied upon the word of Chenier regarding customers and accounts of ICB in entering the asset purchase agreement was not credible. Chenier was not at fault in failing to complete the share purchase transaction, as Cyr did not satisfy the conditions precedent. Cyr failed to demonstrate that Chenier did not use good faith efforts to secure the extension of the lease. Chenier did not breach the covenant not to compete by obtaining contracts for Ottawa Freezer, because Ottawa Freezer was not a competitor of ICB or OCB 2001 as it was a freezer and storage company, not a food distributor. No fiduciary relationship existed between Cyr and Chenier. They were two businessmen with equal bargaining power and experience negotiating business deals at arm's length with their own interests in mind.

HELD: Appeal dismissed. The trial judge made clear findings of credibility in Chenier's favour in rejecting Cyr's testimony, holding that he had attempted to deceive the court with his evidence. There was ample basis in the record for these findings. The trial judge made no palpable or overriding error in making findings in favour of Chenier in the wrongful dismissal action. The trial judge correctly interpreted the contractual documentation entered into by the parties. The trial judge properly dismissed all of Cyr's allegations that Chenier had acted in bad faith in his dealings with Cyr.

Appeal From:

On appeal from the judgment of Justice H.S. Polowin of the Superior Court of Justice at Ottawa dated July 12, 2005, with reasons reported at (2005), 45 C.C.E.L. (3d) 15.

Counsel:

Richard R. Marks and Bruce D. Marks for the appellants I.C.B. Distribution 2001, C.Y.R. Distributions and Pierre Cyr.

Douglas G. Menzies for the respondents I.C.B. Distribution Inc., Ottawa Freezer Services Inc., and Robert Chenier.

The judgment of the Court was delivered by

R.A. BLAIR J.A.:--

OVERVIEW

1 The issues on this appeal have their genesis in a business deal involving the sale of two Ottawa businesses owned by the respondent, Robert Chenier. The appellant, Pierre Cyr -- acting through his companies -- was the intended purchaser. One of the transactions closed. The other did not.

2 Three lawsuits ensued. The first (the "VTB Loan Action") involved a claim by one of the Chenier vendor companies for the balance of the purchase price on the sale of its assets. The second (the "Wrongful Dismissal Action") was by Mr. Chenier for monies owing under a management consultant agreement entered into with respect to that asset transaction. The third (the "Cyr Action") was brought by Mr. Cyr and his companies claiming damages from Mr. Chenier and his companies for breach of contract, breach of fiduciary duty, breach of good faith, and breach of a duty to avoid conflict of interest.

3 After a four week trial, Justice Polowin allowed the Chenier claims in the Loan Action and the Wrongful Dismissal Action and dismissed the Cyr Action. The Cyr appellants now seek to set aside those judgments.

4 For the reasons that follow, I would dismiss the appeals.

FACTS

5 Mr. Chenier owned a food distribution company, I.C.B. Distributions Inc. ("I.C.B."), based in Ottawa. He also owned a freezer and cold storage business carried on through Ottawa Freezer Services Inc. ("O.F.S.") in premises located at 400 Industrial Ave. in that city. Mr. Chenier had had some health problems and wished to semi-retire and work fewer hours.

6 Mr. Cyr owned an unrelated food distribution company that carried on business as C.Y.R. Distributions.[1] It rented cooler and freezer space from O.F.S. in the latter's premises at 400 Industrial Ave. and, as a result, Mr. Cyr had some exposure to Mr. Chenier's businesses. He felt there was a potential synergy between those operations and his own and, in particular, that the wider territory served by I.C.B. and its access to distribution business flowing from the O.F.S. storage contracts presented an opportunity to expand the scope of C.Y.R. Distributions' undertaking (which, at that point in time had become saturated in Ottawa).

7 When their mutual interests surfaced in September or October 2000, Mr. Chenier and Mr. Cyr began to have discussions about the possible acquisition of I.C.B. and O.F.S. by Mr. Cyr. The deal they negotiated contemplated the purchase of the assets of I.C.B. by I.C.B. Distribution 2001 ("I.C.B. 2001")[2] for approximately $362,500, and of the shares of O.F.S. by C.Y.R. Distributions for approximately $500,000.

8 Several agreements were entered into thereafter to give effect to these intentions. They included the following in relation to the acquisition of I.C.B.'s assets:

(a) an Asset Purchase Agreement, which contained two important promises for the purposes of this appeal, namely:

   (i) a covenant by I.C.B. and Mr. Chenier not to compete with the purchased business for a period of five years, or to permit anyone on their behalf to do so (s. 7.5); and
   (ii) an undertaking by I.C.B. and Mr. Chenier to obtain the commitment of O.F.S. to continue to use the services of the Purchaser for distribution services in respect of O.F.S.'s customers and to permit the Purchaser to operate from the O.F.S. premises at 400 Industrial Ave. in Ottawa (s. 8.1(i));

(b) a Management Consulting Agreement pursuant to which Mr. Chenier was to provide consulting services as requested during a transitional period; and
(c) a Vendor Take-Back Loan Agreement respecting the loan portion of the asset purchase price.

9 The I.C.B. asset purchase closed on July 11, 2001. No share purchase agreement with respect to O.F.S. had been executed at that point, however, and Mr. Cyr refused to complete the asset purchase without one being in place. As a result, there were intense negotiations during the evening and night of the closing, which resulted in two further agreements being prepared and signed by the parties prior to the asset purchase closing. They were:

(a) a Share Purchase Agreement between Mr. Chenier as vendor of the O.F.S. shares and Mr. Cyr and C.Y.R. Distributions as purchasers; and
(b) a Mutual Undertaking between I.C.B. 2001 and O.F.S., giving effect to the covenant in Section 8.1(i) of the Asset Purchase Agreement whereby O.F.S. agreed to provide to I.C.B. 2001 (as the Purchaser of the assets of I.C.B.) a right of first refusal for its customers' distribution contracts and the right to operate from the I.C.B. premises.

10 The provisions of the Mutual Undertaking are central to the issues on this appeal. It is a one page document. I set it out in full:

MUTUAL UNDERTAKING

BETWEEN 3869130 CANADA INC. ("PURCHASER") and OTTAWA FREEZER SERVICES INC.

Re: Purchase of certain assets of ICB Food Distributions Inc. pursuant to an asset purchase agreement dated the 19th day of April, 2001, by 3869130 CANADA INC. (the "Purchaser") and continuing operations from 400 Industrial Avenue, Ottawa

WHEREAS:

1. The Vendor has entered into an agreement of purchase and sale (the "Purchase Agreement") effective the 28th day of February, whereby the Vendor agrees to sell certain assets of ICB Food distributions Inc. (the "Business");
2. And whereas, as a condition of the completion of the said sale of the Business, it was agreed that the Purchaser would provide its written commitment to operate exclusively from the Ottawa Freezer Service's premises from which the Vendor operated prior to the Closing Date at 400 Industrial Ave. (the "Premises") until December 28, 2005, or until the early termination of the Ottawa Freezer Services sub-lease by the Sub-Landlord of the Premises, whichever is earlier.
3. And whereas, it was further agreed between the Vendor and the Purchaser that the gross annual charge payable by the Purchaser for the right to operate from the Premises shall be $120,000.00, annually, for each year of operation to December 28, 2005.

IN CONSIDERATION of the sum of $2.00 the receipt of which is hereby acknowledged, Ottawa Freezer Services does hereby undertake and agree to provide to the Purchaser a first right of refusal, in writing for all distribution contracts for its customers for which the same require distribution and general trucking and delivery services and the right to operate from the Premises for a period of five years from the date hereof, except that, should the sale of shares of Ottawa Freezer Services Inc. to Pierre Cyr and 2794209 Canada Inc. pursuant to a Share Purchase Agreement dated the 11th day of July, 2001, not be completed by November 30th, 2001, the aforementioned gross annual charge shall not exceed NINETY THOUSAND DOLLARS ($90,000.00), without deduction or set-off whatsoever to Ottawa Freezer Services Inc.

11 Regrettably, the relationship between Mr. Cyr and Mr. Chenier -- which had started out very cordially and positively after the Letters of Intent were signed in February -- began to fragment in the Fall of 2001, and eventually ruptured in early 2002. The share purchase transaction never closed, principally because the parties were not able to obtain an extension of the sublease from Loeb or a new head-lease for the O.F.S. premises (a condition precedent to closing) and because Mr. Chenier and his lawyer were not satisfied with the disclosure and security that Mr. Cyr was providing respecting the share purchase (a condition in favour of the vendor). Thus, instead of controlling both the former I.C.B. distribution business and the O.F.S. storage facility, Mr. Cyr found himself controlling only the former. Instead of being semi-retired and working on a part-time consulting basis for his old business, Mr. Chenier found himself still controlling and directing the O.F.S. storage undertaking. The business relationship could not, and did not, survive.

12 Differences arose during the Fall of 2001 over the use of the storage premises at 400 Industrial Ave., the amount of space allotted to the Cyr companies, and their access to the loading docks. Some of these differences were attributable to a new arrangement entered into between O.F.S. and one of its major customers -- the wholesaler of frozen and fresh food products, Giant Tiger Stores Limited -- with respect to the storage, warehousing and distribution of Giant Tiger products. As a result of this arrangement, the Giant Tiger operations took over most, if not all of O.F.S.'s large 15,000 sq. ft. front freezer. O.F.S.'s other customers, including I.C.B. 2001 and C.Y.R. Distributions, were relocated to a smaller 4,900 sq. ft. area at the back. The increased Giant Tiger presence contributed to congestion in the loading dock area and to inefficiencies in the use of that area, which were a further irritant to everyone.

13 Mr. Cyr was not happy about the storage facility difficulties. In November 2001 he negotiated to lease other space from someone else at 800 Belfast Rd. in Ottawa and formalized the agreement in mid-December. Mr. Chenier was not aware of this, but on December 28, 2001, O.F.S. nonetheless -- because of space issues -- gave proper notice to C.Y.R. Distributions to vacate the premises at 400 Industrial Ave. by March 1, 2002. No such notice was given to I.C.B. 2001. Indicating that this is what he had been waiting for, Mr. Cyr gave notice at the end of January 2002 that he was moving the operations of *both* C.Y.R. Distributions and I.C.B. 2001 to 800 Belfast Rd. The move took place at the end of

February. Mr. Chenier took the position that the move of I.C.B. 2001 from the premises was a breach of the Loan Agreement and the Mutual Undertaking. The Loan Action was commenced shortly thereafter.

14 In the meantime, Mr. Chenier had been working for I.C.B. 2001 pursuant to the Management Consulting Agreement. He was also managing and operating O.F.S. The trial judge found that by October 2001 the relationship between Mr. Cyr and Mr. Chenier had seriously deteriorated, and that the parties were treating each other at arm's length and dealing with each other as two separate companies throughout the Fall of 2001.

15 On January 25, 2002, Mr. Cyr's lawyers wrote to Mr. Chenier's lawyers complaining, amongst other things, of Mr. Chenier's performance under the Management Consulting Agreement and purporting to give six months notice of termination in accordance with its terms. Mr. Chenier took this as a breach of the Management Consulting Agreement. He commenced the Wrongful Dismissal Action shortly thereafter.

16 Hovering over both of the foregoing disagreements, and central to the commencement of the Cyr action some time later, was the shadow of Giant Tiger. The Giant Tiger operations had been consuming more and more of the O.F.S. storage facilities -- by mid-2000 it was occupying approximately 12,000 sq. ft. of the front freezer area -- and negotiations respecting a new and larger Giant Tiger storage and distribution contract between it and O.F.S. had begun in late Spring 2001. This increasing Giant Tiger presence was the source of much of the chafing over the storage area and the loading facilities, and the potential new contract was a focal point of much of Mr. Chenier's attention throughout the Fall of 2001.

17 Negotiations respecting this contract had begun much earlier in the year. In June 2001, Mr. Cyr and his financial advisor, Mr. Luigi, attended a meeting with Mr. Chenier and representatives of Giant Tiger in which a proposal was made by the Chenier/Cyr group to Giant Tiger. Under this proposal -- which was contained in a letter dated June 26, 2001, signed by Mr. Chenier, but drafted by Mr. Luigi -- O.F.S. was to receive 68 cent(s) per case for delivery of the Giant Tiger product. Giant Tiger was by this time occupying about 12,000 sq. ft. in the freezer and the trial judge found that Mr. Cyr must have been aware by as early as June, 2001 that if they were successful in wrestling the Giant Tiger business away from its existing service provider, Giant Tiger would be occupying about 15,000 ft. in the freezer.

18 There is no doubt that Mr. Chenier carried the negotiations with Giant Tiger. The Cyr parties complain that he negotiated with Giant Tiger in secret, deliberately keeping the details of the negotiations from Mr. Cyr so that he could personally benefit from the Giant Tiger arrangement. The trial judge found, however, that although Mr. Chenier did not disclose the particulars of the Giant Tiger contract -- she held that a contractor had no obligation to disclose such details to a subcontractor -- Mr. Cyr was aware that Mr. Chenier was negotiating with Giant Tiger for a comprehensive contract and that the distribution work would be contracted out. Mr. Cyr admitted in evidence that he never asked Mr. Chenier about the particulars of the contract with Giant Tiger.

19 I.C.B. 2001 was offered a first right of refusal with respect to the delivery services arising out of the O.F.S./Giant Tiger contract. On October 5, 2001, Mr. Cyr wrote to Mr. Chenier confirming I.C.B. 2001's "agreement to act as Ottawa Freezer's agents in distributing Giant Tiger's frozen and cooled products" at a cost to O.F.S. of 30 cent(s) a case. After further exchanges the bid was re-submitted on October 31, 2001 stipulating a price of 35 cent(s) a case for the same services, i.e., for "[acting] as Ottawa Freezer's agents in distributing Giant Tiger's frozen and cooled products." A formal agreement was executed between O.F.S. and Giant Tiger as of November 2, 2001. It provided for distribution services at 65 cent(s) per case. A formal Distribution Agreement was executed between O.F.S. and I.C.B. 2001 on December 14, 2001 at a delivery tariff of 35 cent(s) per case.

20 The discrepancy between these two prices is the principal bone of contention between the parties in the Cyr action. Mr. Cyr contends that it was not open to Mr. Chenier and O.F.S. to take a profit on the distribution end of the Giant Tiger contract by subcontracting that work to I.C.B. 2001 for a lower price than that obtained by I.C.B.

ISSUES

21 The principal questions on the appeal evolve around the Giant Tiger transaction in relation to the Cyr Action. Other issues are raised with respect to the VTB Loan Action and the Wrongful Dismissal Action, but they were not pressed as forcefully in oral argument as were the matters arising in connection with the Cyr Action.

22 The issues may be summarized as follows:

With Respect to the VTB Loan Action

(a) Whether I.C.B. 2001 breached the VTB Loan Agreement by voluntarily leaving the O.F.S. storage premises at 400 Industrial Ave. or whether they were "pushed out" by Mr. Chenier for his own purposes, as alleged by the Cyr parties;

With Respect to the Wrongful Dismissal Action

(b) Whether the trial judge erred in accepting Mr. Chenier's claim that the Agreement had been improperly terminated without just cause;

With Respect to the Cyr Action

(c) Whether the trial judge erred in failing to find that Mr. Chenier breached his covenant not to compete with the Purchased Business -- and, in particular, whether she erred:

  (i) In her contractual interpretation of the Mutual Undertaking and the other related contractual documentation; and
  (ii) By holding, in effect, that the Mutual Undertaking amended the Asset Purchase Agreement, which the parties did not intend to do and, in any event, could not do contractually without a specific amendment and no such amendment exists;

(d) In drawing a number of mistaken inferences from the evidence;
(e) Whether Mr. Chenier was disqualified from competing with the purchased business, and from causing O.F.S. to take a profit on the distribution component of the Giant Tiger contract, by reason of (i) a fiduciary obligation, (ii) a duty of loyalty and good faith, and (iii) a duty to avoid conflicts of interest, owed by him to I.C.B. 2001 under the Management Consulting Agreement; and
(f) Whether -- if they do not succeed on the foregoing grounds -- the trial judge erred in failing to accept the damage claim of I.C.B. 2001 and Mr. Cyr, as put forward by their financial advisor, Mr. Luigi.

ANALYSIS

23 As the primary focus of the appeal was on the issues touching the Cyr Action, I shall deal first with the grounds of appeal relating to the VTB Loan Action and the Wrongful Dismissal Action because they can be disposed of shortly.

The VTB Loan Action

24 The appellants submit that C.Y.R. Distributions and I.C.B. 2001 did not voluntarily leave the storage premises at 400 Industrial Ave. but, rather, were "pushed out" by Mr. Chenier for his own purposes. This did not constitute a breach of the VTB Loan, they say, and the trial judge erred in determining that the Cyr parties had done so.

25 The trial judge rejected the appellant's claim that C.Y.R. Distributions and I.C.B. 2001 had been "pushed out" of 400 Industrial Ave. by a scheming Mr. Chenier who had decided to frustrate the completion of the Share Purchase transaction and to acquire the expanded and profitable Giant Tiger contract for O.F.S. and for himself. She found that Mr. Cyr had decided in November 2001 to pull both of his companies' operations out of the O.F.S. premises and to move them to new space at 800 Belfast Road. She made clear findings of credibility in Mr. Chenier's favour in rejecting Mr. Cyr's testimony on these issues -- holding, in fact, that he had attempted to deceive the court with his evidence -- and there was ample basis in the record for these findings.

26 I see no basis for interfering with her disposition of the VTB Loan Action.

The Wrongful Dismissal Action

27 Section 3.3 of the Management Consulting Agreement required six months advance notice in writing for termination, except in the event of just cause. The trial judge accepted Mr. Chenier's claim that the Agreement had been improperly terminated without just cause. She concluded that the Agreement was an integral part of the parties' "deal" for the purchase of I.C.B. and found that a part of the purchase price Mr. Chenier expected to receive was reflected in his annual salary of $40,000 for two years under it. She rejected the Cyr parties' contention that Mr. Chenier was to play a key management role with I.C.B. 2001 and found that the consulting arrangement contemplated Mr. Chenier performing only those services requested by Mr. Cyr. Specifically, the trial judge rejected the particular breaches of the Management Consulting Agreement relied on by the appellants, namely:

(a) The alleged failure to advise Mr. Cyr of the cancellation of contracts that O.F.S. had with two customers, Baskin Robbins and Farm Boy (she found that the loss of those contracts was well-known to all of the parties before the closing of the Asset Purchase Agreement);
(b) The alleged failure to keep Mr. Cyr informed of the progress of the negotiations with Giant Tiger;
(c) The alleged diversion of profits and competing with I.C.B. 2001 and Mr. Cyr;
(d) The alleged failure to arrange for the contract for the distribution services to Giant Tiger to be entered into between I.C.B. 2001, or the assignment of that contract opportunity to Mr. Cyr's companies, or at least all the benefits from it, without diverting the profits of it to himself through O.F.S.;
(e) the alleged failure to attract new business; and
(f) the alleged misdirection of monies relating to writing cheques.

28 The trial judge made factual findings against Mr. Cyr and the Cyr companies, and in favour of Mr. Chenier and the Chenier companies, with respect to all of these allegations, in arriving at her disposition of the Wrongful Dismissal Action. She made no palpable and overriding error in making those findings. They are supported on the record. There is no basis for interfering with them.

29 I turn, now, to the principal issues on the appeal, which revolve around the Giant Tiger arrangement.

The Cyr Action

<u>Contractual Interpretation</u>

Principles of Contractual Interpretation

30 The appellants say the trial judge erred in her contractual interpretation of the Mutual Undertaking and the other related documentation, including her interpretation of the interplay between the Non-Competition covenant and the Mutual Undertaking. She did so, they contend, by failing to find that the obligation of O.F.S. was to provide to I.C.B. 2001 the opportunity to perform the delivery service for its customers on the same terms as O.F.S. negotiated with those customers, including receiving the whole of the payment to be made for distribution services. Moreover, they argue, the Non-Competition covenant precluded Mr. Chenier, personally, from causing O.F.S. to do otherwise.

31 In *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 at para. 24, this Court summarized the principles applying to the interpretation of commercial contracts as follows:

> Broadly stated ... a commercial contract is to be interpreted,
>
> (a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;[3]
> (b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the "cardinal presumption" that they have intended what they have said;[4]

(c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties;[5] and (to the extent there is any ambiguity in the contract),

(d) in a fashion that accords with sound commercial principles and good business sense, and that avoids a commercial absurdity.[6]

See also *SimEx Inc. v. IMAX Corp.* (2005), 11 B.L.R. (4th) 214 at paras. 19-23 (Ont. C.A.); and *Dumbrell v. The Regional Group of Companies Inc.* (2007), 85 O.R. (3d) 616 at para. 55 (C.A.).

32 In addition, where the language of a written contract is unambiguous, extrinsic evidence is not admissible to alter, vary, interpret, or contradict the words used in the contract: see *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515; *Mechanical Pin Resetter Co. v. Canadian Acme Screw & Gear Ltd.*, [1971] S.C.R. 628 at 636; *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 at para. 55; and G.H.L. Fridman, *The Law of Contract in Canada*, 5th ed. (Toronto: Thomson Carswell, 2006) at 443-444. Regardless of any ambiguity, however, as noted above, the courts may always have regard to the context and to the objective evidence of the surrounding circumstances underlying the negotiations. As Doherty J.A. noted in *Dumbrell* at paras. 52-56:

> [52] No doubt, the dictionary and grammatical meaning of the words (sometimes called the "plain meaning") used by the parties will be important and often decisive in determining the meaning of the document. However, the former cannot be equated with the latter. The meaning of a document is derived not just from the words used, but from the context or the circumstances in which the words were used. Professor John Swan puts it well in *Canadian Contract Law* (Markham, Ont.: Butterworths, 2006) at 493:
>
>> There are a number of inherent features of language that need to be noted. Few, if any words, can be understood apart from their context and no contractual language can be understood without some knowledge of its context and the purpose of the contract. Words, taken individually, have an inherent vagueness that will often require courts to determine their meaning by looking at their context and the expectations that the parties may have had.
>
> [53] The text of the written agreement must be read as a whole and in the context of the circumstances as they existed when the agreement was created. The circumstances include facts that were known or reasonably capable of being known by the parties when they entered into the written agreement: see *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1, at pp. 23-24 S.C.R.; *H.W. Liebig & Co. v. Leading Investments Ltd.*, [1986] 1 S.C.R. 70, [1986] S.C.J. No. 6, at pp. 80-81 S.C.R., La Forest J.; *Prenn v. Simmonds*, [1971] 1 W.L.R. 1381, [1971] 3 All E.R. 237 (H.L.), at pp. 1383-84 W.L.R.; Staughton, "How Do the Courts Interpret Commercial Contracts?", *supra*, at 307-08.
>
> [54] A consideration of the context in which the written agreement was made is an integral part of the interpretative process and is not something that is resorted to only where the words viewed in isolation suggest some ambiguity. To find ambiguity, one must come to certain conclusions as to the meaning of the words used. A conclusion as to the meaning of words used in a written contract can only be properly reached if the contract is considered in the context in which it was made: see McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at 710-11.
>
> [55] There is some controversy as to how expansively context should be examined for the purposes of contractual interpretation: see Geoff R. Hall, "A Curious Incident in the Law of Contract: The Impact of 22 Words from the House of Lords" (2004) 40 Can. Bus. L.J. 20. Insofar as written agreements are concerned, the context, or as it is sometimes called the "factual matrix", clearly extends to the genesis of the agreement, its purpose, and the commercial context in which the agreement was made: *Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc.*, [1998] O.J. No. 4368, 114 O.A.C. 357 (C.A.), at p. 363 O.A.C.

> [56] I would adopt the description of the interpretative process provided by Lord Justice Steyn, "The Intracticable Problem of the Interpretation of Legal Texts", *supra,* at 8:
>
>> In sharp contrast with civil legal systems the common law adopts a largely objective theory to the interpretation of contracts. *The purpose of the interpretation of a contract is not to discover how the parties understood the language of the text, which they adopted. The aim is to determine the meaning of the contract against its objective contextual scene. By and large the objective approach to the question of construction serves the needs of commerce.*

[Emphasis in original. Citation omitted.]

33 To those principles, I would add the following in the present context. The Cyr parties and the Chenier parties entered into a series of contracts in order to give effect to the "deal" whereby Mr. Cyr was to acquire both the I.C.B. and O.F.S. operations. While the Mutual Undertaking was not signed at the same time as the Asset Purchase Agreement, the commitments it contains were contemplated in the latter Agreement and formed part of the same global transaction. In these circumstances, the court must have regard not only to the language of the particular contract that is being interpreted (the Mutual Undertaking or the Non-Competition covenant), taken as a whole, but to the surrounding contracts as well. As Professor John D. McCamus notes in *The Law of Contracts* (Toronto: Irwin Law Inc., 2005) at 715:

> Many transactions, especially large commercial transactions such as the purchase and sale of a large and complex business, may involve the execution of several agreements. In such contexts, it is an interesting question, then, whether in the interpretation of one of the agreements, regard may be had to the others. *The basic principle is that such regard may be had only where the agreements essentially form components of one larger transaction. Where each agreement is entered into on the faith of the others being executed and where it is intended that each agreement form part of a larger composite whole, assistance in the interpretation of any particular agreement may be drawn from the related agreements.* [Emphasis added. Citation omitted.]

34 In *Mechanical Pin Resetter*, for example, the Supreme Court of Canada read four interrelated agreements together in order to ascertain the geographical scope of a licence to manufacture set out in one of them. Here, in my view, the Non-Competition covenant in the Asset Purchase Agreement and the provisions in the Mutual Undertaking must be considered together in order to determine the true intention of the parties as to their individual and combined meaning and effect, as expressed in the language they used.

The Principles Applied

35 Historically, when O.F.S. had customers who needed delivery services, it simply collected the payments from the customers and then paid the amount relating to the delivery services over to I.C.B., its sister company. The appellants submit that the trial judge should have interpreted to words "*to continue* to use the services of the Purchaser" [emphasis added] in s. 8.1(i) of the Asset Purchase Agreement to encompass a proviso that the relationship would continue to operate in such a fashion after the asset purchase transaction, and even if the share purchase transaction were not completed. They argue that this opportunity was the "goodwill" of the business purchased by I.C.B. 2001 for which it agreed to pay $192,500.

36 Read in this light, the appellants contend, the Mutual Undertaking -- coupled with the Non-Competition covenant -- precludes Mr. Chenier from using O.F.S., indirectly, to derive a benefit for himself and his company from the distribution portion of the O.F.S. contracts. In their view, Mr. Chenier should not be permitted to circumvent his obligations under the Asset Purchase Agreement not to compete for that business. In particular, they insist, he was prohibited from dealing with the Giant Tiger contract in the fashion that he (and O.F.S.) did.

37 The appellants maintain that the agreements are clear and unambiguous. The Non-Competition covenant precluded Mr. Chenier from competing with I.C.B. 2001 for distribution business, and from causing any of his companies to do so. The Mutual Undertaking -- through the use of the words "*to continue to use* the services of the Purchaser" -- make it clear that the old inter-corporate arrangements were to continue.

38 I do not agree. Read together, the various agreements are capable of more than one interpretation, in my opinion.

39 This interpretation advanced by the appellants may have been open to the trial judge. But it is not the one she chose. Based on the principles of contractual interpretation recited above -- which the trial judge properly applied, in my view -- and on her application of those principles in the context of the transactions, the interpretation she chose ought not to be interfered with on appeal. In this respect, I agree with the following comment of Laskin J.A. in *Bradscot (MCL) Ltd. v. Hamilton-Wentworth Catholic District School Board* (1999), 42 O.R. (3d) 723 (C.A.) at 728-729:

> Faced with two interpretations [of the tender instructions], either of which is reasonable, and no error in the application of the relevant legal principles, in my view this court should defer to the finding of the trial judge.

40 This view is consistent with the weight of the post-*Housen*[7] jurisprudence on the standard of review in cases involving the interpretation of contracts. A trial judge must apply the proper principles of contractual interpretation, and a failure to do so is an error of law attracting review on the standard of correctness. To the extent that the contract interpretation involves a consideration of extensive evidence or a determination of the factual matrix, or a question of mixed fact and law, however, a more deferential standard may apply. See *MacDougall v. MacDougall* (2005), 262 D.L.R. (4th) 120 (Ont. C.A.) at paras. 23-32.

41 Here, the trial judge found (i) that the Non-Competition covenant did not stand alone and had to be read in light of the Mutual Undertaking, and (ii) that the Mutual Undertaking was the mechanism created by the parties to give effect to s. 8.1(i) of the Asset Purchase Agreement whereby I.C.B. and Mr. Chenier agreed to obtain O.F.S.'s commitment to continue to use the services of the Purchaser for O.F.S.'s distribution services to its customers. She concluded that the Mutual Undertaking gave to I.C.B. 2001 a right of first refusal for all distribution contracts for O.F.S.'s customers requiring distribution, trucking, and delivery services, and held that I.C.B. 2001 was provided with such a right of first refusal with respect to the Giant Tiger contract.[8] She held further that the right of first refusal contemplated a subcontracting arrangement between O.F.S. and I.C.B. 2001 and that it was accordingly irrelevant whether O.F.S. made a profit on the subcontracting arrangement. Moreover, the trial judge reasoned that the conduct of the parties following the execution of the Mutual Undertaking was in harmony with, and reinforced, her conclusions.

42 The trial judge's interpretation of the contractual documentation entered into by the parties -- and particularly of the interplay between the Mutual Undertaking and the provisions of ss. 7.5 and 8.1(i) of the Asset Purchase Agreement -- is the proper one, in my view. On the contractual principles canvassed above, the two documents are to be read and interpreted together, not in isolation.

43 Neither the Asset Purchase Agreement nor the Mutual Undertaking make any reference to the terms on which I.C.B. 2001 is to provide distribution services to O.F.S.'s customers, including the price. However, the trial judge's interpretation is the most faithful to the language of the documentation, having regard to the factual matrix in which the contracts were made, and makes commercial sense. Indeed, her view is in keeping with the appellants' theory that the purpose of s. 8.1(i) was to protect the goodwill purchased by I.C.B. 2001, although not necessarily in the fashion the appellants contend.

44 Whether characterizing the relationship between O.F.S. and I.C.B. 2001 as one of "contractor/subcontractor" is the most apposite approach is not really important. The notion that O.F.S. would enter into a comprehensive arrangement with its customers and subsequently in some fashion contract out the distribution component of that arrangement to others -- affording I.C.B. 2001 the first right of refusal on that work -- is clearly what the parties had in mind in the Asset Purchase Agreement, as given effect to by the Mutual Undertaking. The Non-Competition covenant must be given effect in that context. I reach these conclusions for the following reasons.

45 First -- and to reiterate -- the specific obligation of I.C.B. and Mr. Chenier under s. 8.1(i) of the Asset Purchase Agreement was to obtain O.F.S.'s two-fold commitment (a) "to continue to use the services of the Purchaser ... for distribution services in respect of Ottawa Freezer Services Inc. customers", and (b) "to permit the Purchaser ... to operate from [the O.F.S. premises]." These obligations were mutually beneficial. The right to bid on the distribution services in respect of O.F.S.'s customers was of considerable importance to the Cyr parties, as purchasers, and the ability to operate from the O.F.S. premises would enable them to do so more efficiently and at less cost.[9] Further, having I.C.B. 2001 as a tenant of its storage facilities and available to provide the distribution services for its customers was advantageous to O.F.S.

46 The Mutual Undertaking gave effect to both of these requirements. It adopted the device of a right of first refusal to ensure that O.F.S. would continue to use the services of I.C.B. 2001 for the distribution services required by its customers. And it gave I.C.B. 2001 the right to operate from the O.F.S. premises at 400 Industrial Ave. for a period of five years. Of some significance -- because it indicates the parties recognized the share transaction might not close, and because it reflects the benefits flowing from having the distribution operations running from the O.F.S. storage premises -- the Mutual Undertaking provides for a reduction in the gross annual charge for the use of the premises from the $120,000 agreed to in the Asset Purchase Agreement to $90,000 in the event the transaction was not completed.

47 Secondly, while I accept that I.C.B. 2001 paid a considerable sum for the "goodwill" of I.C.B., I do not agree with Mr. Marks' submission that what I.C.B. 2001 was entitled to acquire in this respect were all of the distribution contracts entered into by O.F.S. in the future -- even if the share purchase transaction were not completed -- including all of the revenues generated by that component of the O.F.S. contracts. Mr. Marks focuses on two provisions in the Asset Purchase Agreement in support of this argument: s. 2.1(f) incorporates "contracts to provide goods or services entered into after February 28th, 2001" as part of the assets purchased, and s. 3.2(c) allocates $192,500 of the purchase price to the "[g]oodwill of the ... business as set out in section 2.1(f) hereof".

48 This interpretation reflects a misreading of s. 2.1(f) and its purpose, however. A review of s. 2.1 as a whole demonstrates that the purpose of subsection 2.1(f) is to catch all contracts for goods and services entered into *by I.C.B.*, the asset vendor, between the date of the Letter of Intent (February 28, 2001) and the date the asset transaction closed (July 11, 2001). It has nothing to do with future contracts entered into *by O.F.S.*[10]

49 Thirdly, the circumstances surrounding the execution of the Mutual Undertaking -- the factual matrix -- support the trial judge's interpretation of the contractual framework between the parties. To begin with, the parties contemplated that the share transaction might not be completed. It was subject to several covenants for the benefit of either of the vendor or purchaser which could be waived and, most importantly, a true condition precedent which neither party could waive, namely, obtaining the consent of Loeb to extend the 400 Industrial Ave. sublease or obtaining a new head-lease. I note as well that the Mutual Undertaking specifically contemplated a reduction in annual rent from I.C.B. 2001 if the share transaction did not close. In that event, the distribution company (I.C.B. 2001, as purchaser of the I.C.B. assets) and the freezer/cold storage company (O.F.S.) would no longer be part of the same business enterprise and would be operating at arm's length. This would result in a situation quite different from that which prevailed when I.C.B. and O.F.S. were sister companies in the same corporate family.

50 Moreover, the right of first refusal itself contemplates that there may be distribution contracts for O.F.S. customers that I.C.B. 2001 may not take up. What could the parties have intended would happen in the event that the share transaction failed to close but I.C.B. 2001 declined to accept a distribution contract for one of O.F.S.'s storage customers? Mr. Marks conceded that, if the appellants are correct in their interpretation of the effect of the Non-Competition covenant, O.F.S. would simply be barred from contracting the declined distribution work out to someone else as long as Mr. Chenier remained its operating mind. This interpretation makes no commercial sense. O.F.S. would be left with mounting inventories of perishable products in its cold storage/freezer premises with no ability to move them or to honour its distribution commitments to its customers. At best, O.F.S. would be left in a disadvantageous position in obtaining cold storage/freezer business because it would be at the mercy of I.C.B. 2001 before it could bind itself to furnish distribution services to its customers. It is absurd that the parties would have intended such a result.

51 Nor does it make any commercial sense that, if the share transaction failed to close, Mr. Chenier and O.F.S. would simply agree to turn over to I.C.B. 2001 -- on a sort of turn-key basis -- the distribution portion of the their customers' contracts as negotiated. Parties negotiating a multi-faceted agreement may be more concerned about the overall price arrived at than they are about the individual components of that price. It may suit a customer to have a lower storage price component and a higher distribution price component to the contract, or it may suit them to have the reverse. Why should I.C.B. 2001 benefit from the former situation at O.F.S.'s expense when those two entities are operating at arm's length just because O.F.S. is obliged to give it a right of first refusal to provide the distribution services in relation to that particular contract?

52 Further, even if O.F.S. could theoretically benefit from negotiating an unduly high storage price and an unduly low distribution price, the evidence in this case suggests that it did not. O.F.S. offered to and contracted with I.C.B. 2001 for the Giant Tiger distribution contract at a rate of 35 cent(s) per case. Despite the fact that O.F.S. had contracted with Giant Tiger at a rate of 65 cent(s) per case, the fact remains that 35 cent(s) per case for distribution services was reasonable. The trial judge notes at para. 420:

> Moreover, it seems to me that the best indicator to the Court that the 35 cents per case rate was not outside the realm of the reasonable herein was that when Mr. Cyr refused to undertake the distribution work for Giant Tiger for 2003, although offered to him at 40 cents a case pursuant to the right of refusal, S & M Delivery Service contracted for that work at 38 cents a case, and still performs same today, now at 40 cents a case.

This suggests that O.F.S.'s offer of first refusal on the distribution contract at 35 cent(s) per case was a *bona fide* business opportunity.

53 As Estey J. observed in Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co., [1980] 1 S.C.R. 888 at 901:

> ... [T]he normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere ... Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation ... which promotes a sensible commercial result.

54 Finally -- in relation to the surrounding circumstances and the specific context of the Giant Tiger situation -- negotiations towards a new Giant Tiger arrangement had already begun before the closing of the asset purchase on July 11, 2001. Mr. Cyr attended a meeting with Mr. Chenier and Giant Tiger representatives in June 2001 at which he was introduced as the potential purchaser of O.F.S., and at which a new proposal was presented to Giant Tiger. This proposal was reflected in a letter dated June 26, 2001, signed by Mr. Chenier on behalf of O.F.S., *but drafted by Mr. Cyr's financial advisor, Mr. Luigi*. The letter clearly indicated that O.F.S. was proposing to provide the distribution services to Giant Tiger at a per-case price of 68 cent(s). Mr. Cyr therefore knew prior to the negotiation and execution of the Mutual Undertaking -- or, at least, his representative did -- what O.F.S. and Mr. Chenier proposed to charge Giant Tiger for distribution. Indeed, the trial judge found at para. 421 of her reasons that "Mr. Cyr himself was aware, or had to have been aware, that O.F.S. was making money on the Giant Tiger distribution work." This finding is amply supported in the evidence.

55 The parties' conduct in giving effect to the Mutual Undertaking in relation to the Giant Tiger contract bears out the trial judge's interpretation of the agreements and is consistent with their awareness of the foregoing circumstances. Under modern Canadian law, the subsequent actions of the parties may be helpful in explaining the true meaning and intent of their agreement. In *Montreal Trust Company of Canada v. Birmingham Lodge Limited* (1995), 24 O.R. (3d) 97 (C.A.) at 168 Laskin J.A. said:

> Moreover, I think that the respondent's subsequent conduct resolves any doubt about the extent of the appellants' liability under art. 10.1. Subsequent conduct may be used to interpret a written agreement because "it may be helpful in showing what meaning the parties attached to the document after its execution, and this in turn may suggest that they took the same view at the earlier date": S.M. Waddams, *The Law of Contracts*, 3rd ed. (1993), at para. 323. Often, as Thomson J. wrote in *Bank of Montreal v. University of Saskatchewan* (1953), 9 W.W.R. (N.S.) 193 at p. 199 (Sask. Q.B.): "there is no better way of determining what the parties intended than to look to what they did under

it".

See also *Arthur Andersen Inc. v. Toronto-Dominion Bank* (1994), 17 O.R. (3d) 363 at 372 (C.A.).

56 Here, after formally being offered the right of first refusal for the Giant Tiger distribution work, as required by the Mutual Undertaking, Mr. Cyr wrote to Mr. Chenier on two occasions confirming his company's agreement "*to act as Ottawa Freezer's agents* in distributing Giant Tiger's frozen and cooled products." [Emphasis added.] This language is not consistent with an understanding that O.F.S. would simply be turning over the distribution portion of O.F.S.'s contracts with their customers, price and all.

57 Moreover, the terms of the formal Distribution Agreement executed by I.C.B. 2001 and O.F.S. on December 14, 2001 reflect an arrangement that contemplates both separate contracts between O.F.S. and its customers, on the one hand, and I.C.B. 2001 and O.F.S. on the other hand, and a difference in price for those services. For example, the recitals of that Distribution Agreement state:

> WHEREAS
>
> A. OFS has agreed to provide commercial freezer storage space for frozen and fresh food products owned by Giant Tiger Stores Limited;
> B. OFS has granted a right of first opportunity to ICB[11] to provide trucking and general deliveries for OFS on behalf of its customers; and
> C. Whereas OFS and ICB wish to provide for the terms and conditions for the distribution of frozen and fresh food products on behalf of OFS' Customer Giant Tiger Stores Limited on the terms and conditions that are set out herein.

58 The Distribution Agreement then goes on to provide that I.C.B. 2001 will deliver the frozen food products designated in accordance with a prescribed delivery schedule and for the tariff set out in s. 5 of the agreement. That tariff was 35 cent(s) per case, subject to an increase to 38 cent(s) if I.C.B. 2001 is denied access to 400 Industrial Ave. through no fault of its own. Section 5 contains the following addition which, in my view, is significant in relation to the interpretation of these agreements:

> ICB shall be paid *commissions* for deliveries made twenty-one days after providing the deliveries to OFS's Customer, providing that the deliveries have been in accordance with clause two of this agreement. *If OFS is able to negotiate with its Customer Giant Tiger an increased delivery rate for the Goods at any time during the terms of this contract, OFS shall share one-half of the increase in the delivery rate with ICB*. ... [Emphasis added.]

59 There is a disconnect between the concept of "commissions for deliveries" and the view that O.F.S.'s obligation under the Mutual Undertaking was simply to turn over its customers' distribution contracts to I.C.B. 2001 at the price O.F.S. and its customer negotiated for delivery. At the same time, the notion that any increase in delivery rates is to be split 50/50 is entirely consistent with the recognition that some of the revenue from the distribution portion of O.F.S.'s contract with its customer is to go to O.F.S. Indeed, the 50/50 division is not far from the 30 cent(s)/35 cent(s) apportionment that characterized the Giant Tiger arrangement.

60 Mr. Marks submitted that the excess sharing provision could equally be interpreted to support his argument that O.F.S. was not entitled to take anything for distribution; it shows that O.F.S. needed specific authorization to do so, and this provision was inserted to provide an incentive to O.F.S. to negotiate a better deal. I do not think the language supports this contention, however. If Mr. Marks were correct, the provision would not have said that "*OFS* shall share one-half of the increase in the delivery rate with *ICB*".[12] [Emphasis added.] It would have said that *ICB* would split the increase with *OFS*, because it would be I.C.B. 2001 that was contractually entitled to the full amount but for the excess sharing provision.

61 The appellants raise a further argument, in addition. The trial judge erred, they submit, by, in effect, amending the Asset Purchase Agreement through her interpretation process when the parties did not intend to do so and when the Asset Purchase Agreement itself expressly provides that any amendments must be in writing.

62 I do not accept this submission either. The trial judge did not "amend" the Asset Purchase Agreement. Rather, she correctly interpreted and read the Asset Purchase Agreement and the Mutual Undertaking together, and in their appropriate contexts. She concluded that the right of first refusal in the Mutual Undertaking was simply the mechanism chosen by the parties to give effect to the provisions of the Asset Purchase Agreement which required I.C.B. and Mr. Chenier to get O.F.S. onside "to continue to use the services of the Purchaser [I.C.B. 2001] for distribution services in respect of Ottawa Freezer Service's customers". However, there is nothing in the Asset Purchase Agreement or the Mutual Undertaking -- or in any of the other contractual documentation entered into between the parties -- requiring O.F.S. "to continue to use the services" in accordance with the same inter-company arrangements that were in place when O.F.S. and I.C.B. were sister companies in the same business enterprise. For the reasons I have expressed above, it makes no commercial sense that that should be the case in circumstances where -- as everyone recognized might be the case -- the share purchase transaction failed to close and I.C.B. 2001 and O.F.S. were operating at arm's length.

63 The appellants also submit that the trial judge drew various erroneous inferences of fact from the evidence which led her into the error of finding that the Mutual Undertaking had modified the provisions of the Asset Purchase Agreement. The precise inferences complained of are not easy to ascertain from the appellants' argument, but they appear to include findings such as the following:

(a) Mr. Chenier was not negotiating the Giant Tiger arrangement for I.C.B. 2001 but for O.F.S.;
(b) O.F.S. was entitled to make a profit on the distribution component of the Giant Tiger contract;
(c) Mr. Cyr had gone to Giant Tiger himself during the Fall of 2001 to attempt to contract for the distribution work; and
(d) Paragraph 5 of the Distribution Agreement between O.F.S. and I.C.B. 2001 confirmed an understanding that O.F.S. was entitled to compete with I.C.B. 2001.

64 In my view, however, the appellants' attacks on these inferences -- to the extent they were inferences drawn by the trial judge -- are essentially an attempt to re-try the case. With the possible exception of the finding that Mr. Cyr had gone to Giant Tiger himself to attempt to negotiate a distribution contract and was rebuffed -- an inference which I think played little role in her overall conclusions -- the findings of fact that she made and the inferences she drew from those facts were all open to her on the record. Specifically, her finding at para. 421 that "Mr. Cyr himself was aware, or had to have been aware, that O.F.S. was making money on the Giant Tiger distribution work", cited earlier in these reasons, is amply justified by the evidence, also canvassed earlier in these reasons.

65 Accordingly, I would not give effect to the appellants' contractual interpretation ground of appeal.

<u>The Non-Competition Covenant</u>

66 Nor do I accept the argument that Mr. Chenier's Non-Competition covenant precludes O.F.S. from dealing with Giant Tiger and with I.C.B. 2001 in relation to the Giant Tiger contract in the way that it did, or that it precludes Mr. Chenier from causing O.F.S. to do so in the circumstances.

67 O.F.S. is not a party to the Asset Purchase Agreement, or to any other agreement respecting the Chenier/Cyr "deal" other than the Mutual Undertaking. Mr. Chenier did covenant not to compete with the Purchased Business, however. So far as it is relevant, s. 7.5 of the Asset Purchase Agreement states:

> 7.5 Non-Competition
>
> The Vendor and Robert Chenier each covenants and agrees with the Purchaser that he and it will not, nor will either of them permit anyone on their behalf for a period of five years from the Closing Date, either alone or in conjunction with any person, firm, corporation, association, partnership, syndicate, trust or other entity, whether as principal, agent, shareholder or in any other capacity whatsoever, to:
>
> (a) carry on, or be engaged in, concerned with or have any financial or other interest in, directly or indirectly, any undertaking which is in whole or in part competitive with the

Purchased Business during such period ...

68 I.C.B. -- the "Purchased Business" -- was a food distribution business, with some emphasis on cooled and frozen food products. On its face, and in isolation, the Non-Competition covenant might be read as an impediment to the contract entered into between O.F.S. and Giant Tiger and the subsequent Distribution Agreement between O.F.S. and I.C.B. 2001. As the trial judge observed at para. 406, however, "[t]he non-competition provision contained in subparagraph 7.5 of the Asset Purchase Agreement does not stand alone." It must be read and construed in the context of the asset and share purchase transactions, and the various agreements entered into in connection with them viewed as a whole. When that is done, it is apparent the trial judge's finding that the Chenier parties were not in breach of the Non-Competition covenant is supported on the record.

69 The reasons for this have been canvassed above in relation to the contractual interpretation point. Given the commercial reality that the parties had entered into *two* different but related transactions, either one of which might not close, the wording of the Non-Competition covenant is completely inconsistent with the view that it was aimed at the activities of O.F.S., or Mr. Chenier's activities in relation to O.F.S., at all. The parties could not have expected both (i) that if the share transaction did not close, Mr. Chenier would continue to operate O.F.S. and to enter into comprehensive storage/distribution contracts with its customers, and (ii) that he would not be entitled to "carry on, or be engaged in, concerned with or have any financial or other interest in, directly or indirectly, any undertaking which is *in whole or in part competitive* with the Purchased Business." [Emphasis added.]

70 To the contrary, what the parties clearly contemplated, in my opinion, was that O.F.S. would continue to enter into distribution contracts with its customers, in conjunction with its storage contracts, and that I.C.B. 2001 would be given the right to bid on the distribution services arising out of those contracts. O.F.S. has no trucks and has never done delivery and distribution work. The parties could not have intended -- in the event the share purchase transaction was not completed -- that O.F.S. would not be able to service those contracts by subcontracting to someone else if I.C.B. 2001 declined to take up its right of first refusal.

71 The appellants argue that the delivery business available from Giant Tiger constituted "the business" of I.C.B. 2001 that it had purchased from I.C.B. and with respect to which Mr. Chenier had contractually bound himself not to compete. They therefore submit that, without the permission of Mr. Cyr, Mr. Chenier was not in a position to negotiate the transaction with Giant Tiger for the delivery of its products and to benefit personally from that transaction. As such, they rely on *Read v. Cole* (1915), 52 S.C.R. 176 and submit that he should have been held to be a trustee of this business for I.C.B. 2001.

72 I do not accept this line of reasoning, either. I.C.B. 2001 did not purchase "the delivery business available from Giant Tiger" as the appellants' submit. It purchased the promise of Mr. Chenier and I.C.B. to obtain the commitment of O.F.S. to use the services of I.C.B. 2001 for distribution services in respect of O.F.S.'s delivery contract with Giant Tiger.

73 The trial judge summarized her conclusions with respect to the appellant's arguments about the Non-Competition covenant in the following passage at para. 422 of her reasons:

> The covenant not to compete as contained in the Asset Purchase Agreement does not stand alone in this case. It must be read in context. In the face of the covenant not to compete, the parties turned their minds to distribution work and entered into the Mutual Undertaking, with the understanding and intent that any distribution work which O.F.S. might obtain from its customers would be first offered to I.C.B. 2001. The Mutual Undertaking contemplated and provided that O.F.S. would subcontract out this work to I.C.B. 2001 pursuant to the right of first refusal. It stated that O.F.S. would provide I.C.B. 2001 "a first right of refusal, in writing for all *distribution contracts* for its customers for which same require distribution ..." (emphasis mine). The Mutual Undertaking contemplated that O.F.S. could obtain distribution contracts. [Emphasis in original.]

74 I agree with these comments. The Mutual Undertaking shows that the parties intended that O.F.S. would enter into distribution contracts with its customers. The parties contemplated that the share purchase transaction might not close. They recognized that O.F.S. would be operating at arm's length to I.C.B. 2001 if that were the case. They knew that O.F.S. was Mr. Chenier's company. In this context, Mr. Chenier's covenant not to compete ought not to be interpreted in a manner that would preclude O.F.S. from entering into its storage and distribution contract with Giant Tiger.

75 In the end, I do not see the subcontract between O.F.S. and I.C.B. 2001 regarding the Giant Tiger distribution work as creating a state of affairs in which Mr. Chenier or his company are *competing* with I.C.B. 2001. If the Chenier parties are disqualified from entering into such an arrangement with I.C.B. 2001, in my view, it must be because the contractual documentation did not permit it -- an interpretation I have rejected for the reasons set out above -- or because they were prevented from doing so by Mr. Chenier's breach of his a fiduciary obligation or an obligation of good faith and loyalty to I.C.B. 2001 under the Management Consulting Agreement.

76 I will now turn to these latter allegations.

<u>Fiduciary Obligation, Good Faith, and Avoidance of Conflict of Interest</u>

77 The appellants contend that Mr. Chenier was disqualified from competing with I.C.B. 2001 by causing O.F.S. to take a profit on the distribution component of the Giant Tiger contract by reason of a fiduciary obligation, a duty of loyalty and good faith, and a duty to avoid putting himself in a position where his interests conflicted with those of I.C.B. 2001. In the context of this case, these three allegations may be dealt with together. They are in substance an allegation that Mr. Chenier owed a fiduciary duty to I.C.B. 2001 that required him to act in good faith and without a conflict of interest towards it.

78 Whether Mr. Chenier owed a fiduciary duty to I.C.B. 2001 depends primarily on his relationship with that company under the Management Consulting Agreement.

79 Based upon the trial judge's findings -- to which I will come -- no such duty arises, in my view, from the arm's length nature of the relationship between Mr. Chenier and I.C.B., as vendors, and Mr. Cyr and his companies, as purchasers, in relation to the commercial transaction itself. Courts are reluctant to impose fiduciary consequences on commercial interactions between arm's length parties pursuing their own self interest: see *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 at 381, and *Cadbury Schweppes Inc. v. FBI Foods Ltd.*, [1999] 1 S.C.R. 142 at para. 30.

80 The appellants argue that Mr. Chenier was the equivalent of "top management" with an obligation to promote the business interests of I.C.B. 2001. Accordingly, they contend, he was precluded from putting himself in a position of conflict of interest with I.C.B. 2001 and from, in effect, stealing a corporate opportunity from I.C.B. 2001 by skimming 30 cent(s) per case off the price obtained from Giant Tiger for distributing its products. In this respect they rely upon the decision of the Supreme Court of Canada in *Canadian Aero Services Limited v. O'Malley*, [1974] S.C.R. 592.

81 The trial judge rejected this argument. She concluded that the relationship between Mr. Chenier and the Chenier parties did not meet the criteria for a fiduciary relationship. Many authorities have dealt with those criteria, but the common characteristics of a fiduciary relationship as enumerated by Wilson J. in dissent in *Frame v. Smith*, [1987] 2 S.C.R. 99 have since been accepted by the Supreme Court of Canada as setting out a rough and ready guide for the existence of such a relationship: see *Lac Minerals Ltd. V. International Corona Resources*, [1989] 2 S.C.R. 574 at 577-578, Sopinka J.; and *Hodgkinson v. Simms* at 379. At p. 136 in *Frame v. Smith*, Wilson J. said:

> Yet there are common features discernible in the contexts in which fiduciary duties have been found to exist and these common features do provide a rough and ready guide to whether or not the imposition of a fiduciary obligation on a new relationship would be appropriate and consistent.
>
> Relationships in which a fiduciary obligation has been imposed seem to possess three general characteristics:
>
> (1) The fiduciary has scope for the exercise of some discretion or power.
> (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
> (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the

discretion or power.

82 The trial judge found that the parties to the Cyr/Chenier commercial transaction were of equal strength and expertise. There was no imbalance, dependency, or vulnerability in the relationship between them. She rejected the submission that Mr. Cyr and Mr. Chenier were partners, finding that there was nothing in the various agreements entered into that would support the existence of such a relationship. The trial judge found as well that Mr. Chenier was not part of I.C.B. 2001's senior management as a result of his association with I.C.B. 2001 under the Management Consulting Agreement. Instead, she concluded, he was retained as a consultant to perform certain duties at the request of Mr. Cyr, and the duties he was retained to perform did not place him in a fiduciary relationship with the appellants. These factual determinations are all supported on the record and are dispositive of the fiduciary argument, in my opinion.

83 The appellants argue that Mr. Chenier was given complete discretion and control over the negotiations with Giant Tiger, thus creating the unilateral exercise of discretion/vulnerability dynamic that is generally characteristic of a fiduciary relationship. Mr. Chenier abused that position, they contend, when he caused O.F.S. to enter into the distribution component of the Giant Tiger agreement at a rate of 65 cent(s) per case and then to subcontract that work to I.C.B. 2001 at 35 cent(s) per case. In my view, however, the trial judge properly rejected this position, having regard to the Mutual Undertaking the parties had negotiated. She correctly noted at para. 440:

> ... Mr. Chenier did not negotiate with Giant Tiger on behalf of I.C.B. 2001. Mr. Chenier negotiated a comprehensive agreement with Giant Tiger for O.F.S. and for its benefit. It was always understood that the distribution aspect of that comprehensive agreement would be subcontracted out.

84 Under the Mutual Undertaking the parties had specifically agreed that I.C.B. 2001 would be given a first right of refusal "for all distribution contracts for its [O.F.S.'s] customers". The distribution contracts referred to must be contracts between O.F.S. and its customers, not contracts between I.C.B. 2001 and O.F.S.'s customers negotiated through the auspices of Mr. Chenier acting on behalf of I.C.B. 2001. As Mr. Cyr's correspondence tendering the bid for the Giant Tiger distribution work demonstrates, Mr. Cyr was well aware that I.C.B. 2001 was acting "as Ottawa Freezer's agents in distributing Giant Tiger's frozen and cooled products."

85 In the end, the trial judge disposed of the corporate opportunity and conflict of interest arguments with this summary at paras. 446-447 of her reasons:

> The Cyr parties submitted the proposition that where a person has a role in the business which is beyond that of a mere obedient servant, then such person stands in a fiduciary relationship requiring loyalty, good faith and avoidance of a conflict of duty and self-interest. It is submitted that the relationship will include a prohibition against the party acquiring for himself the opportunity sought by the party for whom he is negotiating. *Canadian Aero, supra*, is cited for this proposition, along with *Schauenburg Industries Ltd. v. Borowski* (1979), 25 O.R. (2d) 737. The case at hand can be clearly distinguished from the two cited. Mr. Chenier was not a senior officer of I.C.B. 2001, nor part of its top management. This is not a case of an employee acquiring for himself either secretly or without the approval of the company, any property or business advantage belonging to the company or for which he has been negotiating.
>
> I repeat, Mr. Chenier was acting pursuant to the Mutual Undertaking.

86 I agree.

87 For similar reasons, and because of the nature of the contractual relationship between the parties as outlined above, the appellants' claim that Mr. Chenier is in breach of a duty to avoid conflicts of interest also fails.

88 Finally, the trial judge dismissed all of the Cyr parties' allegations that Mr. Chenier had acted in bad faith in his dealings with Mr. Cyr. Those allegations included the following:

> (a) that, in respect of the VTB Loan Action, Mr. Chenier had manipulated the circumstances and

orchestrated the Cyr departure from 400 Industrial Ave. in order to make more freezer space available to Giant Tiger at a favourable price;

(b) that he had misrepresented the continued existence of the Baskin Robbins and Farm Boy accounts;

(c) that he had taken advantage of his position in order to keep Mr. Cyr in the dark concerning the Giant Tiger negotiations with a view to obtaining a personal benefit;

(d) that he had acted in bad faith in refusing to close the share purchase transaction by not making good faith efforts to obtain the lease extension; and

(e) that he was simply manipulating events in an attempt to frustrate the share purchase transaction so that he could keep the lucrative Giant Tiger contract for himself.

89 The trial judge's factual findings, amply supported in the record, dispose of the appellants' argument with respect to bad faith.

90 In the end, I would not give effect to the appellants' ground of appeal relating to the Cyr Action.

Damages

91 In view of the foregoing conclusions it is not necessary to deal with the appellants' grounds of appeal dealing with the damage issues.

DISPOSITION

92 For the reasons outlined above, I would dismiss the appeals.

93 The respondents are entitled to their costs of the appeals, fixed at $75,000 inclusive of disbursements and GST.

R.A. BLAIR J.A.
R.G. JURIANSZ J.A.:-- I agree.
H.S. LaFORME J.A.:-- I agree.

cp/e/qlkxl/qlprp/qltxp/qljxl/qlcxm/qlbrl/qlhcs

1 2794201 Canada Inc. c.o.b. as C.Y.R. Distributions.

2 3869130 Canada Inc. c.o.b. as I.C.B. Distribution 2001. This company was incorporated by Mr. Cyr for the purpose of purchasing I.C.B.

3 *B.G. Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12 at 23-24; *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744 at 770 (C.A.).

4 *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1998), 40 B.L.R. (2d) 1 at para. 403 (Ont. Gen. Div.), aff'd (1999), 45 O.R. (3d) 417 (C.A.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325 at para. 26 (C.A.); *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 at 166-68.

5 *Eli Lilly, ibid.* at 166; *Kentucky Fried Chicken v. Scott's Food Services Inc.* (1998), 114 O.A.C. 357 at paras. 25-27 (C.A.).

6 *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901; *Kentucky Fried Chicken, ibid.*

7 *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235.

8 I.C.B. 2001 chose to exercise that right for an initial term of one year but not to do so thereafter.

9 Indeed, the Distribution Agreement subsequently entered into between O.F.S. and I.C.B. 2001 for the distribution of Giant Tiger products specifically called for an increase in the price I.C.B. 2001 would receive per case in the event that it was required to provide the services from other premises through no fault of its own.

10 It may well be that the reference to "section 2.1(f)" in s 3.2(c) is a typographical error, since it is s 2.1(e), the section dealing with the purchase price, that refers to "goodwill". However, there does not appear to have been any evidence led on this point.

11 In this context, "ICB" refers to I.C.B. 2001.

12 In this context the reference to "I.C.B." is to I.C.B. 2001, not to Mr. Chenier's company I.C.B. Distribution Inc.

Indexed as:

Hunters Trailer & Marine Ltd. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF Hunters Trailer & Marine Ltd.

[2001] A.J. No. 857

2001 ABQB 546

[2001] 9 W.W.R. 299

94 Alta. L.R. (3d) 389

295 A.R. 113

27 C.B.R. (4th) 236

106 A.C.W.S. (3d) 841

Action No. 0003 19315

Alberta Court of Queen's Bench
Judicial District of Edmonton

Wachowich C.J.Q.B.

Heard: May 2, 2001.
Judgment: June 21, 2001. Filed: June 25, 2001.

(53 paras.)

Counsel:

Kentigern A. Rowan, for Canadian Western Bank.
Juliana E. Topolniski, Q.C., for Gillespie Farrell.
Terrence M. Warner, for CIT Financial Ltd.
Charles P. Russell, for Reynolds, Mirth, Richards and Farmer.
Douglas H. Shell, for Deutsche Financial Services.
Michael J. McCabe and K. Becker, for Hunters Trailer & Marine Ltd.

Jeremy H. Hockin and Deborah J. Polny, for Deloitte Touche Inc.

REASONS FOR DECISION

WACHOWICH C.J.Q.B.:--

BACKGROUND

1 On October 11, 2000 I granted Hunters Trailer & Marine Ltd. ("Hunters"), ex parte, a 30 day stay of proceedings under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 as. am. ("CCAA") and further authorized limited debtor in possession ("DIP") financing with a super-priority status over other claims. I granted the Monitor appointed by my Order and Hunters' counsel and financial advisors a charge against the present and future property of Hunters ("Administrative Charge") in priority to all other charges except the DIP security. In addition, I ordered that Canadian Western Bank ("CWB"), the DIP lender, be reimbursed from the authorized DIP financing for any advances made between September 25, 2000 and the date of my Order. Those advances amount to $150,596.10, approximately 94 percent of which was used to cover Hunter's payroll. The balance was for payment of essential expenses such as security for the premises. My Order of October 11th also contained a standard comeback clause in which a two day notice period was specified.

2 The stay of proceedings was extended by Wilson J. on November 8, 2000. By Order dated December 7, 2000 I terminated the stay and appointed Deloitte Touche Inc. as interim receiver of the company under the Bankruptcy and Insolvency Act. Deutsche Financial Services ("Deutsche") and Bank of America Specialty Group Ltd. ("Bank of America"), two of Hunters' floor plan financiers, take issue with the Administrative Charge as it relates to Hunter's legal and financial advisors. Along with C.I.T. Financial Ltd. ("CIT"), they also question this Court's jurisdiction to direct that funds advanced prior to the commencement of the CCAA proceedings be paid from the DIP financing provided for in those proceedings and question the propriety of my direction based on the facts of this case. At the time of my October 11th Order, Deutsche, Bank of America and CIT were owed in excess of $7.5 million by Hunters, representing over 70 percent of the secured debt and 60 percent of the total indebtedness of Hunters.

PAYMENT OF HUNTERS' LEGAL AND ACCOUNTING ADVISORS

Arguments of the Parties

3 Deutsche recognizes that the Court has inherent jurisdiction to allow super-priority for administrative costs, thereby subordinating existing security, but argues that this jurisdiction should only be exercised in exceptional circumstances. The Bank submits that it is wrong that Reynolds Mirth Richards and Farmer ("Reynolds"), as Hunters' solicitors, and Gillespie Farrell LLP, as their accountants, should be granted a super-priority over the secured claims of Deutsche and other floor financing creditors to the extent that such costs were incurred to unsuccessfully defend the stay of proceedings granted in the ex parte CCAA Order of October 11, 2000. According to Deutsche, super-priority should only apply if:

(a) the accounts were reasonably incurred for the restructuring of Hunters as opposed to any defence of the initial Order; and

(b) there is clear and cogent evidence that there was a reasonable prospect of a successful restructuring.

4 Deutsche also contends that it would not be appropriate to uphold the super-priority of the Administrative Charge for the payment of the accounts as Hunters did not seek the cooperation of Deutsche for the restructuring of its affairs prior to bringing its ex parte application, Deutsche has never agreed to super-priority for the Administration Charge and Deutsche and the other floor financing secured creditors ultimately were successful in securing an order lifting the stay of proceedings.

5 During oral argument, Deutsche indicated that it was no longer contesting the legal fees for the period October 11th to November 17th, the date on which Deutsche, CIT and Bank of America brought application to have the stay of proceedings lifted and the CCAA Order vacated.

6 In presenting its initial application for a stay, Hunters put affidavit evidence before the Court stating that Bank of America had indicated its willingness to participate in a work-out plan. Bank of America maintains that this representation was misleading. Bank of America did not have the benefit of legal counsel until after my initial Order was granted. While it was prepared to consider reasonable proposals by Hunters as an alternative to liquidation, it had not been provided with current financial statements which would have demonstrated the magnitude of Hunters' financial problems and it did not indicate that it would consider an arrangement based on a CCAA order such as the Order granted.

7 Bank of America suggests that it was inappropriate for the initial CCAA Order or at least those clauses in the Order dealing with the accounting and legal fees to have been sought or granted on an ex parte basis given that the relief claimed was clearly prejudicial to the rights and interests of the first charge secured lenders and no emergent or extraordinary need existed to prioritize the legal and accounting fees of the debtor's advisors over the interests of those lenders.

8 The primary argument advanced by Bank of America appears to be that super-prioritization of the fees of the debtor's professional advisors is not justified as the CCAA proceedings were doomed to failure.

9 CWB makes no submissions with respect to payment of Hunters' legal and accounting expenses, but indicates that it is prepared to pay its fair share thereof if the Court deems that these expenses properly form part of the Administrative Charge.

10 Gillespie notes in its submissions that one of its partners, Brian Farrell, acted as Hunters' external accountant for approximately 10 years and during that period also effectively functioned as its chief financial officer. From about September 30 to December 7, 2000, Mr. Farrell performed some of the functions of Hunters' comptroller. Mr. Farrell deposed in an affidavit filed in these proceedings that he had believed that a restructuring of Hunters' financial affairs could be accomplished under the CCAA and that secured creditors could have been paid out in full if Hunters was permitted to carry on its operations during what was its traditionally low season. He further indicated that Gillespie would not have provided professional services to Hunters without the assurance provided by the Administrative Charge that it would be compensated for its work. Gillespie suggests that there was unreasonable delay on the part of Deutsche and Bank of America in bringing their application challenging this aspect of the Administrative Charge.

11 Gillespie argues that while the CCAA was intended to preserve the status quo, that does not mean preservation of the relative pre-debt status of each creditor nor is it intended to create a rigid freeze of relative pre-stay positions.

12 Hunters and Reynolds submit that it is not uncommon for orders to be sought under the CCAA either on short notice or without notice to certain creditors and with little opportunity on the part of the court for review and consideration of the facts and issues in advance.

13 They argue that the affidavit of Kent Andrews confirms that Bank of America participated in some discussions with Hunters regarding a work-out prior to October 11, 2000 and the affidavit of Gerhard Rodrigues demonstrates that up until the motion to set aside the initial Order Bank of America was considering how it might participate in a restructuring of Hunters.

14 Hunters and Reynolds suggest that it was reasonable for Hunters to continue working towards an arrangement under the CCAA and to incur legal costs in the process at least so long as the stay was in place. They contend that a debtor company requires legal advice in order to successfully restructure its affairs under the CCAA and that legal counsel must be given reasonable assurance of payment.

Analysis

15 The aim of the CCAA is to maintain the status quo while an insolvent company attempts to bring its creditors on side in terms of a plan of arrangement which will allow the company to remain in business to the mutual benefit of the company and its creditors (Reference re Companies' Creditors Arrangement Act (Canada), [1934] S.C.R. 659, 16 C.B.R. 1 at 2; Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990) 4 C.B.R. (3d) 311 at 315-316 (B.C.C.A.)).

16 Madam Justice Huddart in Re Alberta-Pacific Terminals Ltd. (1991), 8 C.B.R. (3d) 99 (B.C.S.C.) and Mr. Justice Brenner in Re Pacific National Lease Holding Corp. (1992), 72 B.C.L.R. (2d) 368, leave to appeal denied (1992) 15 C.B.R. (3d) 265 (C.A.) suggested that maintaining the status quo does not necessarily mean preservation of the relative pre-stay debt status of each creditor as other interests are served by a stay order under the CCAA.

17 Finlayson J.A. (Krever J.A. concurring) in Elan Corporation v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101 at 120 (Ont. C.A.) agreed with the statement made by Gibbs J.A. in Hongkong Bank of Canada that the Act was designed to serve a "broad constituency of investors, creditors and employees" and instructed that:

> Because of that "broad constituency", the Court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest. That interest is generally, but not always, served by permitting an attempt at reorganization: see S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," [(1947) 25 Can. Bar Rev. 587] at p. 593.

18 I agree with the statement made by Mackenzie J.A. in Re United Used Auto & Truck Parts Ltd. (2000) 16 C.B.R. (4th) 141 at 146 (B.C.C.A.) that: "...the CCAA's effectiveness in achieving its objectives is dependent on a broad and flexible exercise of jurisdiction to facilitate a restructuring and continue the debtor as a going concern in the interim."

19 To qualify for CCAA protection a company must be insolvent. The reality is that most companies that find themselves in such a position are unlikely to have the financial resources to pay for the advisors required to embark upon, formulate and present a restructuring plan under the CCAA. As a result, the practice has developed whereby debtor companies in the initial application for CCAA protection seek to secure payment of their professional advisors through an administrative charge on the assets of the company in priority to the claims of other secured creditors, except possibly the DIP lender.

20 In Re Starcom International Optics Corp. (1998), 3 C.B.R. (4th) 177 the British Columbia Supreme Court considered whether the fees of professional advisors other than the monitor should be paid in priority to the claims of creditors in CCAA proceedings. As in the present case, the initial ex parte order had provided for such priority. However, on reconsideration of the stay, Saunders J. noted that there was no evidence presented as to whether the priority for professional fees was required to enable the operations of the debtor company to continue. She concluded that the protection of s. 11.3 of the Act permitting a person providing services to require immediate payment for those services and the significant cash flow projections of the company would serve as adequate protection for the fees for professional services. The terms of the initial order therefore were amended to provide for priority only for the monitor's fees. However, it was apparent that Saunders J. was of the view that the court had the jurisdiction to grant a super-priority for the administrative charge and that she considered it important that professional fees be protected in some manner.

21 Many initial orders under the CCAA are sought on short notice or on an ex parte basis. In fact, the Act allows for initial ex parte orders and gives the applicant 30 days in which to generate support for the order among its creditors.

22 As Mr. Justice Blair recognized in Re Royal Oak Mines Inc.(1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]), the court in most cases is asked on the initial application to respond with little advance opportunity to examine the materials filed in support of the application. In view of the "real time" nature of such applications, he recommended to those drafting initial stay orders that they confine the relief sought to what is essential for the continued operations of the company during a brief "sorting out" period. He suggested that extraordinary relief such as DIP financing and super-priorities be kept in the initial order to what is reasonably necessary to meet the debtor company's urgent needs during the sorting-out period since such measures may involve a significant reordering of the pre-application priorities. At p. 322 he advised that:

> Such changes should not be imported lightly, if at all, into the creditor's mix; and affected parties are entitled to a reasonable opportunity to think about their potential impact, and to consider such things as whether or not the CCAA approach to the insolvency is the appropriate one in the circumstances - as opposed for instance, to a receivership or bankruptcy - and whether or not, or to what extent, they are prepared to have their positions affected by DIP or super priority financing.

23 Although Mr. Justice Blair did not specify what he considered to be a reasonable "sorting out" period, he did state at p. 319:

> Conceptually, then, the applicant is provided with the protections of a stay, a restraining order and a prohibition order for a period "not exceeding 30 days" in

> order to give it time to muster support for and justify the relief granted in the Initial Order, all interested persons then having received reasonable notice and having had a reasonable opportunity to consider their respective positions. The difficulties created by ex parte and short notice proceedings are thereby attenuated.

24 Mr. Justice Farley, who subsequently took carriage of the Royal Oak Mines case, held at (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List] that, "in light of the very general framework of the CCAA, judges must rely upon inherent jurisdiction to deal with CCAA proceedings. However, inherent jurisdiction is not limitless; if the legislative body has not left a functional gap or vacuum, the inherent jurisdiction should not be brought into play." He refused to interfere with the super-priority granted by Blair J. for DIP financing as he felt that Mr. Justice Blair had properly engaged in the necessary balancing of the interests of the debtor company, the creditors and other interested parties.

25 Michael B. Rotsztain, in an article entitled "Debtor-In-Possession Financing in Canada: Current Law and a Preferred Approach," presented on February 22, 2000 at the Conference of the Canadian Turnaround Management Association, Toronto, Ontario suggested that DIP financing as a whole only be considered to meet urgent short-term needs and that further DIP financing be granted only in limited circumstances.

26 The jurisdiction of the court to grant super-priority for legal expenses incurred by a debtor-in-possession in connection with its efforts to restructure its affairs under the CCAA was considered by an appellate court for the first time in Re United Used Auto & Truck Parts Ltd., supra (leave to appeal to S.C.C. granted [2000] S.C.C.A. 142, appeal discontinued). The chambers judge, Tysoe J., had granted an ex parte order which specified that the reasonable fees and disbursements of counsel for the debtors should be included with the monitor's fees and disbursements in an administrative charge which was to be given super-priority over the charges of other creditors. The secured creditors brought an application to set aside the order. The application was heard 11 days after the initial order was granted. Tysoe J. continued the charge as he considered that these were necessary expenses for the successful restructuring of the company. At pp. 154-155 of his decision ((1999), 12 C.B.R. (4th) 144 (B.C.S.C.)), Mr. Justice Tysoe held:

> ... in the event that the restructuring is not successful and there is a shortfall in the recovery for the secured lenders, it would not be fair to require those lenders to bear all of the burdens of the expense of the lawyers for the Petitioners in acting against them. The secured lenders should not be expected to underwrite the expense of lawyers who act unreasonably or who act on unreasonable instructions to frustrate them in the recovery of the monies owed to them.
>
> Hence, I am prepared to give a priority charge in respect of the Petitioners' legal expenses to the extent that they are reasonably incurred in connection with the restructuring. As an example, if the Court were to conclude that the position of the Petitioners' on an application was unreasonable, the Petitioners' counsel would not have the benefit of the priority and would have to look to other sources for payment.

27 It was apparent in Re United Used Auto & Truck Parts Ltd. that the cash flow of the business would be insufficient to pay the legal expenses, particularly in the absence of DIP financing which

Tysoe J. refused to grant. Mackenzie J.A., who delivered the judgment of the Court of Appeal, commented at p. 152 in terms of the super-priority granted for the monitor's expenses:

> When, as here, the cash flow from operations is insufficient to assure payment and asset values exceeding secured charges are in doubt, granting a super-priority is the only practical means of securing payment. In such circumstances, if a super-priority cannot be granted without the consent of secured creditors, then those creditors would have an effective veto over CCAA relief. I do not think that Parliament intended that the objects of the Act could be indirectly frustrated by secured creditors.

28 Mackenzie J.A. characterized the administrative charge as a limited substitute for DIP financing. He was of the view that the jurisdiction to grant super-priority for the debtor's legal fees was dependent on the court's power to allow a super-priority for DIP financing. This type of super-priority was first allowed over the objections of a secured creditor in Re Dylex (January 23, 1995), Doc. B-4/95 (Ont. Gen. Div.). Houlden J.A. in that case considered that the broader interest of 12,000 employees of the debtor company justified imposing a super-priority for bridge financing.

29 Mackenzie J.A. also indicated in Re United Used Auto & Truck Parts Ltd. at p. 151 that the jurisdiction to grant a super-priority for the debtor's legal expenses, whether alone or as part of DIP financing, rests on the same equitable foundation as the monitor's fees and disbursements. He drew an analogy between the jurisdiction to grant the monitor's fees and the jurisdiction to secure the fees of a court-appointed receiver. Both are rooted in equity but as Mackenzie J.A. pointed out at p. 150: "the monitors' jurisdiction serves a broader statutory objective under the CCAA." Therefore, the court's inherent or equitable jurisdiction cannot be restricted as it is in a receivership where the receiver's fees and disbursements may only be charged against the security held by the secured creditors of the debtor:

> (a) if a receiver has been appointed with the approval of the holders of security;
> (b) if a receiver has been appointed, on notice to the creditors, to preserve and realize assets for the benefit of all interested parties, including secured creditors; or
> (c) if a receiver has expended money for the necessary preservation or improvement of the property.

(Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd. (1975), 21 C.B.R. (N.S.) 201 (Ont. C.A.)).

30 In commenting on Re United Used Auto & Truck Parts Ltd. at the Eleventh Annual Conference and General Meeting of the Insolvency Institute of Canada held in October, 2000, Douglas I. Knowles suggested that as the Supreme Court of Canada had granted leave to appeal:

> ... monitors and DIP financiers must carefully consider whether or not to become involved in [the] CCAA process absent some other source of security for their fees and loans until the Supreme Court of Canada has affirmatively concluded that the jurisdiction to create such priority charges exist. If such is not the conclusion of the Supreme Court of Canada then, at least with respect to the Monitor's fees, the CCAA will only be available to those insolvent companies with suffi-

> cient unencumbered assets or unencumbered cash flow to ensure payment of the monitor's fees without the necessity of creating such a charge.

31 The appeal has since been discontinued.

32 Having reviewed the jurisprudence on this issue, I am satisfied that the Court has the inherent or equitable jurisdiction to grant a super-priority for DIP financing and administrative charges, including the fees and disbursements of the professional advisors who guide a debtor company through the CCAA process. Hunters brought its initial CCAA application ex parte because it was insolvent and there was a threat of seizure by some of its major floor planners. If super-priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively would be denied a debtor company in many cases.

33 I am aware, however, that administrative costs and DIP financing can erode the security of creditors. LoVecchio J. in Re Smoky River Coal Ltd. (2000), 19 C.B.R. (4th) 281 at 290 (Alta. Q.B.), raised a caution flag in this regard, stating at p. 290:

> While the CCAA requires a large and liberal interpretation in order to be effective, the need for caution arises when the Court exercises its inherent jurisdiction under this statute. Although the CCAA serves a vital and important role in a reorganization, the general statutory scheme of priorities of creditors must not be overlooked. As the Court is altering this scheme, the exercise of the power of the Court to create classes of creditors with a super-priority status should not be taken lightly. Especially in light of the fact that this action could prejudice the recovery of creditors who would, but for the Order, enjoy a priority if a receivership or bankruptcy ultimately ensues.

34 It is preferable that priority for administrative costs and DIP financing be dealt with on notice to all interested parties. However, if the circumstances warrant, priority may be granted on the initial application, but on a limited basis only until the matter is considered on notice to those affected by the order. That is precisely what occurred in this case. Hunters brought an application on November 8th for an extension of the stay of proceedings. This application was made on notice to the secured creditors. If they had wanted to challenge the initial Order before that date, they could have done so on two days' notice.

35 In my view, the services of both Reynolds and Gillespie were essential if Hunters was to have any possibility of arriving at an arrangement with its creditors which would allow Hunters to carry on its business. The priority assigned to the Administrative Charge in my Order of October 11, 2000 was granted as there was no other reasonable alternative to assure that the services of Reynolds and Gillespie would be available to Hunters. The Administrative Charge met the debtor company's urgent needs during the sorting-out period.

36 I do not accept the argument advanced by the objecting creditors that it is only in the case of a successful arrangement under the CCAA that priority for the fees and disbursements of professional advisors should be confirmed. Professional advisors acting for a debtor company must act in a reasonable manner, but they are not guarantors of the success of restructuring. Nor is it unreasonable for the debtor company to defend a creditor's challenge to the initial CCAA order.

37 My initial Order was granted as I was satisfied on the facts then before me that there was a reasonable prospect that Hunters could make arrangements with its creditors which would allow it to remain in business. Despite the express provision in my Order of October 11, 2000 permitting interested parties to apply on two days notice to vary the Order or to seek other relief, the first indication received by the Court from Bank of America that it opposed the Order was the application of Hunter's major secured creditors to have the initial Order vacated and the supporting affidavit of Kent Andrews filed on November 17, 2000.

38 Counsel for Bank of America had sent a letter to Hunters and CWB on November 8th expressing concern with the terms of the Order, particularly the terms of the DIP financing, but no mention was made of the Administrative Charge. The letter indicated that unless a satisfactory agreement could be reached on amendment of the Order, an application would be brought to have the terms of the Order varied or to terminate the stay. On December 1, 2000 I refused Hunters' request for an extension of the stay but extended the existing stay to December 8, 2000. It was apparent at that time that there was insufficient evidence to establish that the benefits of DIP financing (and the Administrative Charge) would clearly outweigh the potential prejudice to the objecting creditors.

39 In my view, the legal and accounting expenses of Hunters incurred up to Dec. 1st were reasonably incurred in connection with the CCAA proceedings and restructuring efforts. Any such expenses incurred after December 1st are not entitled to super-priority status.

40 Certain of the accounts of Reynolds are for work undertaken between September 25, 2000 and October 11th in preparation for the initial CCAA application. I have concluded below that this Court has jurisdiction to grant priority to DIP financing advanced prior to my Order of October 11th. I reach the same conclusion in terms of the legal and accounting fees and disbursements which pre-date the initial CCAA order. Hunters' expenses in this regard were incurred in connection with the initial application and should receive the same priority as the post-application expenses.

JURISDICTION TO ORDER PRE-CCAA CWB ADVANCES TO BE PAID FROM DIP FINANCING

Background

41 According to CWB, it was informed by representatives of Hunters on September 22, 2000 that Hunters was insolvent. As of that date, Hunters was indebted to CWB in an amount in excess of $1 million. On September 25, 2000 CWB agreed to a proposal presented by Hunters whereby Hunters would apply for an order pursuant to the CCAA and then would attempt to formulate a plan of arrangement acceptable to its creditors. CWB also agreed to provide DIP financing if the CCAA Order could be obtained.

42 CWB recognized that it would take Hunters some time to make the initial CCAA application. Therefore, it agreed to provide interim financial assistance to cover Hunters' payroll and other critical expenses pending the granting of a CCAA order on condition that, if Hunters was successful in obtaining the order and DIP financing, CWB's advances would form part of the DIP financing to be repaid in priority to other creditors.

Position of Canadian Western Bank

43 CWB contends that the Court's inherent jurisdiction is sufficiently broad to allow for an order that pre-CCAA advances may be paid from DIP financing. According to CWB, the CCAA is remedial legislation that should be given a wide and liberal interpretation in order to effect a practical result. The intention of the legislation is to give corporations facing a business failure breathing room in order to negotiate with creditors.

44 CWB further argues that since its actions were directed toward the preservation of the assets and business of Hunters for the benefit of all creditors, it was appropriate that the advances be reimbursed from the DIP financing. In an affidavit filed in support of the application by CWB, Richard Hallson, a manager of commercial banking for CWB, deposes that it was the opinion of CWB at the time that Hunters was suffering a financial crisis by reason of the seasonal nature of its business and the fact that it was entering into the slowest portion of its business cycle. It was also the opinion of CWB that Hunters had a reasonable prospect of formulating an acceptable and reasonable plan of arrangement.

45 CWB argues that the purpose of the CCAA should not be frustrated by denying the benefits of the Act to those debtors who cannot finance their minimum expenses while they prepare a CCAA application.

46 CWB accepts that as a secured creditor it must participate in the costs of the DIP financing and pre-CCAA advances if the Court orders that these be shared amongst the creditors of Hunters.

Position of Other Secured Creditors

47 CIT takes the position that this Court does not have the jurisdiction to grant super-priority status to advances made before commencement of the CCAA as the Court's jurisdiction arises from the CCAA. It argues that creation of a super-priority for such charges would result in the reordering of existing priorities and other vested interests established prior to the date the initial Order was issued. CIT suggests that as DIP financing is an extraordinary remedy, there must be clear evidence that its benefits outweigh the potential prejudice to lenders.

48 CIT also contends that principles of fairness dictate that CWB should not be permitted to foist the entire burden of its unilateral decision to continue to support Hunters on the other secured creditors. Accordingly, if the Court determines that it is appropriate to permit payment of this portion of the DIP financing to CWB, such payment should be prorated so that CWB bears its proportionate share of the burden of the DIP financing.

49 Bank of America adopts the submissions of CIT with regard to the pre-October 11, 2000 advances on DIP financing.

Conclusion

50 In Baxter Student Housing Ltd. v. College Housing Co-operative Ltd., [1976] 2 S.C.R. 475 the Supreme Court of Canada recognized that there is a limit to the inherent jurisdiction of superior courts, stating at p. 480:

> Inherent jurisdiction cannot, of course, be exercised so as to conflict with a statute or a rule. Moreover, because it is a special and extraordinary power, it should be exercised only sparingly and in a clear case.

51 As I have indicated above, I am of the view that the Court has the inherent or equitable jurisdiction to grant a super-priority for DIP financing and administrative costs, including those of the monitor and professional advisors of the debtor company. While this jurisdiction is invoked when an initial application is made under the CCAA, the Court is not limited to granting a priority only for those costs which arise after the date of the application or initial order. So long as the monies were reasonably advanced to maintain the status quo pending a CCAA application or the costs were incurred in preparation for the CCAA proceedings, justice dictates and practicality demands that they fall under the super-priority granted by the Court. To deny them priority would be to frustrate the objectives of the CCAA.

52 In the present case, it is likely that if the advances had not been made by CWB, Hunters' would have ceased to carry on business. The advances were used to cover Hunters' payroll and for security for the premises. Under these circumstances, I am prepared to order that the advances made by CWB from September 25, 2000 to October 11th be paid out of the DIP financing.

COSTS

53 Reynolds, Gillespie, and CWB shall have their costs of this application on a party and party basis.

WACHOWICH C.J.Q.B.

cp/i/qlrds

Ernst & Young Inc. (appellant/plaintiff) v. Central Guaranty Trust Company (respondent/defendant) (0503-0014-AC; 2006 ABCA 337)

Indexed As: Ernst & Young Inc. v. Central Guaranty Trust Co.

Alberta Court of Appeal
Fruman, Costigan and Slatter, JJ.A.
November 15, 2006.

Summary:
International Warranty Co. (IW) entered into agreements with several car manufacturers to enable IW to sell extended warranties on the manufacturer's new and some used vehicles. IW went into receivership. IW's receiver commenced an action against Central Guaranty Trust Co. (Central) in 1992. The receiver alleged that IW had entered into agreements with Central whereby trusts were set up with Central as trustee and that Central withdrew monies from the trusts and improperly dispersed those monies. The trial was held in two parts. The issue in this first part was whether IW's agreements with Central resulted in trust obligations. As a preliminary matter, the receiver argued that Central was estopped from arguing that the agreements did not give rise to trusts.

The Alberta Court of Queen's Bench, in a decision reported at 283 A.R. 325, held that Central was not estopped from questioning the validity of the alleged trusts. The court held that, with the exception of one agreement (Quebec Interim Trust), no trust was established by the agreements. Further, Central was not negligent and owed no fiduciary duty in the circumstances. The second part of the trial proceeded. The main issues were the appropriate remedies. The court also raised the issue of the validity of the Quebec Interim Trust.

The Alberta Court of Queen's Bench, in a decision reported at 365 A.R. 302, held that the Quebec Interim Trust was void because it established a purpose trust that was not charitable. The court dismissed all the plaintiff's claims. The receiver appealed.

The Alberta Court of Appeal allowed the appeal, set aside the judgments in both phases of the trial and ordered a new trial to determine whether Central breached the trusts and, if it did, what remedies should be imposed.

Editor's Note: there are several cases involving these parties.

Courts - Topic 2015
Jurisdiction - General principles - Controlling abuse of its process - International Warranty Co. (IW) went into receivership - IW's receiver commenced an action against the defendant in 1992 alleging, inter alia, that IW entered into agreements with the defendant whereby trusts were set up with the defendant as trustee - The litigation proceeded for eight years on the basis that the agreements were trusts - Just before trial, the defendant moved to amend its statement of defence to allege that the agreements did not give rise to trusts - The receiver argued that the matter was res judicata - The matter of trusts had been brought into issue over the long course of the receivership proceedings, there had been prior court orders, agreements made, positions changed and payments made on that basis - The Alberta Court of Appeal held that the trial judge erred in law in concluding the doctrine of abuse of process did not preclude the defendant from raising the trust invalidity defence in the receiver's action - It was simply too late - The defendant was involved in the receivership proceedings from the outset - It knew there was a potential defence that the trusts were

invalid - To allow it to raise that defence more than a decade later in these circumstances would violate principles of judicial economy and certainty and seriously undermine the administration of justice in Alberta - See paragraphs 52 to 55.

Estoppel - Topic 380

Estoppel by record (res judicata) - Res judicata as a bar to subsequent proceedings - Matters in issue - International Warranty Co. (IW) went into receivership - IW's receiver commenced an action against the defendant in 1992 alleging, inter alia, that IW entered into agreements with the defendant whereby trusts were set up with the defendant as trustee - The litigation proceeded for eight years on the basis that the agreements were trusts - Just before trial, the defendant moved to amend its statement of defence to allege that the agreements did not give rise to trusts - The receiver argued that the matter was res judicata - The matter of trusts had been brought into issue over the long course of the receivership proceedings, there had been prior court orders, agreements made, positions changed and payments made on that basis - The trial judge held that the defendant was not estopped from questioning the validity of the alleged trusts - Alternatively, this was a special case where res judicata should not be applied - The Alberta Court of Appeal allowed the receiver's appeal - Issue estoppel applied - The issue of the validity of the trusts had been decided in the receivership proceedings and constituted a final decision - There were no special circumstances which warranted the suspension of the principles of res judicata - See paragraphs 29 to 46.

Estoppel - Topic 386

Estoppel by record (res judicata) - Res judicata as a bar to subsequent proceedings - Issues decided in prior proceedings - [See **Estoppel - Topic 380**].

Estoppel - Topic 398

Estoppel by record (res judicata) - Res judicata as a bar to subsequent proceedings - Exceptions - Special circumstances - [See **Estoppel - Topic 380**].

Practice - Topic 5408.1

Judgments and orders - General - Collateral attack - International Warranty Co. (IW) went into receivership - IW's receiver commenced an action against the defendant in 1992 alleging, inter alia, that IW entered into agreements with the defendant whereby trusts were set up with the defendant as trustee - The litigation proceeded for eight years on the basis that the agreements were trusts - Just before trial, the defendant moved to amend its statement of defence to allege that the agreements did not give rise to trusts - The receiver argued that the matter was res judicata - The matter of trusts had been brought into issue over the long course of the receivership proceedings, there had been prior court orders, including a July 1998 order directing how the trust funds would be distributed, agreements made, positions changed and payments made on that basis - The trial judge held that the defendant was not trying to vary or nullify the effects of the July 1988 order by raising a trust invalidity defence - The Alberta Court of Appeal held that the trust invalidity defence amounted to a collateral attack on the July 1988 order and the trial judge erred in law in concluding that the question of trust validity was not settled by the rule against collateral attack - See paragraphs 47 to 51.

Cases Noticed:

Saggers v. Human Rights Commission (Alta.) (2000), 271 A.R. 352; 234 W.A.C. 352; 2000 ABCA 259, refd to. [para. 26].

Saggers v. Calgary (City) - see Saggers v. Human Rights Commission (Alta.).

Toronto (City) et al. v. Canadian Union of Public Employees, Local 79 et al., [2003] 3 S.C.R. 77; 311 N.R. 201; 179 O.A.C. 291; 2003 SCC 63, refd to. [para. 30].

Danyluk v. Ainsworth Technologies Inc. et al., [2001] 2 S.C.R. 460; 272 N.R. 1; 149 O.A.C. 1; 2001 SCC 44, refd to. [para. 31].

Angle v. Minister of National Revenue, [1975] 2 S.C.R. 248; 2 N.R. 397, refd to. [para. 31].

Hoystead v. Taxation Commissioner, [1926] A.C. 155 (P.C.), refd to. [para. 31].

Bernier v. Bernier (1989), 35 O.A.C. 367; 62 D.L.R.(4th) 561; 70 O.R.(2d) 372 (C.A.), refd to. [para. 43].

Hennig v. Northern Heights (Sault) Ltd. et al. (1980), 116 D.L.R.(3d) 496; 30 O.R.(2d) 346 (C.A.), leave to appeal refused (1980), 35 N.R. 101; 30 O.R.(2d) 346 (S.C.C.), refd to. [para. 43].

R. v. Wilson, [1983] 2 S.C.R. 594; 51 N.R. 321; 26 Man.R.(2d) 194, refd to. [para. 47].

Authors and Works Noticed:

Lange, Donald J., The Doctrine of Res Judicata in Canada (2nd Ed. 2004), pp. 1 [para. 29]; 40 [para. 31]; 85 [para. 37]; 86 [paras. 37, 38]; 182 [para. 38]; 231 [para. 44]; 232 to 234 [para. 42]; 280 to 282 [para. 44].

Counsel:

D.R. Cranston, Q.C., and C.L. Bailey, for the appellant;

R.B. White, Q.C., K.A. Ryan and W.A. Berkenbosch, for the respondent.

This appeal was heard on October 30, 2006, by Fruman, Costigan and Slatter, JJ.A., of the Alberta Court of Appeal. The following memorandum of judgment was delivered by the court on November 15, 2006.

I. Introduction

[1] By the Court: In the mid 1980s, International Warranty Company Limited ("IW") sold extended warranties to automobile purchasers pursuant to agreements it had with several automobile importers (the "Importers"). Those warranties covered items not covered by the Importers' warranties for up to five years.

[2] At first, IW insured its warranty obligations. Later, it put some of the warranty monies it received into trust. IW deposited some of its warranty monies with Central Guaranty Trust Company ("Central Guaranty") pursuant to various trust agreements.

[3] The trust agreements contemplated that IW would draw down the trust funds to reimburse itself for the cost of repairs as it did warranty work. They also contemplated that, at the end of the warranty period, any trust surpluses would belong to IW.

[4] At some point, IW began withdrawing actuarially projected surpluses from the trusts. It also refrained on occasion from depositing warranty monies with Central Guaranty.

[5] IW stopped carrying on business in December 1987, leaving some warranty holders at risk. A receiver was appointed to determine the extent of IW's warranty obligations and make a recommendation to the Court regarding the most appropriate way to deal with the warranty holders (the "Receiver").

[6] Miller, A.C.J., case managed the receivership. The Receiver filed a report and a series of orders were issued. As a result of the receivership proceedings, the Importers assumed most of IW's warranty obligations, the trust funds held by Central Guaranty were paid to the Receiver, the Receiver paid a substantial portion of the funds it received to the Importers, and the Receiver was authorized to bring an action against Central Guaranty to determine whether it had breached its obligations as trustee. Central Guaranty was involved in the receivership proceedings from the outset.

[7] In 1992, pursuant to Miller, A.C.J.'s, order, the Receiver commenced this action alleging breaches of the trust agreements by Central Guaranty. On the eve of trial, in May 2000, Central Guaranty amended its statement of defence to allege, for the first time, that the trusts were invalid for uncertainty. The Receiver replied that many orders had been made on the assumption that the trusts were valid and it was too late for Central Guaranty to raise a trust invalidity defence. The trial judge found the issue of the validity of the trusts was not settled by principles of res judicata, collateral attack or abuse of process. He also found the trusts invalid and determined no other form of relief was called for. The Receiver appeals.

[8] Many grounds of appeal were raised. It is unnecessary for us to consider most of them because we conclude that Central Guaranty is precluded from attacking the validity of the trusts in this litigation.

II. The Receivership Proceedings

[9] In the report it prepared in March 1988, the Receiver made a number of recommendations. Those recommendations were based upon certain explicit assumptions, including an assumption that the trusts were valid. The Receiver's report estimated that IW owed its creditors (excluding the warranty holders) between $5.85 and $10.85 million, and that IW's unsecured creditors would recover nothing from IW because they had no access to the funds in trust for the warranty holders. Central Guaranty was given an opportunity to review and comment upon the Receiver's report before it was filed.

[10] In April 1988, Central Guaranty was made aware by its lawyers of the existence of a possible defence that the trusts were invalid. It did not, however, raise such a defence at that time.

[11] In June 1988, Miller, A.C.J., directed that the following issues be tried: whether certain payments Central Guaranty made out of the trust funds were improper; whether Central Guaranty was required to repay any amounts it improperly paid out of the trust funds; and, who would be the beneficiaries of any monies Central Guaranty was required to repay (the "June 1988 Order").

[12] In July 1988, Miller, A.C.J., made an order that accomplished a number of things (the "July 1988 Order"). The July 1988 Order approved an agreement which provided that the Importers would assume most of IW's warranty obligations in exchange for trust funds held by Central Guaranty. It also directed Central Guaranty to pay virtually all the trust funds it held to the Receiver, and the Receiver to pay most of those funds to the Importers. In addition, it varied the trusts so that: the rights vested in Central Guaranty as trustee were vested in the Receiver for the benefit of the Importers; the Importers re-placed the warranty holders as beneficiaries of the trusts; and, upon the trusts' termination, any remaining trust funds would be paid to the Importers.

[13] Both Central Guaranty and Lloyds Bank, one of IW's main secured creditors, commenced appeals from the July 1988 Order. Those appeals were later abandoned as part of a settlement agreement reached between the Importers, the Receiver, Lloyds Bank and Central Guaranty.

[14] The trust funds were distributed pursuant to the July 1988 Order.

[15] In January 1992, Miller, A.C.J., authorized the Receiver to bring an action against Central Guaranty on behalf of the warranty holders and their heirs, successors and assigns. The Receiver commenced that action in October 1992 alleging that, in breach of the trust agreements, Central Guaranty made several improper payments to IW from the trust funds and consented, agreed or acquiesced to IW's failure to pay certain warranty monies into the trusts.

[16] In December 1992, Central Guaranty filed a statement of defence in which it admitted the validity of the trusts.

[17] In March 1995, Miller, A.C.J., released Central Guaranty as trustee of the trusts and ordered the Receiver to act as trustee.

[18] Central Guaranty retained new counsel a month before the trial of the Receiver's action was scheduled to commence. Consequentially, the trial was delayed by three weeks. In May 2000, just before the trial commenced, Central Guaranty amended its statement of defence to allege, for the first time, that the trusts were not validly constituted because they lacked certainty of subject matter and objects. The Receiver replied that the issue of the validity of the trusts was res judicata, and that Central Guaranty's trust invalidity defence was a collateral attack on Miller, A.C.J.'s, orders and an abuse of process. It also asserted the trusts were valid and, in the alternative, claimed relief for breach of fiduciary duty and negligence.

III. Decisions Below

[19] The trial took place in two phases. The parties made submissions on liability in the first phase and submissions on remedies in the second phase.

[20] In the first phase decision, reported at 283 A.R. 325; 2001 ABQB 92 (Phase I), the trial judge concluded that the issue of the validity of the trusts was not settled by principles of res judicata, collateral attack or abuse of process. He also concluded that all but one of the trusts failed for lack of certainty of subject matter and objects, and that grounds were not made out for breach of fiduciary duty or negligence.

[21] In the second phase decision, reported at 365 A.R. 302; 2004 ABQB 389 (Phase II), the trial judge concluded that the one trust he had deemed valid in the first phase was an invalid purpose trust. Because he concluded all the trusts were invalid, the trial judge declined to consider most of the issues relating to whether the trusts had been breached by Central Guaranty and, if they had, what the appropriate remedies were.

[22] The trial judge accepted Central Guaranty's argument that the July 1988 Order was interlocutory, rather than final, and was made without an adjudication of the validity of the trusts. He concluded the issue of trust validity was not central to the receivership proceedings and was left, by Miller, A.C.J., to be determined in other proceedings. In his view, once the June 1988 Order was issued any trust invalidity defence most properly belonged to the separate trial contemplated by that Order, rather than the receivership proceedings. Accordingly, the trial judge concluded the doctrine of res judicata was inapplicable: Phase I at paras. 17-18.

[23] The trial judge also concluded that, even if the doctrine of res judicata was applicable, there were special circumstances that made it necessary not to apply the doctrine. Among the special circumstances he found was the fact the court might be called upon to administer uncertain trusts if the doctrine of res judicata was applied: Phase I at paras. 19-21.

[24] The trial judge found Central Guaranty was not attempting to vary or nullify the July 1988 Order by raising a trust invalidity defence. In his view, because Central Guaranty was not seeking to undo the arrangements and distributions which flowed from the July 1988 Order, its trust invalidity defence was not a collateral attack: Phase I at para. 22.

[25] The trial judge also concluded it was not an abuse of process for Central Guaranty to raise a trust invalidity defence: Phase I at paras. 4 and 11.

IV. Standard of Review

[26] The applicability of the doctrine of res judicata is a question of law reviewable on the correctness standard: **Saggers v. Human Rights Commission (Alta.)** (2000), 271 A.R. 352; 234 W.A.C. 352; 2000 ABCA 259, at para. 19.

[27] Whether special circumstances exist which warrant the suspension of the principles of res judicata is a question of mixed fact and law reviewable on the standard of palpable and overriding error. However, where the alleged error is an extricable error of law, the applicable standard of review is correctness.

[28] The applicability of the rule against collateral attack and the applicability of the doctrine of abuse of process are questions of law reviewable on the correctness standard.

V. Analysis

A. Res Judicata

[29] The doctrine of res judicata has two branches: issue estoppel and cause of action estoppel. Issue estoppel precludes the litigation of an issue previously decided in another court proceeding, and cause of action estoppel precludes the litigation of a cause of action which was adjudged in a previous court proceeding: Donald J. Lange, **The Doctrine of Res Judicata in Canada,** 2nd Ed. (Ontario: LexisNexis Canada Inc., 2004), at 1 (res judicata). We need not consider the applicability of cause of action estoppel because issue estoppel precludes Central Guaranty from attacking the validity of the trusts in this litigation.

(i) Issue Estoppel

[30] For issue estoppel to be successfully invoked, the issue must be the same as the one decided in the prior judicial decision, the prior judicial decision must have been final, and the parties to both proceedings must be the same, or their privies: **Toronto (City) et al. v. Canadian Union of Public Employees, Local 79 et al.**, [2003] 3 S.C.R. 77; 311 N.R. 201; 179 O.A.C.

291; 2003 SCC 63, at para. 23 (**Toronto**).

(a) "Same Issue" Precondition

[31] The first precondition for issue estoppel requires that the same issue was decided, rather than could have been decided, in the prior decision: Res Judicata, supra, at 40. Issue estoppel only "extends to the material facts and the conclusions of law or of mixed fact and law ... that were necessarily (even if not explicitly) determined in the earlier proceedings": **Danyluk v. Ainsworth Technologies Inc. et al.**, [2001] 2 S.C.R. 460; 272 N.R. 1; 149 O.A.C. 1; 2001 SCC 44, at para. 24 (**Danyluk**). Put another way, the first precondition for issue estoppel is only met when "[t]he question out of which the estoppel is said to arise [was] 'fundamental to the decision arrived at' in the earlier proceedings": **Angle v. Minister of National Revenue**, [1975] 2 S.C.R. 248; 2 N.R. 397, at 255 [S.C.R.], citing Lord Shaw in **Hoystead v. Taxation Commissioner**, [1926] A.C. 155 (P.C.).

[32] Miller, A.C.J., was not explicitly called upon to determine the issue of the validity of the trusts in the receivership proceedings, and none of the Orders he made contain an express pronouncement on that issue. Nonetheless, we conclude that a finding that the trusts were valid was fundamental to, and made in, the receivership proceedings.

[33] The Orders of Miller, A.C.J., were all based on the existence of valid trusts. Trust validity was a foundational underpinning of the Orders. The trial judge acknowledged this when he said: "[s]o much was done in the Receivership in the long lead time to this action, all of which appears from the recital to have been on the assumption by all concerned, including the Receiver ... that these arrangements were formal trusts": Phase I at para. 5. Therefore, a finding that the trusts were valid was at the heart of Miller, A.C.J.'s, decisions. It is illogical to suggest otherwise. This is demonstrated by the trial judge's acknowledgment that "one should not vary a trust without finding that one exists": Phase I at para. 17. It also follows that one would not direct how trust funds should be distributed without finding that a trust exists.

[34] Had it not been found that valid trusts existed, neither the warranty holders nor the Importers would have had any preferred claim on the funds held by Central Guaranty. Those funds would have been shared with IW's other creditors. Thus, the direction of payment to the Importers had to be based on a trust foundation.

[35] Central Guaranty argued the issue of the validity of the trusts could not have been finally determined in the receivership proceedings because Miller, A.C.J.'s, Orders contemplated there would be further litigation on the issues of whether it breached the trusts and, if it did, what remedies should follow. We do not find this argument convincing. The issues Miller, A.C.J., directed to be tried, and contemplated would be tried, were all based on the existence of valid trusts. An invalid trust cannot be breached. Had Miller, A.C.J., thought the issue of the validity of the trusts still needed to be determined, he would have said so.

[36] The determination of the issue of the validity of the trusts was fundamental to Miller, A.C.J.'s, Orders, particularly the July 1988 Order. Therefore, that issue was decided in the receivership proceedings and the first precondition for issue estoppel is met.

(b) "Final Decision" Precondition

[37] The second precondition for issue estoppel is met if a decision is final in the sense that it determines the question between the parties conclusively. A decision is final if the court that made it "has no further jurisdiction to rehear the question or to vary or rescind the finding": Res Judicata, supra, at 85-86.

[38] A decision need not determine the entire subject matter of the relevant litigation in order to meet the second precondition. Rather, the precondition is met where a decision finally disposes of a substantive right between the parties. Consequentially, "a final disposition in an interlocutory proceeding may give rise to issue estoppel in a different proceeding:" Res Judicata, supra, at 86 and 182.

[39] The July 1988 Order directed how the trust funds would be distributed. Payments were made pursuant to that Order and the Importers assumed liabilities to warranty holders. There has been no suggestion that this distribution can be undone or that monies can be returned. Accordingly, the second precondition for issue estoppel was met in this case.

(c) "Same Parties" Precondition

[40] The third precondition for issue estoppel is not in issue. Neither party argued it was not met in this case.

[41] As all its preconditions are met in this case, we conclude issue estoppel applies and the trial judge erred in law in finding the issue of the validity of the trusts was not settled by principles of res judicata.

(ii) Special Circumstances Exception

[42] The special circumstances exception bars the application of issue estoppel in a second proceeding. In order to demonstrate special circumstances, a party must show that he or she exercised reasonable diligence in the first proceeding. The standard of reasonable diligence is an objective standard: Res Judicata, supra, at 232-234.

[43] The special circumstances exception is not applicable "when all the relevant facts were known to the applicant's solicitor and he, for reasons unknown, did not advance them in argument": **Bernier v. Bernier** (1989), 35 O.A.C. 367; 62 D.L.R.(4th) 561; 70 O.R.(2d) 372 (C.A.), at para. 13. Nor is it applicable simply because the court that made the decision in the first proceeding may have reached a wrong conclusion: **Hennig v. Northern Heights (Sault) Ltd. et al.** (1980), 116 D.L.R.(3d) 496; 30 O.R.(2d) 346 (C.A.), at paras. 33-36, leave to appeal refused (1980), 35 N.R. 101; 30 O.R.(2d) 346 (S.C.C.).

[44] The types of circumstances that have been held to constitute special circumstances include allegations that the decision in the first proceeding was obtained by fraud, the discovery of new evidence which could not have been discovered by the exercise of reasonable diligence in the first proceeding, changes in the law, public policy considerations and circumstances amounting to a denial of natural justice: Res Judicata, supra, at 231 and 280-282. Special circumstances do not exist when the litigant knew of the issue in the first proceedings and did not raise it. Therefore, there were no such circumstances in this case.

[45] It is not necessary for us to decide if the trusts are uncertain, but we have reservations about the trial judge's analysis of this issue. In any event, while it is true that courts are reluctant to supervise and enforce uncertain trusts, once the trusts are found to be valid the court must (with the assistance of the Receiver) administer those trusts as best it can.

[46] Accordingly, we are of the view that the trial judge made an extricable error of law in finding there were special circumstances in this case which warranted the suspension of the principles of res judicata. He failed to apply the correct legal test.

B. Collateral Attack

[47] In **R. v. Wilson**, [1983] 2 S.C.R. 594; 51 N.R. 321; 26 Man.R.(2d) 194, at 599 [S.C.R.], the Supreme Court described the rule against collateral attack as follows:

> "It has long been a fundamental rule that a court order, made by a court having jurisdiction to make it, stands and is binding and conclusive unless it is set aside on appeal or lawfully quashed. It is also well settled in the authorities that such an order may not be attacked collaterally - and a collateral attack may be described as an attack made in proceedings other than those whose specific object is the reversal, variation, or nullification of the order or judgment."

[48] The rule against collateral attack seeks to ensure "that a judicial order pronounced by a court of competent jurisdiction [is] not ... brought into question in subsequent proceedings except those provided by law for the express purpose of attacking it": **Danyluk**, supra, at para. 20.

[49] Central Guaranty chose not to attack the July 1988 Order directly when it abandoned its appeal from that Order.

[50] The trial judge found Central Guaranty was not trying to vary or nullify the effects of the July 1988 Order by raising a trust invalidity defence. This is not the test for determining whether Central Guaranty offended the rule against collateral attack. The fact Central Guaranty does not take issue with how the trust funds were distributed is irrelevant. The problem with the trust invalidity defence is that it threatens to render the July 1988 Order nonsensical. If the July 1988 Order did not finally dispose of the issue of the validity of the trusts, the trusts should not have been varied and the trust funds should not have been distributed. IW had many creditors who might have been entitled to some or all of the funds Central Guaranty held if the trusts were not valid.

[51] Accordingly, the trust invalidity defence amounted to a collateral attack on the July 1988 Order and the trial judge erred in law in concluding that the question of trust validity was not settled by the rule against collateral attack.

C. Abuse of Process

[52] Courts enjoy an inherent and residual discretion to prevent an abuse of process: **Toronto**, supra, at para. 35. In **Toronto**, supra, at para. 37, at the Supreme Court noted:

> "Canadian courts have applied the doctrine of abuse of process to preclude relitigation in circumstances where the strict requirements of issue estoppel ... are not met, but where allowing the litigation to proceed would nonetheless violate such principles as judicial economy, consistency, finality and the integrity of the

administration of justice."

The Court also said: "[t]he attraction of the doctrine of abuse of process is that it is unencumbered by the specific requirements of res judicata while offering the discretion to prevent relitigation, essentially for the purpose of preserving the integrity of the court's process": **Toronto**, supra, at para. 42.

[53] Accordingly, it was within the trial judge's discretion to find Central Guaranty's attempt to relitigate the issue of the validity of the trusts was an abuse of process notwithstanding that he concluded the doctrine of res judicata was inapplicable.

[54] In our view, it was an abuse of process for Central Guaranty to attempt to relitigate the issue of the validity of the trusts. It is simply too late. Central Guaranty was involved in the receivership proceedings from the outset. It participated while agreements were reached and orders were granted varying the trusts and distributing the trust proceeds. It watched unsecured creditors' claims go unpaid as the trusts were administered. It stood by as the Importers assumed IW's obligations to the warranty holders. All of this transpired while Central Guaranty knew there was a potential defence that the trusts were invalid. To allow Central Guaranty to raise that defence more than a decade later in these circumstances would violate principles of judicial economy and certainty and seriously undermine the administration of justice in this province.

[55] Accordingly, the trial judge erred in law in concluding the doctrine of abuse of process did not preclude Central Guaranty from raising the trust invalidity defence in the Receiver's action.

VI. Disposition

[56] Our conclusion that the issue of the validity of the trusts was settled by the principles of res judicata, collateral attack and abuse of process disposes of this appeal. The judgments in both phases of the trial are set aside and a new trial is ordered to determine whether Central Guaranty breached the trusts and, if it did, what remedies should be imposed.

[57] As a result of this disposition, it is not necessary for us to consider the trial judge's conclusions relating to the validity of the trusts, the existence of a fiduciary duty and negligence. However, we have reservations about the trial judge's conclusions on those issues and the disposition of this appeal on a narrow ground is not an endorsement of those conclusions.

[58] The Receiver will have costs of the appeal and of the proceedings below.

Appeal allowed.

Editor: Rodney A. Jordan/klf

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BARRISTER & SOLICITOR

Rescue! The Companies' Creditors Arrangement Act

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CHAPTER 3

THE ROLE OF THE COURTS IN *CCAA* PROCEEDINGS

I. THE JURISDICTION OF THE COURTS

The *CCAA* gives public policy recognition to the value of restructuring processes. The crux of the success of the *CCAA* as a restructuring tool has been the willingness of the courts to interpret the statute in a purposive manner. As the Québec Superior Court observed in *PCI Chemicals Canada Inc.*, the courts have consistently held that the *CCAA* should be interpreted in a fair, large and liberal manner, with the court considering the equities in each case.[1] Mr. Justice Tysoe of the British Columbia Supreme Court has observed that the successful reorganization of *Quintette Coal* was as a result of the flexibility of the *CCAA* and the court in allowing the parties time to craft a viable plan.[2]

As noted in the introduction, the *CCAA* is broad remedial legislation designed to facilitate a restructuring of debtor corporations in the interests of the company, its creditors and the public.[3] Unlike much litigation in which the court is assessing liability, harm or other conduct *ex post*, proceedings under the *CCAA* primarily engage the court's supervisory powers. The court's role is to approve the framework for negotiation, determining matters that will facilitate the process. It also has overall responsibility to ensure that the statutory requirements are met. The court is not

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[1] *PCI Chemicals Canada Inc., Re* (2002), 2002 CarswellQue 831, [2002] J.Q. no. 433 (Que. S.C.). See also *Nova Metal Products Inc.* v. *Comiskey (Trustee of)* (1990), (sub nom. *Elan Corp.* v. *Comiskey*) 1 O.R. (3d) 289 (Ont. C.A.), *ibid.*; *Algoma Steel Corp.* v. *Royal Bank* (1992), 1992 CarswellOnt 2843, [1992] O.J. No. 795 (Ont. Gen. Div.).

[2] Mr. Justice Tysoe, "Quintette Coal – The Story of its Reorganization" in J. Ziegel and D. Baird, eds., *Case Studies in Recent Canadian Insolvency Reorganizations, In Honour of the Honourable Lloyd W. Houlden* (Toronto: Carswell, 1997) 377 at 396. *Quintette Coal Ltd., Re* (1991), 10 C.B.R. (3d) 197, 62 B.C.L.R. (2d) 218 (B.C. S.C.) at 240.

[3] *Playdium Entertainment Corp., Re* (2001), 2001 CarswellOnt 3893, [2001] O.J. No. 4252 (Ont. S.C.J. [Commercial List]), additional reasons at (2001), 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]), at para. 27; *Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.); *Icor Oil & Gas Co.* v. *Canadian Imperial Bank of Commerce* (1989), 102 A. R. 161 (Alta. Q.B.) at 165; *Quintette Coal Ltd.* v. *Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.), leave to appeal refused (1991), 7 C.B.R. (3d) 164 (note) (S.C.C.); *Consumers Packaging Inc., Re* (2001), [2001] O.J. No. 3908, 27 C.B.R. (4th) 197 (Ont. C.A.).

Case Name:
BG International Ltd. v. Canadian Superior Energy Inc.

Between
BG International Limited, Respondent, (Plaintiff), and
Canadian Superior Energy Inc., Appellant, (Defendant)

[2009] A.J. No. 358

2009 ABCA 127

Docket: 0901-0048-AC

Registry: Calgary

Alberta Court of Appeal
Calgary, Alberta

R.L. Berger, F.F. Slatter and P.A. Rowbotham JJ.A.

Heard: March 10, 2009.
Judgment: April 7, 2009.

(20 paras.)

Creditors and debtors law -- Receivers -- Court appointed receivers -- Order -- Appointment of receiver -- Appeal by oil well operator from order appointing receiver over well dismissed -- Another party with interest in well brought application when operator failed to pay owner of rig working on well out of fear rig would be removed -- Rig operator had taken steps to terminate contract -- Subsequent creditor protection granted to operator showed it could not pay obligation to rig operator -- Receivership not unreasonable.

Natural resources law -- Oil and gas -- Offshore -- Appeal by oil well operator from order appointing receiver over well dismissed -- Another party with interest in well brought application when operator failed to pay owner of rig working on well out of fear rig would be removed -- Rig operator had taken steps to terminate contract -- Subsequent creditor protection granted to operator showed it could not pay obligation to rig operator -- Receivership not unreasonable.

Appeal by Canadian Superior Energy from an order appointing an interim receiver to take control of the Endeavour oil well. Canadian and BG International both had an interest in the well. Canadian was the operator of the well, and BG was to take over in April 2009. Canadian had failed to pay the owner of the rig operating at the well and the rig owner had taken some steps toward terminating its contract and removing the rig from the well. BG had the receiver appointed in February 2009, and agreed to advance $47 million through the receiver to the rig owner to complete work on the well. Shortly after the receivership order was made, Canadian was granted creditor protection.

HELD: Appeal dismissed. The evidence showed there was a real risk the rig owner would remove the well, so the appointment of the receiver was necessary. Canadian's subsequent application for protection from its creditors demonstrated it was still in no position to pay the rig owner. There was no significant prejudice to Canadian worked by the order, which merely speeded up the process by way of which BG took over the well's operations. The receivership order did not reflect an unreasonable balancing of the parties' respective rights and interests.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Judicature Act, RSA 2000, c. J-2,

Appeal From:

Appeal from the Whole of the Interim Orders by The Honourable Madam Justice B.E.C. Romaine Dated the 11th day of February, 2009 Filed on the 11th day of February, 2009 (Docket: 0901-02012).

Counsel:

V.P. Lalonde and M.A. Thackray, Q.C., for the Appellant.

C.L. Nicholson and M.E. Killoran, for the Respondent.

T.S. Ellam, for interested/affected party Challenger Energy Corp.

H.A. Gorman, for the interested/affected party Canadian Western Bank.

L.B. Robinson, Q.C., for the receiver Deloitte & Touche Inc.

Memorandum of Judgment

The following judgment was delivered by

1 THE COURT:-- This is an appeal of a decision appointing an interim receiver to take control of the Endeavour oil well located off the coast of Trinidad and Tobago. The appeal was dismissed following oral argument, with reasons to follow.

Facts

2 The appellant and the respondent both have an interest in the well. The appellant is the operator of the Endeavour well under the standard form joint operating agreement approved by the Association of International Petroleum Negotiators. While Challenger Energy Corp. is a party to the joint operating agreement, there is some dispute as to whether Challenger has effectively acquired a part of the appellant's interest, which would trigger its obligations.

3 There is at present a semi-submersible rig working on the well. The rig is operated by Maersk Contractors Services on behalf of the owners of the rig. All the parties agree that it is extremely important that the rig is not removed from the well, and that the well be flow tested. Maersk sent its invoice for its November operations. The respondent paid its share of the invoice to the appellant, but those funds were not forwarded to Maersk. Once the invoice became overdue, Maersk commenced the process under the drilling contract that would allow it to terminate the contract.

4 When the respondent found out that Maersk had not been paid, it became very concerned. It deposes that operating funds were not being kept in a segregated account as covenanted. It deposes that the appellant is in default of its obligations by not paying Maersk. The appellant does not dispute that Maersk has not been paid. It proposed a payment schedule to Maersk (which Maersk rejected), which is essentially an acknowledgment that payments are overdue.

5 The respondent commenced arbitration proceedings in accordance with the joint operating agreement. It then immediately applied to the Court of Queen's Bench for interim relief pending the hearing of the arbitration, as contemplated by Article 18.2 (C)(9) of the arbitration clause. The application for an interim receiver was brought on very quickly. The Canadian Western Bank, which held security over the appellant's assets, was given notice and appeared. While the appellant was also given notice of and appeared at the application, it did not have time to file an affidavit in response nor to cross examine on the respondent's affidavit. An adjournment to do that was denied, and the interim receiver was appointed on February 11th, 2009. The order protected the priority of the Canadian Western Bank, and gave second priority to the respondent's advances. This appeal was promptly launched and expedited.

Standard of Review

6 Granting a receivership order under the *Judicature Act*, R.S.A. 2000, c. J-2, involves the exercise of a discretion. The granting of the order will not be interfered with on appeal unless it is based on an error of law, or the granting of the remedy is wholly unreasonable in the circumstances: ***Wewaykum Indian Band v. Canada***, 2002 SCC 79, [2002] 4 S.C.R. 245 at para. 107; ***Medical Laboratory Consultants Inc. v. Calgary Health Region,*** 2005 ABCA 97, 43 Alta. L.R. (4th) 5 at para. 3.

Appointment of the Receiver

7 The chambers judge was motivated to appoint the interim receiver without any delay because she perceived a real risk that Maersk would remove the rig, thereby causing irreparable harm to all concerned. The respondent was prepared to advance $47 million through the receiver to complete the work on the well. The appellant argues, first, that there was no real prospect of Maersk removing the rig, and that Maersk was merely taking steps to preserve its legal rights. It is argued the chambers judge committed a palpable and overriding error in finding a real risk the rig would be removed.

8 The record shows, however, that Maersk was taking the formal steps under the drilling contract that were conditions precedent to the termination of that contract. While Maersk wrote that it would show "flexibility", that was premised on the appellant proposing an "acceptable" solution. Maersk had already rejected the appellant's payment schedule, and was resisting attempts to postpone the dispute resolution meeting that was a precondition to termination. The respondent's witness deposed that Maersk did not propose to test the well unless paid, and that Maersk preferred to move the rig to another well in Australia. He also deposed that if the rig was removed, it would take approximately one year and cost $35 million to bring in a replacement. The finding of a risk of removal of the rig made by the trial judge is supported by the record, and does not warrant appellate interference.

9 Next the appellant argues that it was denied its basic rights because it was not granted an adjournment, it was not allowed to cross examine on the respondent's affidavit, and it was not given time to file its own affidavit. Despite the presence of the appellant, the application proceeded almost as if it was an *ex parte* application. While there is substance to this complaint, it is not uncommon for interim receivers to be appointed on an *ex parte* basis, and there were remedies available to review or withdraw the order granted. Given the urgency found by the chambers judge, the method of proceeding was not, in this case, fatal. We do not find that Article 18.2 (C)(9) of the arbitration provisions, which enables electronic hearings, effectively prohibits *ex parte* procedures.

10 The appellant was asked to suggest terms on which an adjournment might be granted, but persisted in its request for an adjournment that did not address the respondent's legitimate concerns. The chambers judge was entitled to conclude that the requested adjournment could itself have led to irreparable damage to all parties.

11 We note that in the weeks that have followed since the granting of the order, the appellant has still not cross examined on the respondent's affidavit, nor has it filed an affidavit in reply. Any such evidence could have been used in an application to set aside or vary what was similar to an *ex parte* order, it could have been used on the stay application, and it would likely have been admitted on this appeal. We conclude that the appellant's objections are to some extent tactical. Even though the record may be incomplete, many of the key facts are not in dispute, and the key documents are included. A fair picture of the situation can be obtained from this record, supplemented as it has been by counsels' submissions.

12 The appellant notes that under Article 18.3 (A) of the joint operating agreement, when one party gives notice of default it is required by the contract to pay the amounts owed by the defaulting party. The appellant points out that this is a contractual obligation, and that the respondent was required to pay all outstanding amounts without seeking any more security or protection than that provided by the operating agreement. By advancing the $47 million by way of receiver's certificates, the respondent has in effect managed to enhance its position under the contract. The respondent replies that it had already paid its share of the Maersk invoice, and the clause cannot mean that it has to pay twice the amount misapplied by the appellant. It also argues that the security provided by Article 18.4 (E) of the joint operating agreement may not cover all of the money the respondent proposes to advance.

13 The default clause in the joint operating agreement provides in Article 18.4 (H) that it is not intended to exclude any other remedies available to the parties. The enhanced security collaterally obtained by the respondent through the use of receiver's certificates has not been shown on this record to create any serious prejudice to the appellant. After all, it is the appellant that is in default, and the respondent is prepared to advance significant sums to cure that default, even if it is required to do so by the contract. The chambers judge found that the appellant had been commingling joint venture funds, and that the respondent had a reasonable concern about the protection of future advances. Unlike in most receivership cases, the funds advanced under this enhanced security are to be used to pay other creditors, and would not further subordinate their interests. The security of the receiver's certificates may merely be parallel to that already provided for in the operating agreement. While the appointment of the receiver does arguably have the effect identified by the appellant, that does not make the receivership order unreasonable in the circumstances.

14 The appellant also points out that the appointment of the interim receiver has had the effect of displacing it as the operator. While the respondent has initiated the procedure under Article 4 of the joint operating agreement to replace the appellant as operator because of its default, the mechanism provided for in the agreement would take at least 30 days. By applying for an interim receiver, the respondent has essentially accelerated that period of time during which the appellant could cure its default, and maintain its status as operator. Again, this submission of the appellant is not without substance. We note, firstly, that the appellant has not offered to cure its default, and indeed it appears it is unable to do so. We are advised by counsel that last Thursday the appellant was granted protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. If the appellant was now in a position to cure its defaults, this point might be determinative of the appeal. Secondly, the parties had already agreed that the respondent should become the operator in April of this year. There is no significant prejudice to the appellant by the brief acceleration.

15 The appellant complains that the respondent was not required to post an undertaking to pay damages if it turns out its allegations are unfounded. Filing an undertaking in these circumstances is not the usual practice in Alberta. Damages for wrongful appointment of a receiver were granted in ***Royal Bank of Canada v. W. Got & Associates Electric Ltd.,*** [1999] 3 S.C.R. 408 without the presence of an undertaking. We note that the respondent has paid significant sums of money on behalf of the appellant, and that the appellant would likely have a right of set-off if it obtains an award of damages against the respondent. An undertaking would add little.

Conclusion

16 We agree that the appointment of a receiver is a remedy that should not be lightly granted. The chambers judge on such an application should carefully explore whether there are other remedies, short of a receivership, that could serve to protect the interests of the applicant. For example, the order might be granted but stayed for, say, 48 hours to allow the company to cure deficiencies, propose alternatives, or clarify the record.

17 In particular, the chambers judge must carefully balance the rights of both the applicant and the respondent. The mere appointment of a receiver can have devastating effects. The respondent referred us to the statement in ***Swiss Bank Corp. (Canada) v. Odyssey Industries Inc.*** (1995), 30 C.B.R. (3d) 49 (Ont. C.J. G.D.) at para. 31:

> [31] With respect to the hardship to Odyssey and Weston should a receiver be appointed, I am unable to find any evidence of undue or extreme hardship. Obviously the appointment of a receiver always causes hardship to the debtor in that the debtor loses control of its assets and business and may risk having its assets and business sold. The situation in this case is no different.

This quotation does not reflect the law of Alberta. Under the *Judicature Act*, it must be "just and convenient" to grant a receivership order. Justice and convenience can only be established by considering and balancing the position of both parties. The onus is on the applicant. The respondent does not have to prove any special hardship, much less "undue hardship" to resist such an application. The effect of the mere granting of the receivership order must always be considered, and if possible a remedy short of receivership should be used.

18 The chambers judge was aware of all of the points now raised by the appellant. She had a difficult job balancing the rights and interests of the parties. It is in the interests of all parties that the rig stay on the well, and that the well be flow tested. The appellant is in default. The respondent has not disputed its obligation to pay the appellant's share of operating expenses, and is quite willing to pay the $47 million required to do that. In all the circumstances it was not an unreasonable exercise of her discretion for the chambers judge to extend to the respondent the protection of receiver's certificates. The practical effect of accelerating the removal of the appellant as the operator was apparent to her. If the appellant does not have the necessary funds to cure its defaults, then its removal as operator merely accelerated the inevitable.

19 The chambers judge had to make a difficult decision in a very short period of time based on limited materials. Deference is owed to her discretionary decision to appoint a receiver. While an order short of a receivership might have been crafted, we have not been satisfied that her eventual balancing of the various rights and interests involved was unreasonable. She was primarily motivated by preserving the value of the well for the benefit of all concerned. We cannot see any error that warrants appellate interference, and the appeal is dismissed.

20 The dismissal of the appeal is not intended to limit the powers of the chambers judge or the CCAA case management judge. The receivership was to be "interim" only, and it has an internal mechanism for review. The Queen's Bench retains the ability to revoke or amend the order as circumstances dictate.

R.L. BERGER J.A.
F.F. SLATTER J.A.
P.A. ROWBOTHAM J.A.

cp/e/qlcct/qlpwb/qlaxw

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

And in the Matter of a Proposed Plan of Compromise or Arrangement with Respect to Stelco Inc. and the Other Applicants Listed Under Schedule "A"

Application Under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

[Indexed as: Stelco Inc. (Re) (No. 2)]

Court of Appeal for Ontario, Laskin, Rosenberg and LaForme JJ.A.
November 4, 2005

Debtor and creditor — Companies' Creditors Arrangement Act — Jurisdiction — Jurisdiction of supervising judge not limited to preserving status quo — Supervising judge having power to vary stay and allow company to enter into agreements to facilitate restructuring, provided that creditors have final decision whether or not to approve Plan — Supervising judge entitled to use his own judgment and conclude that plan was not doomed to fail despite creditors' opposition — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

The debtor company negotiated agreements with two of its stakeholders and a finance provider which were intrinsic to the success of the Plan of Arrangement that the company proposed. While the stakeholders did not have a right to vote to approve any plan of arrangement and reorganization, they had a functional veto in the sense that no restructuring could be completed without their support. The company sought court authorization to enter into the agreements. Authorization was granted by the supervising judge. Creditors of the company appealed the orders, arguing that the supervising judge did not have jurisdiction generally to make the orders and that he did not have jurisdiction to approve orders that would facilitate a Plan that was doomed to fail, considering the creditors' opposition to the Plan.

Held, the appeal should be dismissed.

The motions judge had jurisdiction to make the orders authorizing the company to enter into the agreements. Section 11 of the *Companies' Creditors Arrangement Act* provides a broad jurisdiction to impose terms and conditions on the granting of the stay. Section 11(4) includes the power to vary the stay and allow the company to enter into agreements to facilitate the restructuring, provided that the creditors have the final decision under s. 6 whether or not to approve the Plan. The court's jurisdiction is not limited to preserving the *status quo*. The orders in this case did not usurp the s. 6 rights of the creditors and did not unduly interfere with the business judgment of the creditors. The orders moved the process along to the point where the creditors were free to exercise their rights at the creditors' meeting. It must be a matter of judgment for the supervising judge to determine whether a Plan is doomed to fail. It was apparent in this case that the motions judge brought his judgment to bear and decided that the Plan was not doomed to fail. There was no basis for second guessing him on that issue.

Cases referred to

Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 7 O.R. (3d) 362, [1992] O.J. No. 374, 4 B.L.R. (2d) 306, 10 C.B.R. (3d) 23 (Gen. Div.); *Chef*

Ready Foods Ltd. v. Hongkong Bank of Canada, [1990] B.C.J. No. 2384, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136, 4 C.B.R. (3d) 311 (C.A.) (*sub nom. Hongkong Bank of Canada v. Chef Ready Foods*); *Inducon Development Corp. (Re)*, [1992] O.J. No. 8, 8 C.B.R. (3d) 306, 31 A.C.W.S. (3d) 94 (Gen. Div.)

Statutes referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 6 [as am.], 11 [as am.], 13 [as am.]

APPEAL from the orders of Farley J., [2005] O.J. No. 4309 (S.C.J.) authorizing the company to enter into agreements.

Robert W. Staley and *Alan P. Gardner*, for Informal Committee of Senior Debentureholders, appellants.
Michael E. Barrack and *Geoff R. Hall*, for Stelco Inc., respondent.
Robert I. Thornton and *Kyla E.M. Mahar*, for Monitor, respondent.
John R. Varley, for Salaried Active Employees, respondents.
Michael C.P. McCreary and *David P. Jacobs*, for USW Locals 8782 and 5328, respondents.
George Karayannides, for EDS Canada Inc., respondent.
Aubrey E. Kauffman, for Tricap Management Ltd., respondents.
Ben Zarnett and *Gale Rubenstein*, for the Province of Ontario, respondents.
Murray Gold, for Salaried Retirees, respondents.
Kenneth T. Rosenberg, for USW International, respondents.
Robert A. Centa, for USWA, respondents.
George Glezos, for AGF Management Ltd., respondents.

The judgment of the court was delivered by

[1] ROSENBERG J.A.: — This appeal is another chapter in the continuing attempt by Stelco Inc. and four of its wholly-owned subsidiaries to emerge from protection from their creditors under the *Companies' Creditors Arrangement* Act, R.S.C. 1985, c. C-36 ["*CCAA*"]. The appellant, an Informal Committee of Senior Debenture Holders who are Stelco's largest creditor, applies for leave to appeal under s. 13 of the *CCAA* and if leave be granted appeals three orders made by Farley J. on October 4, 2005 in the *CCAA* proceedings. These orders authorize Stelco to enter into agreements with two of its stakeholders and a finance provider. The appellant submits that the motions judge had no jurisdiction to make these orders and that the effect of these orders is to distort or skew the *CCAA* process. A group of Stelco's equity holders support the submissions of the appellant. The various other players with a stake in the restructuring and the court-appointed Monitor support the orders made by the motions judge.

[2] Given the urgency of the matter it is only possible to give relatively brief reasons for my conclusion that while leave to appeal should be granted, the appeal should be dismissed.

The Facts

[3] Stelco Inc. and the four wholly-owned subsidiaries obtained protection from their creditors under the *CCAA* on January 29, 1994. Thus, the *CCAA* process has been going on for over 20 months, longer than anyone expected. Farley J. has been managing the process throughout. The initial order made under s. 11 of the *CCAA* gives Stelco sole and exclusive authority to propose and file a plan of arrangement with its creditors. To date, attempts to restructure have been unsuccessful. In particular, a plan put forward by the Senior Debt Holders failed.

[4] While there have no doubt been many obstacles to a successful restructuring, the paramount problem appears to be that stakeholders, the Ontario government and Stelco's unions, who do not have a formal veto (*i.e.*, they do not have a right to vote to approve any plan of arrangement and reorganization) have what the parties have referred to as a functional veto. It is unnecessary to set out the reasons for these functional vetoes. Suffice it to say, as did the Monitor in its Thirty-Eighth Report, that each of these stakeholders is "capable of exercising sufficient leverage against Stelco and other stakeholders such that no restructuring could be completed without that stakeholder's support".

[5] In an attempt to successfully emerge from *CCAA* protection with a plan of arrangement, the Stelco board of directors has negotiated with two of these stakeholders and with a finance provider and has reached three agreements: an agreement with the provincial government (the "Ontario Agreement"), an agreement with The United Steelworkers International and Local 8782 (the "USW Agreement"), and an agreement with Tricap Management Limited (the "Tricap Agreement"). Those agreements are intrinsic to the success of the Plan of Arrangement that Stelco proposes. However, the debt holders including this appellant have the ultimate veto. They alone will vote on whether to approve Stelco's Plan. The vote of the affected debt holders is scheduled for November 15, 2005.

[6] The three agreements have terms to which the appellant objects. For example, the Tricap Agreement contemplates a break fee of up to $10.75 million depending on the circumstances. Tricap will be entitled to a break fee if the Plan fails to obtain the requisite approvals or if Tricap terminates its obligations to provide financing as a result of the Plan being amended without Tricap's approval. Half of the break fee becomes payable if the Plan

is voted down by the creditors. Another example is found in the Ontario Agreement, which provides that the order sanctioning the Final Plan shall name the members of Stelco's board of directors and such members must be acceptable to the province. Consistent with the Order of March 30, 2005 and as required by the terms of the agreements themselves, Stelco sought court authorization to enter into the three agreements. We were told that, in any event, it is common practice to seek court approval of agreements of this importance. The appellant submits that the motions judge had no jurisdiction to make these orders.

[7] There are a number of other facts that form part of the context for understanding the issues raised by this appeal. First, on July 18, 2005, the motions judge extended the stay of proceedings until September 9, 2005 and warned the stakeholders that this was a "real and functional deadline". While that date has been extended because Stelco was making progress in its talks with the stakeholders, the urgency of the situation cannot be underestimated. Something will have to happen to either break the impasse or terminate the *CCAA* process.

[8] Second, on October 4, 2005, the motions judge made several orders, not just the orders to authorize Stelco to enter into the three agreements to which the appellant objects. In particular, the motions judge extended the stay to December and made an order convening the creditors' meeting on November 15 to approve the Stelco Plan. The appellant does not object to the orders extending the stay or convening the meeting to vote on the Plan.

[9] Third, the appellant has not sought permission to prepare and file its own plan of arrangement. At present, the Stelco Board's Plan is the only plan on the table and as the motions judge observed, "one must also realistically appreciate that a rival financing arrangement at this stage, starting from essentially a standing start, would take considerable time for due diligence and there is no assurance that the conditions will be any less onerous than those extracted by Tricap" [at para. 5].

[10] Fourth, in his orders authorizing Stelco to enter into these agreements, the motions judge made it clear that these authorizations, "are not a sanction of the terms of the plan . . . and do not prohibit Stelco from continuing discussions in respect of the Plan with the Affected Creditors".

[11] Fifth, the independent Monitor has reviewed the Agreements and the Plan and supports Stelco's position.

[12] Finally, and importantly, the Senior Debenture Holders that make up the appellant have said unequivocally that they will not approve the Plan. The motions judge recognized this in his reasons [at para. 7]:

> The Bondholder group has indicated that it is firmly opposed to the plan as presently constituted. That group also notes that more than half of the creditors by $ value have advised the Monitor that they are opposed to the plan as presently constituted. . . . The present plan may be adjusted (with the blessing of others concerned) to the extent that it, in a revised form, is palatable to the creditors (assuming that they do not have a massive change of heart as to the presently proposed plan).

Leave to Appeal

[13] The parties agree on the test for granting leave to appeal under s. 13 of the *CCAA*. The moving party must show the following:

(a) the point on appeal is of significance to the practice;

(b) the point is of significance to the action;

(c) the appeal is *prima facie* meritorious; and

(d) the appeal will not unduly hinder the progress of the action.

[14] In my view, the appellant has met this test. The point raised is a novel and important one. It concerns the jurisdiction of the supervising judge to make orders that do not merely preserve the *status quo* but authorize key elements of the proposed plan of arrangement. The point is of obvious significance in this action. If the motions judge's approvals were to be set aside, it is doubtful that the Plan could proceed. On the other hand, the appellant submits that the orders have created a coercive and unfair environment and that the Plan is doomed to fail. It was therefore wrong to authorize Stelco to enter into agreements, especially the Tricap Agreement, that could further deplete the estate. The appeal is *prima facie* meritorious. The matter appears to be one of first impression. It certainly cannot be said that the appeal is frivolous. Finally, the appeal will not unduly hinder the progress of the action. Because of the speed with which this court is able to deal with the case, the appeal will not unduly interfere with the continuing negotiations prior to the November 15th meeting.

[15] For these reasons, I would grant leave to appeal.

Analysis

Jurisdiction generally

[16] The thrust of the appellant's submissions is that while the judge supervising a *CCAA* process has jurisdiction to make orders that preserve the *status quo*, the judge has no jurisdiction to make an order that, in effect, entrenches elements of the proposed Plan. Rather, the approval of the Plan is a matter solely for

the business judgment of the creditors. The appellant submits that the orders made by the motions judge are not authorized by the statute or under the court's inherent jurisdiction and are in fact inconsistent with the scheme and objects of the *CCAA*. They submit that the orders made in this case have the effect of substituting the court's judgment for that of the debt holders who, under s. 6, have exclusive jurisdiction to approve the plan. Under s. 6, it is only after a majority in number representing two-thirds in value of the creditors vote to approve the plan that the court has a role in deciding whether to sanction the plan.

[17] Underlying this argument is a concern on the part of the creditors that the orders are coercive, designed to force the creditors to approve a plan, a plan in which they have had no input and of which they disapprove.

[18] In my view, the motions judge had jurisdiction to make the orders he did authorizing Stelco to enter into the agreements. Section 11 of the *CCAA* provides a broad jurisdiction to impose terms and conditions on the granting of the stay. In my view, s. 11(4) includes the power to vary the stay and allow the company to enter into agreements to facilitate the restructuring, provided that the creditors have the final decision under s. 6 whether or not to approve the Plan. The court's jurisdiction is not limited to preserving the *status quo*. The point of the *CCAA* process is not simply to preserve the *status quo* but to facilitate restructuring so that the company can successfully emerge from the process. This point was made by Gibbs J.A. in *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*, [1990] B.C.J. No. 2384, 4 C.B.R. (3d) 311 (C.A.), at para. 10:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. It is available to any company incorporated in Canada with assets or business activities in Canada that is not a bank, a railway company, a telegraph company, an insurance company, a trust company, or a loan company. When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo *and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure*. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

(Emphasis added)

[19] In my view, provided the orders do not usurp the right of the creditors to decide whether to approve the Plan the motions judge had the necessary jurisdiction to make them. The orders made in this case do not usurp the s. 6 rights of the creditors and

do not unduly interfere with the business judgment of the creditors. The orders move the process along to the point where the creditors are free to exercise their rights at the creditors' meeting.

[20] The argument that the orders are coercive and therefore unreasonably interfere with the rights of the creditors turns largely on the potential $10.75 million break fee that may become payable to Tricap. However, the motions judge has found as a fact that the break fee is reasonable. As counsel for Ontario points out, this necessarily entails a finding that the break fee is not coercive even if it could to some extent deplete Stelco's assets.

[21] Further, the motions judge [at para. 9] both in his reasons and in his orders made it clear that he was not purporting to sanction the Plan. As he said in his reasons, "I wish to be absolutely clear that I am not ruling on or considering in any way the fairness of the plan as presented". The creditors will have the ultimate say on November 15 whether this plan will be approved.

Doomed to fail

[22] The appellant submits that the motions judge had no jurisdiction to approve orders that would facilitate a Plan that is doomed to fail. The authorities indicate that a court should not approve a process that will lead to a plan that is doomed to fail. The appellant says that it has made it as clear as possible that it does not accept the proposed Plan and will vote against it. In *Inducon Development Corp. (Re)*, [1992] O.J. No. 8, 8 C.B.R. (3d) 306 (Gen. Div.), at p. 310 C.B.R., Farley J. said that, "It is of course, . . . fruitless to proceed with a plan that is doomed to failure at a further stage."

[23] However, it is important to take into account the dynamics of the situation. In fact, it is the appellant's position that nothing will happen until a vote on a Plan is imminent or a proposal from Stelco is voted down; only then will Stelco enter into realistic negotiations with its creditors. It is apparent that the motions judge is of the view that the Plan is not doomed to fail; he would not have approved steps to continue the process if he thought it was. As Austin J. said in *Bargain Harold's Discount Ltd. v. Paribas Bank of Canada* (1992), 7 O.R. (3d) 362, [1992] O.J. No. 374 (Gen. Div.), at p. 369 O.R.:

> The jurisprudence is clear that if it is obvious that no plan will be found acceptable to the required percentages of creditors, then the application should be refused. *The fact that Paribas, the Royal Bank and K Mart now say there is no plan that they would approve, does not put an end to the inquiry.* All affected constituencies must be considered, including secured, preferred and unsecured creditors, employees, landlords, shareholders, and the public generally . . . .

(Emphasis added)

[24] It must be a matter of judgment for the supervising judge to determine whether the Plan is doomed to fail. This Plan is supported by the other stakeholders and the independent Monitor. It is a product of the business judgment of the Stelco board as a way out of the *CCAA* process. It was open to the motions judge to conclude that the plan was not doomed to fail and that the process should continue. Despite its opposition to the Plan, the appellant's position inherently concedes the possibility of success, otherwise these creditors would have opposed the extension of the stay, opposed the order setting a date for approval of the plan and sought to terminate the *CCAA* proceedings.

[25] The motions judge said this in his reasons [at para. 2]:

> It seems to me that Stelco as an ongoing enterprise is getting a little shop worn/shopped worn. It would not be helpful to once again start a new general process to find the ideal situation [*sic* solution?]; rather the urgency of the situation requires that a reasonable solution be found.

He went on to state [at para. 7] that in the month before the vote there "will be considerable discussion and negotiation as to the plan which will in fact be put to the vote" and that the present Plan may be adjusted. He urged the stakeholders and Stelco to "deal with this question in a positive way" and that "it is better to move forward than backwards, especially where progress is required". It is obvious that the motions judge has brought his judgment to bear and decided that the Plan or some version of it is not doomed to fail. I can see no basis for second-guessing the motions judge on that issue.

[26] I should comment on a submission made by the appellant that no deference should be paid to the business judgment of the Stelco board. The appellant submits that the board is entitled to deference for most of the decisions made in the day-to-day operations during the *CCAA* process except whether a restructuring should proceed or a plan of arrangement should proceed. The appellant submits that those latter decisions are solely the prerogative of the creditors by reason of s. 6. While there is no question that the ultimate decision is for the creditors, the board of directors plays an important role in the restructuring process. Blair J.A. made this clear in an earlier appeal to this court concerning Stelco reported at (2005), 75 O.R. (3d) 5, [2005] O.J. No. 1171 (C.A.), at para. 44:

> What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. *The company's role in the restructuring*, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply

> to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in *Lehndorff*, *supra*, at para. 5, "to make order[s] so as to effectively maintain the *status quo* in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors". But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. *Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance the company's restructuring efforts.*

(Emphasis added)

[27] The approvals given by the motions judge in this case are consistent with these principles. Those orders allow the company's restructuring efforts to move forward.

[28] The position of the appellant also fails to give any weight to the broad range of interests in play in a *CCAA* process. Again to quote Blair J.A. in the earlier *Stelco* case at para. 36:

> In the *CCAA* context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, *thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders*. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction.

(Emphasis added)

[29] For these reasons, I would not give effect to the submissions of the appellant.

Submissions of the equity holders

[30] The equity holders support the position of the appellant. They point out that the Stelco *CCAA* situation is somewhat unique. While Stelco entered the process in dire straits, since then almost unprecedented worldwide prices for steel have boosted Stelco's fortunes. In an endorsement of February 28, 2005, [2005] O.J. No. 730, 7 C.B.R. (5th) 310 (S.C.J.), the motions judge recognized this unusual state of affairs [at para. 5]:

> In most restructurings, on emergence the original shareholder equity, if it has not been legally "evaporated" because the insolvent corporation was so far under water, is very substantially diminished. For example, the old shares may be converted into new emergent shares at a rate of 100 to 1; 1,000 to 1; or even 12,000 to 1. . . . Stelco is one of those rare situations in which a change of external circumstances . . . may result in the original equity having a more substantial "recovery" on emergence than outline above.

[31] The equity holders point out that while an earlier plan would have allowed the shareholders to benefit from the continued

and anticipated growth in the Stelco equity, the present plan does not include any provision for the existing shareholders. I agree with counsel for Stelco that these arguments are premature. They raise issues for the supervising judge if and when he is called upon to exercise his discretion under s. 6 to sanction the Plan of arrangement.

Disposition

[32] Accordingly, I would dismiss the appeal. On behalf of the court, I wish to thank all counsel for their very helpful written and oral submissions that made it possible to deal with this appeal expeditiously.

Appeal dismissed.

Sasso v. Copeland

Superior Court of Justice, Harvison Young J. *December 2, 2005*

Insurance — Automobile insurance — No fault provisions — Threshold requirements — Plaintiff injuring shoulder in motor vehicle accident — Plaintiff suffering from post-traumatic migrainous headaches, insomnia, anxiety, decreased coping ability and personality changes — Fact that plaintiff continued to work not constituting evidence that she was free of pain or that her injuries had healed — Plaintiff sustaining permanent serious impairment of important physical or psychological function within meaning of s. 267.5(5) of Insurance Act — Insurance Act, R.S.O. 1990, c. I. 8, s. 267.5(5).

The plaintiff was injured in a motor vehicle accident in 2001. Four and a half years later, she continued to suffer from left shoulder pain, headaches and insomnia. She was more anxious, irritable and moody than she was before the accident, and her coping skills were impaired. The defendant brought a motion for a determination of whether the plaintiff's claim for non-pecuniary loss was barred by virtue of s. 267.5(5) of the *Insurance Act*.

Held, the question should be answered in the negative.

For the purposes of the motion, the defendant conceded that the plaintiff had sustained a permanent impairment of a physical or psychological function and that the functions permanently impaired were important ones. The question was whether the impairment was serious. In answering that question, it was important to focus not on any particular aspect of the plaintiff's impairment, but rather on the totality of her circumstances and the cumulative effect on her life. The fact that she was working and was apparently well regarded by her employer was a tribute to her work ethic and was not to be taken as evidence that she was free of pain and that her injuries had healed. The plaintiff's situation had apparently plateaued and was unlikely to improve significantly. Her injuries had and were likely to continue to have a lasting and serious impact on her career. She required

Case Name:

Temple City Housing Inc. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, As Amended
AND IN THE MATTER OF Temple City Housing Inc.
Temple City Housing Inc., Applicant

[2007] A.J. No. 1489

2007 ABQB 786

[2007] G.S.T.C. 188

42 C.B.R. (5th) 274

162 A.C.W.S. (3d) 879

2007 CarswellAlta 1806

[2008] 2 C.T.C. 61

Docket: 0701 12190

Registry: Calgary

Alberta Court of Queen's Bench

B.E.C. Romaine J.

December 21, 2007.

(14 paras.)

Insolvency law -- Claims -- Priorities -- Petition by the protected company for a $300,000 debtor-in-possession credit facility allowed -- The Canada Revenue Agency objected to the facility taking priority to its claim for $870,000 on the basis that the company was undercapitalized, and its claim was a property interest that could not be subordinated due to a trust deemed by s. 227(4.1) of the Income Tax Act -- The court found that the amount of financing was justifiable and necessary -- The *deemed trust provision was not intended to freeze the company's assets or prevent super-priority over security interests for the financing sought -- Income Tax Act, s. 227(4.1).*

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 227(4), s. 227(4.1)

Counsel:

Frank R. Dearlove and Chris Simard: for the Applicant Temple City Housing Inc.

Howard Gorman: for the Proposed Debtor-In-Possession Lender, Echo Merchant Fund.

Jill Medhurst-Tivadar: for the Canada Revenue Agency.

[Editor's note: A corrigendum was issued on January 8, 2008; the corrections have been made to the text and the corrigendum is appended to this judgment.]

Reasons for Judgment

B.E.C. ROMAINE J.:--

Introduction

1 Temple City Housing Inc. ("Temple") filed a petition seeking protection from its creditors under the ***Companies' Creditors Arrangement Act***, including an interim stay, the appointment of a Monitor and a Debtor-In-Possession credit facility ("DIPCharge"). Temple's major creditor is the Canada Revenue Agency ("CRA"), which opposed the priority of the DIP Charge sought in the order. I granted an Initial Order which included a super priority DIP Charge in the amount of $300,000 despite the objection of the CRA, and these are my reasons.

Facts

2 Temple produces pre-engineered packaged homes. Its construction facilities are in Cardston, Alberta, and it employs 170 people in its major business, with 25 additional people in a separate truss production facility. Most of Temple's labour staff are members of local First Nations groups, and it is the largest employer in Cardston.

3 The president of Temple deposes that Temple has been seriously impacted by the labour crisis experienced in Alberta over the past year, necessitating a shift in its business model. He states that Temple has made changes to resolve these labour issues and problems it has had with suppliers, and that it proposes to use the stay period and the financing provided by the DIP lender to put its production lines fully into use. Temple's president deposes that if Temple is able to carry on business as a going concern, rather than liquidating its assets, the CRA and its secured creditors will be paid in full and the return to unsecured creditors will be significantly enhanced.

4 A DIP Charge in the amount of $300,000 was essential in the short term despite the fact that this was the initial application because payroll obligations in the amount of $238,000 gross were due the same day as the application was heard, and a retainer was necessary for the Monitor and legal counsel. The application originally sought approval of DIP financing up to a maximum of $600,000, but counsel conceded that $300,000 was sufficient to allow Temple to continue with its operational plan before creditors received notice of the Initial Order. An order authorizing DIP financing in this amount was justifiable in accordance with the reasoning set out in ***Hunters Trailer & Marine Ltd.***, Re, [2001] 9 W.W.R. 299, 27 C.B.R. (4th) 236, 94 Alta. L.R. (3d) 389, [2001] 9 W.W.R. 299 at paras. 22 and 23.

5 Counsel for Temple explained that Temple's management had not been aware of the possible availability of the CCAA, and had sought legal advice only a few days before the payroll issue became a crisis.

6 Temple qualifies for protection under the CCAA, and the only contentious issue before me in this application was whether the DIP Charge could rank in priority to the CRA's claim.

7 Temple owes the CRA approximately $870,000 in source deductions which it has failed to remit for about a year. It is likely entitled to a refund of GST in the amount of $150,000, making the CRA claim roughly $720,000 net. The CRA took the position that Temple is undercapitalized, and that its business too unpredictable for the CRA to agree to have its claim subordinated to a DIP lender. The CRA also submitted that its claim for source deductions is a property interest that cannot be subordinated.

8 The CRA relied upon s. 227(4) and (4.1) of the ***Income Tax Act***, R.S.C. 1985, c. 1 (5th Supp.):

> 227(4) **Trust for moneys deducted** - Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to her Majesty in the manner and at the time provided under this Act.
>
> (4.1) **Extension of trust** - Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed
>
> (a) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and
>
> (b) to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in

> fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest

and is property beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

9 The CRA submitted that the deemed trust created by s. 227(4.1) prevents the CRA's claim from being superceded by the super-priority of a DIP order under the CCAA. I was advised that there was no case authority to support this submission.

10 The Supreme Court of Canada considered this provision of the ***Income Tax Act*** in ***First Vancouver Finance v. Minister of National Revenue***, 2002 SCC 49, 2002 CarswellSask 317, 2002 D.T.C. 6998 (Eng.), 2002 D.T.C. 7007 (Fr.), [2002] 3 C.T.C. 285, 212 D.L.R. (4th) 615, 288 N.R. 347, [2003] 1 W.W.R. 1, [2002] 2 S.C.R. 720, 45 C.B.R. (4th) 213, [2002] G.S.T.C. 23, REJB 2002-28499, J.E. 2002-960. In that case, property had come into the hands of a tax debtor after the deemed trust arose, and was then sold to a third party. One of the issue was whether the sale of the trust property released the property from the ambit of the trust. Iacobucci, J. for the Court found that it did.

11 He noted that the deemed trust takes priority in situations where the CRA and secured creditors of a tax debtor both claim an interest in the tax debtor's property. On the issue of whether the deemed trust attached to after-acquired property, Iacobucci, J. found that the language of the relevant section implied that "Parliament has contemplated a fluidity with respect to the assets of the debtor to which the trust attacks": para. 32. He commented that, since the deemed trust is a statutory creation, it is not subject to the "restraints imposed by ordinary principles of trust law"; para. 34. Thus, while conceptually it could be considered that the source deductions themselves are the corpus of the trust, according to the language of the section, "property of the person ... equal in value to the amount so deemed to be held in trust is deemed" to be held in trust. As the Court noted, this saves the CRA from having to trace specific assets to the funds originally deducted for source deductions. Iacobucci, J. referenced the comments of Gonthier, J. in ***Royal Bank v. Sparrow Electric Corp.***, [1997] 1 S.C.R. 411 (SCC) at para. 31 that the "trust is not in truth a real one, as the subject matter of the trust cannot be identified from the date of creation of the trust ..."

12 Following logically from this characterization of the statutory trust, Iacobucci, J. found on the issue of whether the deemed trust continued to operate on property that had been sold to third parties that "the deemed trust is in principle similar to a floating charge over all the assets of the tax debtor in the amount of the default": para. 40. He thus found that while the trust has priority, it does not attach specifically to particular assets, and that the debtor is thus free to alienate property in the ordinary course of business. The Court noted that, from the language of the section, "it is anticipated that the character of the tax debtor's property will change over time." This interpretation allows the tax debtor to carry on business without the uncertainty that would be created if the CRA's claim was allowed to follow an asset that had been sold to innocent third parties, and prevents a situation where the deemed trust, in effect, freezes the debtor's assets and prevents it from carrying on business, "clearly not a result intended by Parliament": para. 45.

13 This interpretation of the deemed trust provision is inconsistent with the CRA's argument that it creates a property interest that cannot be superceded by a DIP Charge, despite the concluding words of s. 227(4.1). As pointed out by counsel for the proposed DIP lender, the characterization of the deemed trust claim as a security interest, albeit one that takes priority over other secured interests, is supported by the definition of "security interest" in the ***Income Tax Act*** itself, which includes reference to a "deemed or actual trust."

14 It is clear that a court in a CCAA proceeding is able to grant a super-priority over existing security interests for DIP financing. If it were otherwise, and if super-priority could not be granted without the consent of secured creditors, "the protection of the CCAA effectively would be denied a debtor company in many cases": ***Hunters Trailers & Marine Ltd.***, at para. 32. It is also undoubtedly true that, since DIP financing may erode the security of creditors, the Court should be cautious in exercising its inherent jurisdiction to order priority for a DIP Charge over the objection of a secured creditor. I am satisfied that, in this case, Temple requires the protection of the CCAA if there is to be any possibility that it will be able to continue in business for the benefit of its creditors, employees and other stakeholders. I am also satisfied that granting a limited DIP Charge to take the company through the first crucial weeks of the process is necessary and in the best interests of the company's stakeholders generally. For this reason, I allowed a DIP Charge in the amount of $300,000.

* * * * *

Corrigendum
Issued: January 8, 2008

Please replace your judgment with this Corrigendum.

A Corrigendum has been filed on these Reasons for Judgment as follows:

Citation line has been changed to read: Temple City Housing Inc. (Companies' Creditors Arrangement Act)

Paragraph 13, second sentence has been changed to read: As pointed out by counsel for the proposed DIP lender, ...

Appearances has been changed to read: Howard Gorman for the Proposed Debtor-In-Possession Lender, Echo Merchant Fund.

"instrument" means

(a) a bill of exchange, note or cheque within the meaning of the *Bills of Exchange Act* (Canada),

(b) any other writing that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, or

(c) a letter of credit or an advice of credit if the letter of credit or advice of credit states on it that it must be surrendered on claiming payment under it,

but does not include

(d) chattel paper, a document of title or investment property, or

(e) a bond, debenture or similar document evidencing an obligation secured, in whole or in part, by a mortgage of an interest in land unless the interest being mortgaged is, itself, a mortgage of land;

"intangible" means

(a) personal property, but does not include goods, chattel paper, a document of title, an instrument, money or investment property, and

(b) a licence;

Alberta Personal Property Security Act Handbook

Fourth Edition

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Thomson Professional Publishing

creditor cannot obtain payment under a cheque, section 31(2) will be of no benefit to the creditor.[8a] Section 31(2) protects the creditor only after he has received payment.

¶31[3] Purchasers of Instruments or Securities

Section 31(3) ensures the free transferability of instruments and securities through negotiation. As with money, a security interest in an instrument or security may be perfected by possession, registration or by temporary perfection. Quite apart from constitutional problems relating to instruments under the federal *Bills of Exchange Act*,[9] it is commercially unacceptable to require ordinary course transferees of instruments or securities to conduct searches of the Personal Property Registry before dealing with this type of property. The effect of the section is to give priority to a transferee of an instrument or a security who has acquired physical possession of it for value and without knowledge that it is subject to a security interest. The term "knowledge" is specially defined for the purposes of this subsection and subsection (4). See section 31(4.1).

An "instrument" to which the section applies is defined in section 1(1)(u) to include not only the traditional types of negotiable instruments to which the *Bills of Exchange Act* applies, but, as well, any other "writing" that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment. The definition also includes a letter of credit or advice of credit if the letter or advice of credit states that it must be surrendered on claiming payment under it. These types of instruments could be described as being midway between a negotiable instrument and a pure intangible. They need not be negotiable in the sense that the transferee may acquire a better title than that of the transferor. However, they must be recognized in the commercial community as evidencing the right to collect the debt they represent or as being a method through which that right can be transferred. Accordingly, an instrument is more than just a written record of a debt.

It is a "purchaser" of an instrument or a security who gets the protection of the section if the prescribed conditions are met. A "purchaser" includes a person who takes a security interest in the property "purchased". See section 1(1)(hh) and (jj). Accordingly, a secured party who perfects his security interest in an instrument or security by taking possession of it will have priority over a registered security interest in it so long as the other

8a Re Lynn Holdings Ltd. (1996), 11 P.P.S.A.C. (2d) 42 (B.C. C.A.).

9 R.S.C. 1985, c. B-4.

requirements of section 31(3) have been met. This is one instance in which perfection by registration is less effective than perfection by possession. This is illustrated in the following scenario:

> SP1 is given a security interest in all D's present and after-acquired personal property to secure a loan. D is the registered owner of 500 shares of a publicly traded corporation. D obtains a loan from SP2 and gives SP2 possession of the share certificates as security for the loan. SP2 does not conduct a search of the registry, and does not know of SP1's security interest.

SP2 is entitled to priority over SP1 by virtue of section 31(3).

In *Flexi-Coil Ltd. v. Kindersley District Credit Union Ltd.*,[10] a dealer in farm equipment granted a purchase-money security interest to its supplier, Flexi-Coil. The dealer sold the equipment and took the proceeds in the form of cheques of customers. The cheques were "deposited" into an account, maintained at the Kindersley District Credit Union, which at the time was in debit balance. The Saskatchewan Court of Appeal held that the Credit Union was a purchaser of the instruments (cheques). The court concluded that by reducing the balance owing by the dealer to the Credit Union when the cheques were deposited, the Credit Union gave value to the dealer for the cheques and took them without notice of Flexi-Coil's interest in them as proceeds. Consequently, the Credit Union was a purchaser of the instruments within the meaning of section 31(3).[11]

In *Indian Head Credit Union v. Andrew*,[12] the Saskatchewan Court of Appeal held that a bank which took a security interest in a term deposit certificate which it had sold to the debtor was not a "purchaser" of an instrument within the meaning of section 31(3).

A "security" to which the section applies is defined in section 1(1)(oo) to include not only shares of a corporation, but also debt obligations. The definition of "instrument" in section 1(1)(u) excludes a security. However, this distinction between an instrument and a security is seldom crucial for priority purposes.

10 *Supra*, note 7.

11 *Ibid.*, at 208-10. See also *Belarus Equipment of Canada Ltd. v. C & M Equipment (Brooks) Ltd. (Receiver of)* (1994), 8 P.P.S.A.C. (2d) 32 (Alta. Master).

12 (1992), [1993] 1 W.W.R. 673 at 683-85 (Sask. C.A.).

Protection of transferees of negotiable and quasi-negotiable collateral

31 (1) A holder of money has priority over a security interest in money perfected under section 25, or temporarily perfected under section 28 (3), if the holder

(a) acquired the money without knowledge that it was subject to a security interest, or

(b) is a holder for value whether or not the holder acquired the money with knowledge that it was subject to a security interest.

(2) A creditor who receives an instrument drawn or made by a debtor and delivered in payment of a debt owing to the creditor by that debtor has priority over a security interest in the instrument whether or not the creditor has knowledge of the security interest at the time of delivery.

(3) A purchaser of an instrument has priority over a security interest in the instrument perfected under section 25 or temporarily perfected under section 26 or 28 (3) if

(a) the purchaser gave value for the instrument,

(b) the purchaser acquired the instrument without knowledge that it was subject to a security interest, and

(c) the purchaser took possession of the instrument.

(4) A holder of a negotiable document of title has priority over a security interest in the document of title that is perfected under section 25 or temporarily perfected under section 26 or 28 (3), if the holder

(a) gave value for the document of title, and

(b) acquired the document of title without knowledge that it was subject to a security interest.

(5) For the purposes of subsections (3) and (4),

(a) a purchaser of an instrument, or

(b) a holder of a negotiable document of title,

who acquired his or her interest under a transaction entered into in the ordinary course of the transferor's business has knowledge only if he or she acquired the interest with knowledge that the transaction violates the terms of the security agreement creating or providing for the security interest.

(6) A purchaser of chattel paper who takes possession of the chattel paper in the ordinary course of business and for new value has priority over any security interest in it that

(a) was perfected under section 25, if the purchaser does not know at the time of taking possession that the chattel paper is subject to a security interest, or

(b) has attached to proceeds of inventory under section 28, whatever the extent of the purchaser's knowledge.

"instrument" means

(a) a bill of exchange, note or cheque within the meaning of the *Bills of Exchange Act* (Canada),

(b) any other writing that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, or

(c) a letter of credit or an advice of credit if the letter of credit or advice of credit states on it that it must be surrendered on claiming payment under it,

but does not include

(d) chattel paper, a document of title or investment property, or

(e) a bond, debenture or similar document evidencing an obligation secured, in whole or in part, by a mortgage of an interest in land unless the interest being mortgaged is, itself, a mortgage of land;

"intangible" means

(a) personal property, but does not include goods, chattel paper, a document of title, an instrument, money or investment property, and

(b) a licence;

Perfection by possession of collateral

24 (1) Subject to section 19, possession of the collateral by the secured party, or on the secured party's behalf by another person, perfects a security interest in

(a) chattel paper,

(b) goods,

(c) an instrument,

(d) [Repealed 2007-10-128.]

(e) a negotiable document of title, and

(f) money,

unless possession is a result of seizure or repossession.

(2) For the purposes of subsection (1), a secured party does not have possession of collateral that is in the actual or apparent possession or control of the debtor or the debtor's agent.

(3) Subject to section 19, a secured party may perfect a security interest in a certificated security by taking delivery of the certificated security under section 68 of the *Securities Transfer Act*.

(4) Subject to section 19 of this Act, a security interest in a certificated security in registered form is perfected by delivery when delivery of a certificated security occurs under section 68 of the *Securities Transfer Act* and remains perfected by delivery until the debtor obtains possession of the security certificate.

Perfection of security interest in investment property by control

24.1 (1) Subject to section 19, a security interest in investment property may be perfected by control of the collateral under section 1 (1.1).

(2) Subject to section 19, a security interest in investment property is perfected by control under section 1 (1.1) from the time the secured party obtains control and remains perfected by control until

(a) the secured party does not have control, and

(b) one of the following occurs:

(i) if the collateral is a certificated security, the debtor has or acquires possession of the security certificate;

(ii) if the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner;

(iii) if the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

Perfection by registration

25 Subject to section 19, registration of a financing statement perfects a security interest in collateral.

Residual priority rules

35 (1) If this Act does not provide another method for determining priority between security interests,

(a) priority between perfected security interests in the same collateral is determined by the order of the occurrence of the following:

(i) the registration of a financing statement without regard to the date of attachment of the security interest;

(ii) possession of the collateral in accordance with section 24 without regard to the date of attachment of the security interest;

(iii) perfection under section 5, 7, 26, 29 or 78;

whichever is the earliest,

(b) a perfected security interest has priority over an unperfected security interest, and

(c) priority among unperfected security interests is determined by the order of attachment of the security interests.

(2) For the purposes of subsection (1), a continuously perfected security interest must be treated at all times as perfected by the method by which it was originally perfected.

(3) Subject to section 28 for the purposes of subsection (1), the time of registration, possession or perfection of a security interest in original collateral is also the time of registration, possession or perfection of its proceeds.

(4) A security interest in goods that are equipment and that are of a kind defined in the regulations as serial numbered goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (8) unless a financing statement relating to the security interest and containing a description of the goods by serial number is registered.

(5) Subject to subsection (6), the priority that a security interest has under subsection (1) applies to all advances, including future advances.

(6) A perfected security interest has priority over the interest of persons referred to in section 20 (a) only to the extent of

(a) advances made before the interests of the persons arise, or before the sheriff seizes the collateral or obtains a right to it under the *Creditor Assistance Act*,

(b) advances made before the secured party acquires knowledge of

(i) the interests of the persons,

(ii) seizure of the collateral by the sheriff, or

(iii) an order giving the sheriff a right to the collateral,

(c) advances made in accordance with

(i) a statutory requirement, or

(ii) a legally binding obligation owing to a person other than the debtor entered into by the secured party before the secured party acquired the knowledge referred to in paragraph (b),

(d) reasonable costs and expenses incurred by the secured party for the protection, preservation or repair of the collateral, and

(e) the amount of taxes paid by the secured party under section 27 (1) of the *Manufactured Home Act*.

(7) If registration of a security interest lapses as a result of failure to renew the registration or if a registration has been discharged without authorization or in error, and the secured party re-registers the security interest not later than 30 days after the lapse or discharge, the lapse or discharge does not affect the priority status of the security interest in relation to a competing perfected security interest that immediately before the lapse or discharge had a subordinate priority position, except to the extent that the competing security interest secures advances made or contracted for after the lapse or discharge and before the re-registration.

(8) If a debtor transfers an interest in collateral which, at the time of the transfer, is subject to a perfected security interest, that security interest has priority over any other security interest granted by the transferee before the transfer, except to the extent that the security interest granted by the transferee secures advances made, or contracted for,

(a) after the expiry of 15 days from the day the secured party who holds the security interest in the transferred collateral has knowledge of the information required to register a financing statement disclosing the transferee as the new debtor, and

(b) before the secured party referred to in paragraph (a) amends the registration to disclose the name of the transferee as the new debtor or takes possession of the collateral.

(9) Subsection (8) does not apply if the transferee acquires the debtor's interest free from the security interest granted by the debtor.

Perfection by possession of collateral

24 (1) Subject to section 19, possession of the collateral by the secured party, or on the secured party's behalf by another person, perfects a security interest in

(a) chattel paper,

(b) goods,

(c) an instrument,

(d) [Repealed 2007-10-128.]

(e) a negotiable document of title, and

(f) money,

unless possession is a result of seizure or repossession.

(2) For the purposes of subsection (1), a secured party does not have possession of collateral that is in the actual or apparent possession or control of the debtor or the debtor's agent.

(3) Subject to section 19, a secured party may perfect a security interest in a certificated security by taking delivery of the certificated security under section 68 of the *Securities Transfer Act.*

(4) Subject to section 19 of this Act, a security interest in a certificated security in registered form is perfected by delivery when delivery of a certificated security occurs under section 68 of the *Securities Transfer Act* and remains perfected by delivery until the debtor obtains possession of the security certificate.

Perfection of security interest in investment property by control

24.1 (1) Subject to section 19, a security interest in investment property may be perfected by control of the collateral under section 1 (1.1).

(2) Subject to section 19, a security interest in investment property is perfected by control under section 1 (1.1) from the time the secured party obtains control and remains perfected by control until

(a) the secured party does not have control, and

(b) one of the following occurs:

(i) if the collateral is a certificated security, the debtor has or acquires possession of the security certificate;

(ii) if the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner;

(iii) if the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

Perfection by registration

25 Subject to section 19, registration of a financing statement perfects a security interest in collateral.

RANGE v. BELVEDERE FINANCE CORP.

Supreme Court of Canada, Fauteux, Abbott, Martland, Hall and Pigeon, JJ. February 17, 1969.

Bills and notes — Form — Unconditional — Promissory note form attached by perforations to conditional sale contract form — Both transferred to bank and later to finance company — Whether promissory note form, when later detached, is bill of exchange in hands of finance company — Bills of Exchange Act (Can.), s. 176(1).

Bills and notes — Holder in due course — Note form attached to conditional sale contract form — Document transferred for value despite non-delivery of goods by seller — Finance company taking with knowledge of non-delivery — Onus of proving good faith — Bills of Exchange Act (Can.), s. 58.

Defendant who had agreed to purchase a fur coat on conditional sale contract signed a form prepared by ULC (a finance company) and delivered a number of post-dated cheques to the seller, receiving his promise to deliver the coat within a few days, before the first instalment fell due. The coat was never delivered, as the seller went into bankruptcy shortly thereafter, transferring the cheques, conditional sale contract and (still attached) promissory note form to ULC which proceeded to cash two of the cheques, although a telephone call to defendant's wife by an employee of ULC had disclosed that the coat had not been received. Several months after defendant had stopped payment on the remaining cheques, the trustees for the holders of the then bankrupt ULC's guaranteed notes (acting with the concurrence of the bank to which the documents had originally been transferred as collateral security by ULC) sold the claim to plaintiff who took it, knowing of the default and non-delivery.

Plaintiff's action on the detached promissory note form was dismissed on the ground of notice of failure of consideration. The dismissal of the action was reversed by a majority of the Quebec Court of Appeal on the ground that there was ample consideration and no evidence of want of good faith by plaintiff.

On appeal to the Supreme Court of Canada, *held*, allowing the appeal, if the seller had transferred the sale documents (which included a signed acknowledgement by the buyer that the goods had been received) before actually delivering the coat he would be guilty of fraud and ULC had failed to satisfy the onus placed upon it by s. 58 of the *Bills of Exchange Act*, R.S.C. 1952, c. 15, to show good faith. As it appeared that ULC had known of the defect of title at the time of the transfer to it, it could not claim to stand as holder in due course of the note.

However, as the bank to which the documents had been transferred as collateral security for ULC's indebtedness had taken in good faith, for value and without notice, before the first instalment had fallen due it could claim that status as could plaintiff, under s. 57 of the Act, if the instrument was a valid bill of exchange. But the "note" was only an "unconditional promise to pay" within the meaning of s. 176(1) of the Act if read independently of the terms of the conditional sale contract to which it was still attached (by perforations) at the time of the transfer to both the bank and plaintiff. By taking a transfer of the combined documentation, plaintiff had clearly evidenced an intention to exercise all the seller's rights arising out of the contract of sale. It had taken the requisite steps upon proceeding on the conditional sale contract and had only detached the note form for the purposes of this litigation. There being no cut-off clause such as that contained in the instrument sued upon in *Killoran v. Monticello State Bank* plaintiff could not claim the status of holder in due course either by statute or by contract and so could not avoid the defences of non-delivery and total failure of consideration.

Bills and notes — Holder in due course — Bank taking promissory note and conditional sale form as collateral security for advances in excess of face value may take as holder in due course.

[*Benjamin v. Weinberg,* [1956] S.C.R. 553; affg [1954] Que. Q.B. 582*n*; *Bonenfant v. Canadian Bank of Commerce,* [1930] 4 D.L.R. 18, [1930] S.C.R. 386; affg 46 Que. K.B. 219, apld; *Killoran v. Monticello State Bank,* 57 D.L.R. 359, 61 S.C.R. 528, [1921] 1 W.W.R. 988, distd]

APPEAL from the reversal by the Quebec Court of Queen's Bench, Appeal Side, [1967] Que. Q.B. 932, of the judgment of Morin, J., dismissing plaintiff's claim on a promissory note.

Guy Dorion, Q.C., for appellant.
Vincent Marron, Q.C., for respondent.

The judgment of the Court was delivered by

PIGEON, J. (translation) :—On April 7, 1960, the appellant signed an order for a fur coat for his wife. The total price, including tax, was $792, payable in 24 instalments of $33 each, starting on May 10th. When signing this order, addressed to Durand Fourrures Inc., he also signed a "conditional sales contract" at the same time, using a printed form supplied by United Loan Corporation, a "finance company". In this document, the vendor was described as Durand & Coutu Enrg., and the first condition printed on the back of the form read as follows:

1. Title to the articles being sold pursuant to this contract shall remain in the vendor until the full purchase price with respect to this conditional sale has been paid: in the event of default by the purchaser in making payments in accordance with the conditions contained herein, vendor shall have the option of demanding immediate payment of the instalments which have fallen due, or of repossessing the said articles without liability, and without being required to repay money already received by it on account of the purchase price under this conditional sale, in which case purchaser shall not be liable for the balance of the purchase price owing on this conditional sale.

The total amount of the deferred payments was shown as $792 payable at the office of United Loan in 24 monthly instalments of $33 each, beginning on May 10, 1960, with the following stipulation:

> A negotiable promissory note has been delivered by the purchaser to the vendor as evidence of the said total deferred payments, but not in payment thereof.

In fact, there was only one document, the "note" comprising the lower portion of the page, the top portion of which was entitled "Conditional Sales Contract". There was only a perforated line separating the two portions. On the left-hand side, the words "Negotiable Instrument" were printed sideways on the "note", and on the back there was a printed endorsement to the order of United Loan Corp. The vendor's signature was inserted in the appropriate space, and below this can also be seen an endorsement in the name of United Loan Corp. Only when this action was commenced did the respondent detach the "note" from the contract.

When the order and the conditional sales contract were signed, the vendor verbally promised to deliver the fur coat in two or three weeks. In fact it was never delivered, and the vendor made an assignment in bankruptcy a few months later. On and after April 13th, however, the conditional sales contract, including the note, was in the possession of United Loan Corp. at its Montreal office. On April 26th the latter delivered it along with a large number of other similar instruments, to the Imperial Bank, as collateral security for loans exceeding one million dollars.

When signing the order and the conditional sales contract, the appellant also signed a series of cheques in the amount of $33 each, payable to the order of Durand & Coutu Enrg., on each of the instalment dates. These cheques (or, I should say, these drafts: *Leduc v. Banque d'Hochelaga,* [1926] 1 D.L.R. 433, [1926] S.C.R. 76) were endorsed, and United Loan was in possession of them, thereby enabling it to cash the first two. After that, the appellant stopped payment on the remaining cheques, so that payment was refused, and threats of legal action obtained no result. It should be added that prior to the first payment falling due, United Loan knew that the coat had not been delivered; by telephone, one of its employees had asked the appellant's wife if her coat had been delivered to her, and she answered in the negative.

The following year, United Loan itself became insolvent, and on October 19, 1961, the trustee for the holders of its guaranteed notes, with the concurrence of the bank, sold to the respondent a certain number of claims, including the one against the appellant. Upon execution of this agreement, the conditional sales contract, along with the "note" which had never been detached therefrom, was delivered to the respondent. An account card was also delivered to it, indicating that only the first two monthly payments had been received, and the words "non-delivery" also appeared on the card. The respondent detached the "note", and began an action based solely on it, alleging that it was a holder in due course.

The Superior Court dismissed the action, finding the note void for lack of consideration, and holding that the respondent did not have the rights of a holder in due course.

This judgment was reversed by a majority of the Court of Appeal, on the following grounds:

> Since U.L.C. acquired the note for valuable consideration before it was dishonoured, it must be deemed to have been a holder in due course, unless it could be proved that it acted in bad faith when it acquired the note, or that it had received notice of a defect affecting the title of Durand & Coutu Enrg.
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> But there was no such evidence. It is true that the defendant's wife swore that she had told U.L.C. on the telephone that the subject-matter of the sale had not been delivered to her; but that occurred some ten days after the note had been signed and negotiated to U.L.C. It is also true that U.L.C. knew that the note had been given as payment for a coat sold under a conditional sales contract, because the contract had been assigned to it. But the contract contained nothing which would lead U.L.C. to suspect that the coat had not been delivered; on the contrary, in the contract, the purchaser admitted having received the subject-matter of the sale.

With respect, this reasoning seems to me to be incorrect. It is based on the premise that it is incumbent upon the defendant to prove bad faith on the part of United Loan. But our Court, affirming a decision of the Quebec Court of Appeal, has held that where fraud surrounds the origin of a negotiable instrument, the onus is on the person acquiring that instrument to prove his good faith: *Benjamin v. Weinberg,* [1956] S.C.R. 553; affg [1954] Que. Q.B. 582. In the case at bar, the uncontradicted evidence indicates that the vendor was required to deliver the fur coat prior to the due date of the first instalment. If under these circumstances, in order to obtain money, it (the vendor) availed itself of a document indicating that delivery had been made, without revealing in fact that delivery had not been made, it would seem clear to me that it was committing fraud. On the other hand, if it did reveal the fact to United Loan, it is clear that the latter knew of the defect in title. In my opinion, this is what must be deduced from the only evidence in the record: the telephone call was intended to verify delivery. If it is to be argued that United Loan was acting in good faith, such good faith must be proved, and no attempt was made to bring evidence of this.

This, however, certainly does not dispose of the problem, because the "note" was transferred to the bank prior to the first instalment payment date, and the evidence was complete with respect to the circumstances of this transfer, and with respect to the bank's good faith. During the course of the hearing, counsel for the appellant admitted that the latter was a holder for value, but he alleged that because it had taken the note as collateral security, it was not a holder in due course. This argument contradicts a unanimous decision of our Court, affirming a judgment of the Quebec Court of Appeal (*Bonenfant v. Canadian Bank of Commerce*, [1930] 4 D.L.R. 18, [1930] S.C.R. 386; affg 46 Que. K.B. 219. In that case, it was held that the bank, under these conditions, was a holder in due course, at least to the extent of the amount of the debt in respect of which the note had been assigned to it as collateral security. In the case at bar, however, the agreement shows that the amount due to the bank exceeded the total amount of the debts being transferred to it, and this total included the price being paid by the respondent, but was subject to a reduction in case of non-delivery. It must therefore be admitted that the respondent should be considered as having the same rights as those of the bank, and since the latter took the note prior to maturity, it is of little importance, if the note is considered to be a bill of exchange within the meaning of the *Bills of Exchange Act*, R.S.C. 1952, c. 15, that its subsequent negotiation to respondent took place after it had been dishonoured, since s. 57 makes no distinction in this connection.

It must still be determined, therefore, whether or not the instrument forming the subject-matter of this action is truly a "bill of exchange" within the meaning of the *Bills of Exchange Act*. To so qualify, it must be unconditional (s. 176(1)). Clearly, however, the instrument in question is not unconditional, unless it is to be considered independently of the conditional sales contract. If, on the other hand, the note and the contract are considered as a whole, the first condition indicates that the promise to pay is conditional: in the event of repossession of the article sold, the purchaser is exonerated from further liability. There is no doubt that the same result must obtain in the event of non-delivery. The evidence indicates that the respondent acquired rights arising out of the conditional sales contract and the "note" considered as a whole. Notices were published by it as if it were a conditional sale. Clearly it wished to be in a position to exercise rights arising out of the contract of sale, as well as those arising out of the "note". Only when it contemplated instituting legal proceedings, did it detach the "note", in order to argue that it should be considered as a separate and unconditional contract. We need not inquire what the situation would be if the respondent, and the bank prior to it, had taken the "note" after it had been detached from the contract. What was transferred in this case was the entire documentation as a whole, and upon examining this, it is impossible to conclude that the purchaser's promise is unconditional. The instrument in question, therefore, is not a bill of exchange.

It must also be noted that the contract produced in the case at bar differs from the one which was associated with the note forming the subject-matter of the decision of this Court in *Killoran v. Monticello State Bank,* 57 D.L.R. 359, 61 S.C.R. 528, [1921] 1 W.W.R. 988. That contract contains the following provision [p. 362 D.L.R., p. 532 S.C.R.]:

> "These notes . . . may be discounted, pledged or hypothecated by the promisee and in every such case payment thereof is to be made to the holder of the notes instead of the promisee, and *no holder* of the said notes . . . shall be affected by . . . any equities existing between the subscriber and the promisee, *but shall be, and shall be deemed to be a holder in due course* and for value of the notes held by him."

There, it was expressly stipulated that the obligation arising with respect to the note was unconditional, and would enure to the benefit of any holder of the note, notwithstanding anything which might take place between the purchaser and the vendor as a result of the conditional sale. No such provision appears in the case at bar, and I would even go so far as to say that the clause in the contract relating to the "note" implies the contrary.

For these reasons, I would allow the appeal, reverse the judgment of the Court of Appeal, and affirm the judgment of the Superior Court dismissing the action, the whole with costs against the respondent in all Courts.

Appeal allowed.