

NEGOTIABLE INSTRUMENTS

Highlights

- Identifying negotiable instruments
- Types and function of negotiable instruments
- Endorsing and transferring negotiable instruments
- The rights and responsibilities of the parties

*Toronto Dominion Bank v. Jordan*¹

Mrs. Jordan was a bank clerk who had convinced her husband and Mr. Courage, the manager of the local branch of the Toronto Dominion Bank, that she was a wealthy and successful business executive. In fact, she was using bank accounts of several relatives to move money from account to account to support her speculation in the stock market. Such a practice is known as “kiting” and involves drawing cheques on a succession of accounts to cover funds drawn from those accounts. Because there is a time delay in clearing the cheques and the final cheque covers the deficit caused by the first cheque, it is difficult to detect that there is an amount outstanding.

Mrs. Jordan gave Mr. Courage gifts and involved him in some of her profitable speculations. When two other bank managers became suspicious and warned him that she might be kiting cheques, he ignored their warnings. Mr. Courage did become nervous, however, and pressed her to cover a \$350 000 overdraft that he had allowed her to accumulate. Mrs. Jordan covered this with a blank cheque she had obtained from her husband drawn on the Teacher’s Credit Union, which she filled in for \$359 000. She gave the cheque to Mr. Courage, but when it was dishonoured, it brought her “kiting” scheme to an end.

The Toronto Dominion Bank branch of which Mr. Courage was the manager then sued Mr. Jordan for the face value of the cheque drawn on his account. Normally, the bank would be in no better position than Mrs. Jordan and would not be able to collect because of her fraud. But when a negotiable instrument is involved, the situation can be quite different. If an innocent third party acquires a cheque in good faith, it can be enforced against the drawer, even if the intervening party has been fraudulent.

This raised the question of whether Mr. Courage had acted in good faith. The court looked at his involvement with Mrs. Jordan and decided that while he may not have been directly dishonest, he certainly had not acquired the cheque in good faith and, therefore, the bank could not enforce it against Mr. Jordan.

This complicated set of transactions illustrates the most significant characteristic of negotiable instrument—that is, their enforceability in the hands of innocent third parties and the corresponding extreme vulnerability of those who make such negotiable instruments and allow them to be circulated. In this chapter, we will examine negotiable instruments and the rights and obligations of the parties to them.

Cheques, bills of exchange (often called drafts), and promissory notes are all negotiable instruments. They are in common use today because of several characteristics that greatly facilitate the commercial process. First, they can be used as a substitute for money. They

represent a claim on a particular debtor or financial institution and so can be used to transfer funds without actually handling large amounts of cash. They can be transferred to others not associated with the original transaction, without notice and with the assurance of payment, independent of any dealings between the initial parties or anyone else associated with the instrument. Negotiable instruments can also be used to advance credit. The negotiable instrument gives the holder a claim for a stated amount, and if this is made payable at some future date, a creditor-debtor relationship is created. Negotiable instruments can be made payable by installments, bear a stated interest, and have the additional advantage of being freely transferable to other creditors, independent of any problems associated with the original transaction. While the use of negotiable instruments has fallen because of the growing use of credit cards, debit cards, and the electronic transfer of funds, they still play a significant role in commercial transactions and consumer credit.

NEGOTIABILITY

Essential Characteristics

At the outset, it is necessary to distinguish between the assignment of contractual rights, as discussed in Chapter 7 of the text, and the negotiation of negotiable instruments. When contractual rights are assigned, it is necessary to notify the debtor of the transfer before the assignee can enforce payment directly. The element that makes negotiable instruments an effective substitute for money in many situations is their free transferability from one party to another without having to notify or acquire the consent of the original parties to the transfer.

To facilitate their transferability, negotiable instruments have acquired a second characteristic that makes them unique in the field of special contractual relationships. When contractual rights are assigned, the assignee is in no better position than the assignor, and any defence the debtor has against the assignor will hold against the assignee as well, thus allowing the debtor to avoid payment. This possibility obligates the assignee to investigate and accept the risks associated with the dealings between the original parties, since the assignee is subject to them. A negotiable instrument is unique because when it is transferred through negotiation to a third party who meets certain qualifications, that third party may take the instrument free of any problems which may exist between the original parties to it. The holder of the negotiable instrument may have better claims than the person from whom it was received. Even if the debtor under the instrument has a good defence against the original creditor, it cannot be used against an innocent third party, who is called a holder in due course, and the debtor will have to pay. This is the essential pre-requisite to making negotiable instruments freely transferable because it removes much of the risk and uncertainty that might otherwise interfere with their use.

*Trans Canada Credit Corp. Ltd. v. Zaluski et al.; Niagara Peninsula Compact Agency, Third Party*²

Mr. and Mrs. Zaluski were persuaded to purchase a vacuum cleaner from Niagara Peninsula Compact Agency through the fraudulent efforts of their salesman Mr. Green. Mr. Green not only misrepresented the nature of the sale but also claimed not to be selling vacuum cleaners at all. This was a scheme whereby Mrs. Zaluski was to give Mr. Green a series of referrals that if they resulted in a sale would earn her a \$25 commission per sale. The Zaluskis signed both a conditional sale agreement for the vacuum cleaner as well as a promissory note. Niagara then assigned the conditional sale agreement and negotiated the promissory note to Trans Canada Credit. This is a common practice allowing the selling company to get their money right away, albeit at a discount, and the finance company to then carry on the business that is their specialty, the advancement of credit. As a result, when the Zaluskis failed to pay, it was Trans Canada Credit that demanded payment.

There is no question that the original sale was based on the fraudulent misrepresentation of Mr. Green and that Niagara was responsible for that fraud. If Niagara had sued, the fraud of Mr. Green would have been a good defence against them, and the Zaluskis would not have had to pay. Had Trans Canada Credit sued on the conditional sale agreement that had been assigned to them, they, too, would have lost. They got only what Niagara had to give and that was tainted by Mr. Green's fraud. However, since Trans Canada Credit qualified as a holder in due course, they sued on the promissory note and were successful. The Zaluskis had to honour the note despite the fraud of Green and had look to Niagara for reimbursement. This case illustrates the difference between the assignment of contractual rights as discussed in Chapter 7 and the more favourable position of a holder in due course of a negotiable instrument. Note that if the same transaction were to happen today, Niagara would be required to stamp the promissory note as a "consumer note," which would seriously weaken the position of any holder in due course. Consumer bills and notes will be discussed below.

A negotiable instrument can only be an effective substitute for money if the person using it does not have to worry about disagreements between the initial parties. For example, if you were to go to a movie and give the teller a \$10 bill for your ticket, you would be very surprised if the teller demanded to know whether that bill had ever been involved in a breach of contract or a fraudulent transaction, the assumption being that if it had, the teller could refuse it because it had lost its value.

Of course, money cannot work that way but must stand on its own as payment, independent of any previous dealings. It must be clearly understood that money is legal tender created by special statute and must not be confused with negotiable instruments, and to say that negotiable instruments are a substitute for money is not to say that they are equivalent. As explained in Chapter 8, when a contract requires the payment of money, a cheque—even a certified cheque—will not be satisfactory performance, unless this is agreed to by the other party.

Money and negotiable instruments, however, come from common roots, and money nicely illustrates the essential quality of negotiation. A negotiable instrument can only be an effective substitute for money when the party receiving it is not obligated to go behind

the instrument and examine the dealings of the parties to it but need only be concerned about the instrument itself.

The primary factors to keep in mind when studying negotiable instruments are the following:

1. They are a claim for funds against the person designated on the instrument.
2. They are freely transferable.
3. They may be used as an instrument of credit.
4. They may bestow greater rights or claims on the bearer of the instrument than on the party from whom the instrument was received.

The Bills of Exchange Act

Negotiable instruments have been around for centuries and were originally created as a means of exchanging funds, allowing merchants to avoid the risks associated with carrying large sums of money in dangerous circumstances. The actual funds were deposited usually in some financial institution created for the purpose, and the merchants simply exchanged bills or notes giving the other person the right to collect those funds. The rules associated with negotiable instruments were originally developed by the merchant guilds and included in their body of law, called the “Law Merchant.” These laws were adopted by the English courts and became an integral part of the common law system, eventually forming the basis of the *Bills of Exchange Act* enacted by the British parliament as part of their general legal reforms taking place in the late 19th century. The Canadian government followed with the passage of the *Canadian Bills of Exchange Act* in 1890.

Although the statute basically codified the existing common law, there were some important changes, and so, the current act makes it clear that common law principles apply, except when specifically contrary to the provisions of the act. One of the effects of leaving the door open to the operation of common law in this way is that the types of negotiable instruments are not limited to promissory notes, bills of exchange, and cheques as set out in the act. The *Bills of Exchange Act* is federal legislation, and so, its provisions apply uniformly throughout Canada.³ The only significant amendment to the act took place in 1970 with the addition of a section concerned with “consumer notes.”⁴

TYPES OF NEGOTIABLE INSTRUMENTS

Although the *Bills of Exchange Act* deals only with bills of exchange (drafts), cheques, and promissory notes, it is important to note that other types of instruments can qualify as negotiable instruments or take on many of their characteristics. For example, bonds made payable to a designated person or to his or her order have been held to be negotiable instruments. Similarly, share certificates where no restrictions are included have been specifically designated as negotiable instruments in some jurisdictions.⁵ The discussion in this chapter will be limited to bills of exchange, cheques, and promissory notes, although

it should be remembered that the principles discussed will also apply to all other types of negotiable instruments.

Bills of Exchange

A bill of exchange, sometimes referred to as a draft, is an order instrument, whereby an order or direction is given by one person to another, usually a bank or financial institution, to pay funds to a third. The person drawing up the instrument is called the drawer. It is the drawer who orders the drawee, usually a financial institution, to make payment to a third party, known as the payee. Although the instrument is addressed to the drawee, it is physically transferred to the payee, and the payee then presents the instrument to the drawee for payment. Normally, the drawer has already established some sort of business arrangement, such as an account, with the person or institution being ordered to pay. Otherwise, the order would simply be ignored. However, in some circumstances, a bill of exchange is used as a means of collecting a debt, and then, the drawer orders the drawee/debtor to make payment to a third party. The idea is that when the payee presents the instrument to the drawee/debtor for payment, it will be honoured; if it is not, there will be damage to the debtor's credit rating.

If the bill is made payable on demand, it is usually presented for payment right away, but where the instrument is made payable at some future time, the payee or subsequent holder must wait for payment. In these circumstances, the holder of the bill can determine whether the bill will be honoured at that future date by presenting it to the drawee for acceptance. The drawee accepts the obligation to pay the amount specified on the instrument at the date of maturity by writing the word "accepted," the date, and the appropriate signature on the bill of exchange. When the drawee has done this, he or she has accepted the bill and is referred to subsequently as the acceptor, rather than the drawee. If the drawee refuses to accept the instrument, it has been dishonoured, and the holder can then seek redress from the drawer without waiting until the maturity date. But if the instrument is accepted, the drawee becomes primarily liable on the instrument and the drawer no longer has any control over the payment of the bill.

It is interesting to note that before acceptance takes place, the drawee owes no obligation to the payee or subsequent holder, since there is no direct relationship between them, but after acceptance the drawee, now the acceptor, is directly obligated. Prior to acceptance, the drawee will only honour because of his relationship to the drawer, and so, the drawer still retains control and can order the drawee not to pay. But after acceptance, the drawee loses the right to countermand the instrument.

For example, if Garcia buys a boat from Saito and gives Saito a bill of exchange, payable three months later, drawn on Ace Trust Company, where Garcia has an account or line of credit, it is quite likely that Saito would go to Ace Trust Company as soon as possible to find out whether Ace would honour the bill three months hence. Ace Trust Company would indicate their willingness to honour the instrument at maturity by their representative writing "accepted" across the instrument, accompanied by the date and the signature of the appropriate signing officer. If they refuse to do this, the bill would be dishonoured, and Saito would then turn to Garcia, the original drawer of the instrument, for satisfaction. But if Ace does accept the bill, Garcia can no longer issue any

instructions to Ace in relation to it. In effect, the primary debtor is now Ace Trust Company. Since they have assumed the debt and the obligation to pay, Garcia has lost control of the situation.

In fact, the *Bills of Exchange Act* states that the position of the acceptor is the same as that of the maker of the promissory note.⁶ If Garcia were to discover that there had been some fraudulent misrepresentation on the part of Saito, Garcia could countermand the order to Ace Trust Company any time before acceptance. But once Ace has accepted the bill and become the primary debtor, it owes an obligation to Saito to honour the instrument independently of Garcia and so must pay independent of any difficulties that exist between Garcia and Saito. If there has been fraud, Garcia has the right to sue Saito for compensation, but he cannot prevent Ace from paying out on the accepted bill of exchange.

Although it is possible to make a qualified acceptance, such as “acceptable when car repair complete,” this can be treated as a dishonour of the bill of exchange.

Bills of exchange can be used to accomplish two purposes. First, they are an extremely effective method of transferring funds between parties without the necessity of carrying cash, and, second, they can be used to create a creditor-debtor relationship. Demand drafts and sight drafts are usually used to transfer funds, the demand draft being payable when it is presented and the sight draft payable three days after being presented. The advantage of the sight draft is that it gives the drawee time to assemble the funds after it has been presented. A bill of exchange payable at some future time is called a time draft.

Although the bill of exchange was traditionally the most significant type of negotiable instrument, its use in modern times has dwindled because of business people’s increased reliance on cheques, and more recently the move to electronic methods of banking. However, the bill of exchange is still a valuable tool of commerce, and there are many circumstances in which, because of tradition or the need for the unique qualities of this instrument, the bill of exchange is still important today.

Cheques

A cheque is a bill of exchange drawn on a bank and payable on demand. It is drawn up by the drawer and made payable to the payee. Thus, a cheque may be viewed as a type of bill of exchange; it has the same general characteristics but is limited to situations in which the drawee is a bank and payment can be demanded immediately. It should be noted that the definition of “bank” for the purposes of the act has been broadened to include other institutions, such as credit unions and some trust companies.⁷ Since a cheque is payable on demand, its primary purpose is to exchange funds conveniently rather than to function as an instrument of credit. However, cheques that are post-dated can be used to create a creditor-debtor relationship over substantial periods of time. Because a creditor-debtor relationship is inconsistent with a cheque being payable on demand, a post-dated cheque does not acquire all the characteristics of a negotiable instrument until the date specified on the instrument. As a result, the drawer retains the right to countermand a post-dated cheque up to the stated date, even when it gets into the

hands of an innocent third party before that date. This is because the post-dated cheque, by its very nature, is irregular on its face.

The bank's obligation is to honour that cheque where there are sufficient funds in the customer's chequing account or an appropriate line of credit. A bank's failure to honour a valid cheque can result in liability to the customer to pay substantial damages for the problems caused. If there are not enough funds to cover a cheque, the bank normally will not honour it and the holder must look to the drawer for recourse. It is a criminal offence to issue such an N.S.F. (not sufficient funds) cheque.

Under Section 167 of the *Bills of Exchange Act*, the authority of the bank to honour a cheque drawn on it is terminated when the bank has notice of the death of the drawer or when the customer orders a stop payment (countermands payment) on the cheque.⁸ Many banks require their customers to agree to reimburse the bank if the cheque is inadvertently paid after such a countermand.

It is common practice today to require that payment be stopped (countermanded) in person, as opposed to over the phone, and in writing with all the information, including the amount, accurately stated. Accuracy is required because computers are used to identify the cheque. A small discrepancy in the information provided may cause the computer to miss the cheque and let it go through. Although the cheque remains valid until the end of the six-year limitation period, the bank as a matter of policy will not pay out after six months. Any older cheque is said to be stale dated, and a holder must go back to the original drawer for payment.

Certification

Although nothing is said in the *Bills of Exchange Act* about certification, Canadian banks have adopted the American practice of certifying cheques. Certification involves the bank, in effect, giving assurance that there are sufficient funds available to cover the cheque. This certification can be done at the request of the drawer before the cheque is delivered to the payee or by the payee or subsequent holder of the instrument. Although there has been debate about it in the past, recent court decisions have made it clear that the effect of such certification is similar to the acceptance of a bill of exchange, no matter who requested the certification (see the Centrac case set out below). By certification, the bank assumes a primary obligation to the payee or holder to honour the cheque, and the drawer loses all rights to countermand the instrument. To avoid the controversy and uncertainty that has been associated with certification, many financial institutions have adopted the practice of issuing a bank draft rather than certifying cheques. Of course, if the drawer changes his mind before delivering the certified cheque, the bank will have no problem cancelling it when it is returned. It is a more difficult problem when it has been lost or destroyed, since it may still be in circulation and presented later for payment. In that case, the bank will insist that the drawer sign documents agreeing to reimburse the bank should they later have to honour the certified cheque.

A Certified Cheque Is Like Cash

Office Plus Interiors entered into an agreement to purchase office furniture from Centrac for \$48 000. Centrac demanded payment by certified cheque. Mr. Stanway, a principal of Office Plus, deposited a cheque for \$76 000 from another source in their account at the Canadian Imperial Bank of Commerce (CIBC). He then asked the bank to certify an Office Plus cheque for \$48 000 to Centrac, which they did without checking to see if the deposited cheque would be honoured. Centrac took the cheque and delivered the furniture to Office Plus. When it was learned that the \$76 000 cheque deposited earlier would not be honoured, the representatives of the CIBC phoned Centrac and told them not to bother trying to negotiate the \$48 000 cheque, as they had stopped payment on it. But Centrac did present it for payment, and when it was dishonoured, Centrac sued CIBC for payment. The court held that when the bank had certified the cheque, it was giving Mr. Stanway something equivalent to cash, and therefore CIBC was required to honour it. “Once certification was made, any attempt made by the bank to avoid payment was too late.” The bank, in this case, may have made an error in not checking out the first \$76 000 cheque, but they could not hide behind that error.

Centrac Inc. v. Canadian Imperial Bank of Commerce, 120 D.L.R. (4th) 765 (Ontario Court of Appeal)

Promissory Notes

Whereas bills of exchange and cheques are order instruments involving third parties, a promissory note simply involves a promise by one person to pay another. The person making the promise or the debtor who draws up and signs the promissory note is called the maker, and the person to be paid is called the payee. The main function of promissory notes is to advance credit and they are commonly used by financial institutions, especially in consumer loan transactions. These notes often require payment by installments and the payment of interest. When installments are involved, the payment of each installment should be endorsed on the note so that any subsequent holder will have notice of what has been paid.

Abuses associated with promissory notes in consumer creditor transactions led to the 1970 amendments to the *Bills of Exchange Act* that created consumer notes which are discussed below.⁹

The maker of a promissory note corresponds to the acceptor of a bill of exchange having the direct obligation to honour the instrument when it comes due.¹⁰ Promissory notes like bills of exchange and cheques can be negotiated to third parties, who, if they qualify, can enforce them despite any problems associated with the original deal. It is this characteristic that makes promissory notes so attractive to institutions in the business of lending money. The merchant, selling something on credit, would have their customer sign a conditional sale agreement and also sign a promissory note. The merchant would then assign the conditional sale agreement, negotiating the promissory note to an innocent third-party finance company. Thus, the merchant gets paid immediately for his goods, and the finance company can enforce the credit agreement independent of any problems that might be associated with the original deal. If the goods were defective, the debtor could only seek recourse from the original merchant but would still have to pay on

the promissory note. This particular advantage to the credit institution has been significantly reduced by the passage of the 1970 amendment to the *Bills of Exchange Act* dealing with customer notes that will be discussed below.¹¹

A simple IOU (I Owe You) is not a negotiable instrument. A person who signs a document, "I owe you \$500, (signed) J. B. Samra," has acknowledged a debt but has made no promise to pay. There must also be the words "payable on demand," or a commitment to pay on a specific date to make the instrument a promissory note.¹²

Untangling the Web

Credit and debit cards are most commonly used in the electronic environment and especially in consumer transactions and have, to a large extent, replaced the use of negotiable instruments. Soon, there will be access and stored value cards, where value is imbedded in a chip on the card and reduced as it is used. Legislation allowing for electronic signatures or certification will facilitate these forms of payments. Today, credit card transactions are handled through banks, and user's losses are generally limited to \$50. This protection will likely be extended to other forms of electronic payment, at least when a system where it is possible to trace the parties in person is used. In those situations where a form of payment where the parties are anonymous is chosen, it is likely that there will be no such protection. The potential for money laundering using this method will be a real problem as far as governments are concerned. E-money will not become a form of legal tender, although, like cheques, it may become an effective substitute for real money. Payments made in this way will be more like those with a cheque or a credit card.

NEGOTIATION

Negotiation is the process of transferring the instrument to someone who is not one of the original parties to it. A bearer instrument, which is one that states on its face that it is payable to "bearer," is negotiated simply by passing the instrument from one person to another. An order instrument is made payable to a specific person or to their order and is negotiated by that person signing (endorsing) on the back and then delivering it to another. An order instrument will become a bearer instrument with an endorsement in that simple form. Cheques are normally made payable to a specific person. For example, if Paquette draws a cheque made payable to Quon, Quon could negotiate that cheque to Naidu by signing on the back of it and delivering it to Naidu. If this endorsement is only a signature, the cheque becomes a bearer instrument and Naidu could transfer it without further endorsement. If Quon not only signed his name but, as part of the endorsement, stated that the cheque is payable to Naidu or to the order of Naidu, then the instrument remains an order instrument, and Naidu must go through the two-stage process of endorsing it and delivering it to some third party to negotiate it further. In fact, there are many different types of endorsements, each designed to accomplish a different purpose, and these will be discussed in more detail below.

Requirements for Negotiability

*Bank of British Columbia v. Coopers & Lybrand Ltd. et al.*¹³

In the early 1980s, it was common practice for investors to obtain tax advantages through MURBs (multi-unit residential buildings). To facilitate this scheme, Community Builders Ltd. sold 29 units to a series of investors, taking a document purporting to be a promissory note. (In fact, the actual construction of the deal was more complex in order to facilitate the tax shelter requirements of the MURB). Each of the investors paid \$10 000 in cash and signed two of these promissory notes payable to Community for \$22 400 and about \$15 000, varying somewhat unit to unit. All the notes taken together had a face value of well over a million dollars. These notes were then assigned by Community Builders to the Bank of British Columbia as security. They were not actually transferred to the bank; rather, copies of them were given to the bank, and the bank had the right to demand production of the actual documents at any time. The bank advanced almost \$800 000 to Community secured by the assigned promissory notes. Eventually, the bank requested that Community endorse the notes and deliver them to the bank, but before this took place, Community went into receivership. An action was commenced by the bank against the investors for the value of the promissory notes.

In fact, the bank lost their action, and the reasons are quite instructive. First of all, although they had the right to become holders of the negotiable instruments, they did not do so. There was no endorsement and no delivery of the promissory notes to them. Therefore, they had them by right of assignment only. That means they were in no better position than Community and did not obtain the rights of a holder in due course. This nicely illustrates the distinction between assignment and negotiation of negotiable instruments. The bank would have been in a much better position as a holder in due course of the notes, rather than as an assignee.

The second reason is even more telling. The promissory notes themselves provided for interest to be paid on them from the moment construction was completed. A promissory note must be for a sum certain in money. Since the completion date was uncertain, this made the interest payable and amount owing also uncertain, and as a result, these notes did not qualify as negotiable instruments at all, and the bank could not be a holder in due course. It is possible to charge interest on a promissory note, but that interest must be clearly calculable from the information on the face of it.

The following is a summary of the general characteristics these instruments must exhibit to qualify as a negotiable instrument:

1. *Unconditional commitment.* Any instrument that requires an event to take place or qualification to be met before the promise to pay is binding on the maker of that instrument will not qualify as negotiable. To be freely transferable, subsequent holders must not be required to go back and look at the dealings of the original parties. The inclusion of conditions such as this would make it impossible for the holder to know if the conditions had been met and defeat the requirement of certainty. If Quon were to draw a cheque made payable to Paquette “if the barn has been painted” and Paquette then transferred this instrument to Naidu, Naidu could not tell if the condition had been met from the instrument itself. Naidu would have to inquire

of one of the original parties and, because this is inconsistent with the purpose of negotiability, the cheque would not qualify as a negotiable instrument.

A Negotiable Instrument Must Be Unconditional

The plaintiff and the defendant had agreed to buy a hotel together, but when it came time to pay the deposit, the defendant did not have the money. It was agreed, therefore, that the plaintiff would lend the defendant \$25 000 for this purpose but that there would be a promissory note made by the defendant in favour of the plaintiff for that amount, payable on demand. A letter was attached to this promissory note, explaining that if the sale went through, the loan would be credited towards the plaintiff's share of the purchase. If it did not go through, the defendant would have to pay the deposit. In fact, the transaction was not completed, and the plaintiff lost his deposit and refused to honour the promissory note, claiming the note was conditional. The court agreed. The note and the letter had to be taken as one agreement, and it was clear from the letter that the note would only have to be paid if the deal collapsed; this made it conditional, and the *Bills of Exchange Act* defines a promissory note as an unconditional promise to pay a certain sum of money. This was not a promissory note. The plaintiff then was allowed to change his pleading, so he was suing for breach of contract rather than for payment on a promissory note.

Pennefather v. Zanet, British Columbia County Court, October 7, 1988, as reported in The Lawyers Weekly, Vol. 8.

2. *Signed and in writing.* The instrument must be able to stand on its own. It must be in writing, and the name of the maker or drawer must appear on the face of the document. Because the legislation does not require that the person signing the document be the one promising to pay, it is quite permissible to have it created and signed by an agent and still qualify as a negotiable instrument providing that agent is acting within his authority. An agent acting without authority would be personally liable on the instrument. When a person is signing a negotiable instrument on behalf of a company or employer, it is vital that they make it crystal-clear that they are acting on behalf of another. Even stating their position in the organization, such as "President" or "Secretary," is not enough. The person signing on another's behalf must write "per" in front of their signature after stating the name of the principal or state below their signature that they are signing on behalf of a stated principal. Failure to do this will make the signer liable on the instrument in their personal capacity as if they were the drawer or maker.¹⁴
3. *Payable at a fixed time or on demand.* An instrument can be made payable on demand by so stating on the instrument or by making no indication at all of a time for payment. A cheque is an example of a negotiable instrument payable on demand. The holder of the instrument is free to present the instrument for payment at any time during normal business hours. An instrument not payable on demand must be payable on some certain date or at some determinable time as specified on the instrument. Thus, if Quon were to make a note payable 90 days after his death, this would satisfy the requirement, since his death is a certainty, and so, the date is determinable. However, care must be exercised because payment dates determined on some event carry considerable risk. For example, a note which is made payable 90 days after the

wedding day is based on an event that is not a certainty. The note would be conditional and therefore not negotiable. In Canada, an instrument payable “at sight” is quite different from a note payable on demand or presentation. When it is made payable at sight, the payment is really due three days after it is presented, allowing the debtor three days of grace to gather the funds.

4. *For a fixed amount of money.* A negotiable instrument must be for a certain amount of money specified on the face of the instrument. The payment of that money can be made in installments, and interest can be added, but the amount owing must be certain. Thus, a promise by Quon to pay his inheritance to Paquette is not a negotiable instrument because the amount owed is not specified. In the *Coopers & Lybrand* case used to introduce this section, the interest payable on the promissory note was to start after the completion of construction, and there was no way to know when that would be completed on the face of the note. The note, therefore, did not qualify as a negotiable instrument because it was not for a “sum certain” that could be calculated on the face of the instrument.

The amount to be paid must also be payable in Canadian funds if the instrument is to be presented for payment in Canada. The amount could be calculated in other currency, but it must be possible to pay that amount in the equivalent Canadian funds. Thus, an instrument promising to pay U.S. \$500 will not qualify as a negotiable instrument in Canada but one promising to pay U.S. \$500 in the United States will. Here the equivalent in Canadian funds can be delivered, since there is no requirement that it be paid out in American currency.

5. *Delivery of the instrument.* Even if the instrument has been drawn up, it does not qualify as a negotiable instrument until it has been physically transferred to the payee. This first transfer to the payee is called the issue of the instrument, and all subsequent transfers are called deliveries. If delivery has been induced by fraud or if the instrument was stolen before it was issued, the debtor is not obligated to honour it. However, if the instrument gets into the hands of an innocent third party who qualifies as a holder in due course, such delivery will be conclusively presumed.
6. *The whole instrument must pass.* Although you can sell the instrument at a discount, you cannot keep a portion of the amount claimed for yourself. For example, if Quon were to transfer to Paquette all the claim on a negotiable instrument made out for \$500 for only \$300, the instrument would remain negotiable, since the entire instrument is passing. Quon has simply sold it for less than its face value. But if Quon transferred only part of the \$500 claim to Paquette, retaining the right to collect some of the amount specified, this action would destroy the instrument’s negotiability. If a promissory note is involved and installments have been made, those payments must be recorded on the instrument and then the amount still owing must be transferred.

Only when all these requirements have been met will the document in question qualify as a negotiable instrument. It is important to remember that even when the instrument does not qualify as a negotiable instrument, the claimants may still have significant legal rights under the principle of assignment, discussed in Chapter 6.

RIGHTS AND OBLIGATIONS OF THE PARTIES

The right to enforce a negotiable instrument depends on the status of the holder of the instrument and also the type of defence being raised. To understand the rights and obligations of the parties to a negotiable instrument, it is best to examine them from the point of view of the person seeking to enforce the instrument. The following is an examination of the position of a holder in due course, a remote holder, and a payee.

Holder in Due Course

*Royal Bank of Canada Ltd. v. Pentagon Construction Maritime Ltd.*¹⁵

Maramichi Glassworks Ltd. was a customer of the Royal Bank. It was in financial difficulty when it assigned any benefits flowing under a contract it had with Pentagon Construction Maritime Ltd. (Maritime) to the Royal Bank. Maritime was informed of this arrangement and made two cheques totalling approximately \$20 000 payable to Maramichi Glassworks. Maritime made it clear to Maramichi that unless Maramichi performed the appropriate services contracted for, the cheque would not be honoured. Maritime made this clear to the Royal Bank as well. Maramichi Glassworks did not live up to its contractual requirements, and Maritime put a stop payment on these two cheques. The Royal Bank tried to collect, but the cheques were dishonoured. The Royal Bank sued Maritime claiming to be a holder in due course. The court found that because the Royal Bank knew that payment of the cheques was qualified, being payable only if the payee performed the work contracted for, the bank could not qualify as a holder in due course and could not enforce payment against Maritime because the condition had not been met.

This case illustrates that in order to qualify as a holder in due course, a holder must take the instrument in good faith, without notice of any defect of title, such as payment being conditional, as was the case here.

Throughout this chapter, the unique position of a holder in due course has been emphasized. We stated that a person who is not a party to the negotiable instrument, but who acquires possession of it and otherwise qualifies as a holder in due course, can actually acquire better rights or claims under that instrument than previous possessors held. Thus, if ever a problem, such as misrepresentation or breach of contract, existed between the maker of the instrument and the original payee, the holder in due course takes the instrument independently of any of these problems and will be able to enforce it despite their presence. The essential and unique nature of negotiable instruments is embodied in the person of the holder in due course. It is because of this special and privileged position that negotiable instruments are so attractive and useful as a medium of exchange and a method of advancing credit.

Not all third parties to negotiable instruments are holders in due course. The qualifications that must be met to obtain the status of a holder in due course are set out in Section 56 of the *Bills of Exchange Act*. These qualifications can be summarized as follows:

1. A holder in due course must have received the negotiable instrument through negotiation and cannot be one of the immediate parties. In *Bank of British Columbia v. Coopers & Lybrand Ltd.*, discussed above, although the bank had a right to obtain delivery of the notes, they never bothered to exercise that right. The notes were never actually delivered to the bank, and so, they never did become a holder in due course and, as a result, had no better claim to those notes than the other creditors.
2. A holder in due course must have taken the instrument complete and regular on its face. Where important parts of the instrument, such as the amount payable, have been left blank or have been obviously altered, the person acquiring it in such condition will not qualify as a holder in due course. If Yoshida issues Dedrick a cheque with the amount left blank and Dedrick fills in \$5000 and negotiates that cheque to Ramji, Ramji will be a holder in due course, assuming he meets the other qualifications and will be able to enforce the cheque. But if Dedrick passes on the blank cheque to Ramji, who then fills in the \$5000 amount, she will not qualify as a holder in due course, having taken delivery of an incomplete instrument. On the other hand, if the original cheque had been for \$500 and Dedrick has simply added a zero making it read \$5000, Ramji would still qualify as a holder in due course, unless the alteration was obvious. Of course, Yoshida would only have to pay \$500, the original amount of the cheque. Similarly, if the instrument is marked paid or cancelled, the person who takes it in such a condition will not qualify as a holder in due course, the instrument not being “regular on its face.”
3. The holder must have acquired possession of the instrument before it becomes due and payable. An instrument is overdue if the date specified on the face of the instrument has passed, whether that date is fixed or determinable. (A grace period of three days should be included in this calculation, whenever applicable.)

It is a little more difficult to determine whether an instrument is overdue or not if it is payable on demand. A bill of exchange which is payable on demand is said to be overdue when it appears on the face of it to have been in circulation for an “unreasonable length of time.”¹⁶ What qualifies as an unreasonable length of time is a question of fact. When a promissory note payable on demand is involved, the *Bills of Exchange Act* specifically states that the mere fact that the note has not been presented for payment within a reasonable period of time will not make it overdue when negotiated. The holder still qualifies as a holder in due course. The difference in the way that demand bills and notes are treated illustrates an essential difference in their natures. When a cheque or bill payable on demand is drawn, a third party is expected to take payment quickly. But when a promissory note is involved, even if it is payable on demand, the original parties to it would not expect payment to be demanded immediately. That would be inconsistent with the credit nature of the instrument.

It is clear, however, that a promissory note, bill of exchange or cheque becomes overdue as soon as it is presented for payment and refused and so a holder knowing of that refusal would not qualify as a holder in due course. For example, suppose payment is refused when Dedrick presents a \$500 demand promissory note drawn by Yoshida for payment and then Dedrick simply negotiates that promissory note to

Ramji. In these circumstances Ramji would be a holder in due course providing there was nothing in the transaction to alert him to the problem. If he was told of Yoshida's refusal to pay or if he got the note at such a discount from Dedrick so as to arouse his suspicions that it had been presented and refused, that would be enough to disqualify him as a holder in due course.

4. The holder may have acquired the instrument without knowing that it had been dishonoured previously. If the drawer of a cheque stops payment on it because of the payee's fraud, the payee cannot get around this by making a deal with an associate who hopes to enforce it against the original drawer as a holder in due course. Because the third party is aware of the countermand that constitutes dishonour of the cheque, he or she does not qualify as a holder in due course. On the other hand, if the third party who otherwise qualifies as a holder in due course is not aware that the cheque had been countermanded and is not in a position to have known, his or her status as a holder in due course will not be affected. The same principles apply when a bill of exchange or a promissory note is involved.
5. The holder must have no knowledge of any defect of title. A "defect of title" is some problem, such as fraud, undue influence, duress, or incapacity, usually between the payee and the original drawer of the instrument but also possibly between the payee and other holder, which affects the right to possess the instrument. A holder of the instrument who is aware that the person who negotiated it had such a defect of title is not a holder in due course. For example, if Yoshida drew up a promissory note while drunk and Dedrick the payee was aware of his condition, Dedrick's title to the instrument would be defective. If Ramji, a subsequent holder was aware of Yoshida's drunken condition when making the note, he would have notice of the defect of title and not qualify as a holder in due course. Defect of title defences are discussed in more detail below.
6. The holder must have acquired the instrument in good faith. This goes further than qualification 5 above, requiring the holder in due course to be acting honestly. Even where the holder has no actual knowledge of a defect of title but suspects there is a problem, he is not acting in good faith. Similarly, where she allows her position to become compromised, as happened to the bank manager in his dealings with Mrs. Jordan in the *T. D. Bank v. Jordan* case used to open this chapter, she is not acting in good faith and so will not qualify as a holder in due course.
7. Value must have been given for the negotiable instrument. Value, as it is used here, is a little broader than consideration in contract law and includes "an antecedent debt or liability".¹⁷ This exception is to avoid the problem of "past consideration is no consideration," when negotiable instruments are given for already-existing debt or liabilities. It is not necessary that the holder in due course be the one to provide such valuable consideration. Section 53 of the *Bills of Exchange Act* clearly states that a holder is deemed to be a holder for value whenever value has been given for the instrument. Thus, if Yoshida issued Dedrick a promissory note for \$500 in exchange for a motor vehicle and Dedrick gave this negotiable instrument as a gift to Ramji,

Ramji's status as a holder in due course would not be affected by the fact that it was obtained as a gift because Dedrick had given valuable consideration for the instrument.

It should also be noted that under the provisions of the *Bills of Exchange Act* (Section 165 [3]) a bank (not the drawee bank) that is taking the cheque for collection from their customer is also a holder in due course. Thus, where Jones draws a cheque for \$1000 drawn on the Royal Bank and made out to Smith as payee and Smith deposits that cheque with his branch of the Bank of Commerce, that branch becomes a holder in due course with respect to the cheque. Normally, if the cheque is not honoured, the bank will simply debit their customer Smith's account, but if Smith has a line of credit or was otherwise overdrawn so that course of action is not open, the bank as a holder in due course can turn to the drawer of the cheque and demand payment.

What Should a Business Consider?

Business people often use negotiable instruments with no thought of the implications. When we use a cheque to pay a debt, we usually assume that if there is a problem, we can stop payment; while this may be true with respect to the original payee, if that cheque is passed on to an innocent third party (a holder in due course), we will be obligated under the cheque, even if it turns out that the goods purchased were defective or the services below standard. The same applies with promissory notes and bills of exchange. Often, we are asked to sign a promissory note along with other documents where a credit transaction is involved. What we do not realize is that the note or bill can be negotiated to an innocent third party and that we will be obligated to honour it, no matter how dissatisfied we are with the goods or services provided. Business people must be very cautious when dealing with negotiable instruments and appreciate that when we sign them we will likely have to honour them, no matter what problems arise.

A Bank Can Be a Holder in Due Course

May Trucking gave a cheque for over \$25 000 to Scuzzy Creek Logging Ltd. drawn on the Bank of Montreal. The president of Scuzzy Creek Logging delivered that cheque to the Hope Branch of the Canadian Imperial Bank of Commerce (CIBC), even though their account was located in the Williams Lake Branch. The CIBC in Hope gave the president a document called a "Requisition for Draft" which he, in turn, took to the Williams Lake Branch. There was a \$10.51 charge for this transaction. May Trucking then stopped payment on the cheque, and the CIBC branch in Williams Lake was claiming as a holder in due course and demanding payment. This case illustrates that when a bank receives such a cheque for deposit, it becomes a holder in due course and can enforce it. May Trucking argued that because the cheque had been transferred through "Requisition for Draft" from one branch to another, it was not deposited. The court said that was merely an internal way of dealing with the transaction and did not affect CIBC's position as a holder in due course of the cheque.

Canadian Imperial Bank of Commerce v. May Trucking Ltd. et al., 10 D.L.R. (4th) 755 (British Columbia Court of Appeal)

Real Defences

Even when a person qualifies as a holder in due course, that does not ensure payment. A number of defences can be raised against various holders of negotiable instruments. A real defence is good against even a holder in due course because it involves a problem with the instrument itself.

Forgery

When the signature of the drawer has been forged or signed by an agent who has no authority to do so, the drawer or maker will not be liable on the instrument. A drawee is not liable for a forged acceptance nor is an endorser liable for an unauthorized or forged signature. Note, however, that the forgery of the signature of one of the immediate parties will not relieve an endorser of liability to some subsequent holder. Thus, if Lee falsified a cheque payable to himself forging Juarez's signature as the drawer, Juarez would have no liability on the instrument. But if Lee endorsed it and delivered it to Smith, who, in turn, endorsed it and after passing through several more hands, it eventually found its way to Brogham, an innocent holder in due course, Brogham could not force Juarez to honour the forged instrument, but he could require the endorsers to pay, even Smith who was also an innocent victim. An endorsement encourages subsequent holders to believe that the negotiable instrument is what it purports to be, and so, they have recourse against the endorser.

The forgery of other material parts of the negotiable instrument, such as the amount, will also constitute a real defence, although the original drawer will be liable to a holder in due course for the contents of the original unaltered instrument. When a signature is valid but has been given for another purpose (the drawer thought a letter was being signed) and someone subsequently forges a negotiable instrument around that signature, such forgery will constitute a real defence. Negligence on the part of the drawer in these circumstances will preclude raising the defence against an innocent holder in due course.

It is interesting to note that when the forgery is the signature on a bill of exchange or cheque and the drawee or bank pays out under the impression that the instrument is valid, it cannot then turn to the purported drawer for compensation. The drawee or bank in such circumstances is normally the one who bears the loss. Recent cases have established, however, that where a bank has an agreement with a customer requiring him or her to monitor accounts, to examine the cheques cashed, and to notify the bank of any discrepancy, his or her failure to do so within the required period (for example within 30 days of the cheque being cashed) can make the customer responsible for the loss. (See the Kelly case discussed below.)

Discharge

A second type of real defence occurs when the instrument has been discharged. The discharge can take place in several ways:

1. Through payment in due course at the appropriate time which is apparent to the holder.
2. When the holder renounces in writing any claim to that bill (this only constitutes a real defence if the holder in due course has notification of this renunciation).
3. When the instrument itself has been cancelled in such a way that it is apparent on the face of it.
4. When the instrument has been materially altered without the consent of the parties in such a way that it is apparent on the instrument.

Incomplete Instrument

Another real defence is lack of delivery of an incomplete instrument. Where the instrument is complete but has not yet been issued to the original payee and then is stolen or is delivered to the payee by an agent not authorized to do so, the drawer or maker would still be liable to a legitimate holder in due course. But where the instrument is incomplete as well and someone else forges completion, this constitutes a real defence and will defeat even the claim of a holder in due course for payment. For example, when Rasmussen went to Cohen's office he noticed a cheque on the desk made payable to him but with the amount left blank. He took the cheque, filled in the missing amount, and negotiated that check to Jaswal, an innocent holder in due course. Even though Jaswal qualified as a holder in due course he could not enforce payment. On the other hand, if the instrument had been complete, with the appropriate amount filled in and a secretary, without authority to do so, gave it to Rasmussen by mistake, Jaswal would be able to enforce the instrument against Cohen because if a complete instrument gets into the hands of a holder in due course, delivery is "conclusively presumed." If Rasmussen had stolen it, however, it would be arguable that the principle does not apply, since it had never become a negotiable instrument in the first place. (See the Tardivel case below.)

*National Bank of Canada v. Tardivel Associates*¹⁸

Mr. Tardivel and Mr. Didonato decided to go in together in a deal to flip some property, expecting to make a quick profit. Didonato drew a cheque on his corporate account, but when Tardivel was unable to produce some important documentation, Didonato got cold feet and refused to go through with the deal, withholding the signed and completed cheque from Tardivel. He did leave it on his desk, however, and when Didonato was out of his office, Tardivel took the cheque, deposited it in his bank, and immediately wired \$20 000 out of that account to someone else. Didonato stopped payment on the cheque, and when Tardivel's bank presented the cheque for payment, it was refused. Tardivel's bank was left holding the bag and sued, claiming to be a holder in due course.

The bank relied on Section 32(2) of the *Bills of Exchange Act*, which states that when a completed "bill" gets into the hands of a holder in due course, delivery is "conclusively presumed." The court found, however, that for this section to apply, there had to be a bill in existence. It does not become a bill until it has been negotiated, and in this case,

because it was stolen before that happened, it was not a bill, and this section did not apply. Tardivel's bank was not a holder in due course.

Although the case is controversial, it does show that negotiation is necessary for a cheque to become a negotiable instrument, and although delivery will be conclusively presumed, that is not enough to establish negotiation where the instrument, even a completed and signed instrument, is stolen from the drawer.

Incapacity

Some forms of incapacity provide another type of real defence against a holder in due course. The *Bills of Exchange Act* makes it clear that what constitutes capacity in a given jurisdiction corresponds to the principles of contract law.¹⁹ Essentially, if a contract is void because of the incapacity of one of the parties, a negotiable instrument will also be unenforceable against that incapacitated party. A negotiable instrument that has been drawn up by a minor is unenforceable because of his or her incapacity under contract law.

Remember, however, that in some circumstances, infants are obligated to honour contractual rights. Thus, the holder of the instrument may be able to sue the infant, not on the basis of the negotiable instrument, but on the basis that the contract was for necessities. Of course, the infant's obligation in such circumstances is to pay a reasonable price for the necessities, which may or may not correspond to the amount set out on the negotiable instrument.

When insanity or drunkenness is involved, such incapacity will not necessarily amount to a real defence and may not be available against an innocent holder in due course, unless the person has been declared insane under statutory power. Such a person would not be liable to even a holder in due course because the incapacity is absolute.

It is important to point out that when incapacity is claimed as a defence, it is only available to the person incapacitated and will not invalidate the negotiable instrument. Thus, a drawee who pays out or accepts the instrument and a payee or subsequent endorser will be liable despite the incapacity of the original drawer or maker of the instrument. If an infant has a bank account, draws a cheque on it, and delivers it to a payee, that payee can present it to the bank, and the bank is fully entitled to honour the cheque if there are sufficient funds on deposit. If the infant countermands the cheque, there would be no recourse against either the bank or the infant on the basis of the negotiable instrument. The liability of the infant would have to be established on the basis of a contract for necessities. If the instrument is in the hands of a holder in due course, that holder in due course can enforce it against any endorser or against the acceptor, since once those parties have accepted or endorsed, they cannot claim the incapacity of the original drawer or maker as a defence.

Mistake

Under some circumstances, mistake can be a real defence. But this mistake must go to the nature of the instrument itself, that is, the purported drawer or maker of the instrument must have been under the impression that he or she was signing something other than a

negotiable instrument when the signature was affixed to the document. This is an example of the defence of *non est factum*. This defence will not be available when the mistake was caused by the negligence of the drawer or maker. Since the principle puts an obligation on the drawer or maker to make an effort to determine the nature of the document being signed, it may well be that the only situation in which *non est factum* will be available as a defence on a negotiable instrument is when the drawer or maker has been actively misled about the nature of the instrument signed.

Material Alteration

Finally, any material alteration on the instrument will amount to a real defence, if it is apparent to the holder. Thus, a negotiable instrument with scratches on it or which otherwise indicates an erasure or alteration cannot be enforced at all against the original drawer or maker. Only when the alteration is not obvious can the instrument be enforced against the original drawer, and then only on the terms of the original instrument before any alterations. When such a real defence is available, the instrument cannot be enforced against the maker, even by someone who meets all the other requirements set out for a holder in due course. Such obvious material alteration causes the instrument to be discharged as indicated above.

Other Holders—Defect of Title Defences

When the person seeking payment is a remote holder, the drawer or maker of the instrument is in a much better position, since he can raise not only real defences but defect of title defences as well. A remote holder is a holder of the instrument who is not one of the immediate parties and does not qualify as a holder in due course. Thus, where the drawer or maker of a cheque was induced to make it by fraudulent misrepresentation on the part of the payee, that is a defect in the payee's title to that instrument. When the remote holder has knowledge of that misrepresentation, he is not innocent and does not qualify as a holder in due course. Defect of title defences can be used against him. A defect of title defence involves a problem with the way the instrument was acquired. Some examples defect of title defences are as follows:

1. When fraud, undue influence, or duress is used to obtain the instrument.
2. When the consideration given for the instrument is illegal.
3. When there is incapacity in the form of insanity or drunkenness on the part of the maker or drawer and the person to whom it is issued knows or ought to know of the condition of that person, this constitutes a defect of title defence, rather than a real defence.
4. When a complete instrument is not properly delivered. When an instrument is properly delivered but is issued in blank and completed by a subsequent holder, there is no difficulty, since the authority to so complete is presumed. However, when the given authority to complete is violated, such as when the wrong amounts or dates are put in the blanks, this also constitutes a defect of title defence.

5. When the instrument has been discharged in such a way that it is not apparent to the holder. Thus, where the last installment of a promissory note has been made but there is nothing on the instrument itself to indicate the payment, that is a defect of title defence. Similarly, if the holder has renounced claim on the instrument, or it has been cancelled and there is no indication of this on the instrument itself, it is only a defect of title defence.

The only situation where a person who does not qualify as a holder in due course can get the same rights as a holder in due course is when that person acquires the instrument from someone who is a holder in due course. In this circumstance, the remote holder has acquired all the rights that the holder in due course had through the principle of assignment. In these circumstances, the person claiming is called a holder through a holder in due course and can only lose the rights of the holder if he actually participated in the wrongdoing that is being raised in the defence.²⁰

Note as well that under the act, when the payee deposits a cheque in her bank, that bank becomes a holder in due course.

Payees—Personal Defences

When the person claiming payment is the payee ordinary contract law applies and any of the defences available in contract law can be used. The drawer or maker then can use real defences, defect of title defences, and mere personal defences in such circumstances. An example of such a personal defence is the right of set off. This involves the maker being able to set off some other debt or claim that he has against the payee and reduce the amount to be paid to that payee accordingly.

For example, if Nimmo was an employee of Deheer's Used Cars and gave his employer a promissory note for \$1000 to pay for a car he had purchased from his employer, Nimmo would have the right to set off any wages or commissions he was owed against that debt when the note was presented for payment. If those wages and commissions amounted to \$800 he would only have to pay his employer \$200 on the note.

Another typical example of a mere personal defence is when there has been a partial failure of consideration. Thus, where the payee has failed to perform some contractual obligation as promised, this is an example of a personal defence and can be raised by the maker or drawer when the payee presents the instrument for payment.

*Quantum Financial Services (Canada) Ltd. v. Yip*²¹

Because of some misfortune in their futures trading in the currency market, Mr. Yip owed Quantum Financial Services (Canada) Ltd. US \$58 654.64 and made out a promissory note to their benefit for that amount. This amount was based on what they owed Quantum, but in a previous action, the judge had concluded that a substantial portion of the loss was due to negligence on the part of Quantum. In fact, if the loss caused to Mr. Yip by this negligence was taken into consideration, Mr. Yip would owe much less to Quantum. In this action, the court had to decide whether the entire amount of the promissory note had to be paid or whether the defendants could set off their loss caused

by the negligence of Quantum against the promissory note. Quantum argued that the promissory note was payable in full as it represented the settlement of a law suit which amounted to discharge by agreement (as discussed in Chapter 7 of this text). The court rejected this argument. This could be a valid argument, but in this case, as a finding of fact, the court decided that the promissory note was not given as part of such a compromise but as a back up to collect on this debt. Quantum then argued that even though Quantum was an immediate party to the promissory note, the note stood on its own, like cash, and Mr. Yip had to pay the full face amount. They argued that Mr. Yip could not set off another claim against the note. The court disagreed. The judge acknowledged the controversy over this point in Canada, but after examining, the authorities concluded that the defences available against an immediate party to a note seeking payment were based on contract and were not diminished because a promissory note was involved. Mr. Yip therefore had the right to set off the loss caused by Quantum's negligence against the promissory note and the amount he had to pay was reduced accordingly.

There is some confusion and conflicting authority in this area, but this case seems to reflect the current view and practice that immediate parties to negotiable instruments are in no better position than normal parties to contracts, and all contractual defences, including set off and breach, can be used against such an immediate party claiming payment.

It should also be noted that these personal rights based on contract apply to any parties involved that are immediate to each other. Thus, even where one holder delivers the negotiable instrument to another, the rights between those holders are based on contract law and subject to personal defences.

Endorsers

As mentioned previously, an instrument can be a bearer instrument or an order instrument. When it is an order instrument, it must be endorsed as part of the process of delivering it to a third party. The simplest form of endorsement consists of a signature on the back of the instrument. Such a signature usually makes the endorser liable to pay a subsequent holder in due course on the instrument if it is dishonoured by the maker, drawer, or drawee who presented for payment. The endorser then has the right to turn to the drawer or payee for reimbursement.

When a bearer instrument is involved, there usually are no endorsements, no matter how many hands it has passed through. Here, if the instrument is dishonoured, a holder can only go to the immediately preceding party for compensation on the basis of the contract between them. Thus, if Burkholder made a promissory note payable to the bearer and it was then passed to Sakich, Rahal, Diaz, and Black, all without endorsement, and if Black could not collect from Burkholder, he must then turn to Diaz. Even if Black qualifies as a holder in due course, he cannot demand payment from Sakich or Rahal, who have not endorsed the note.

The liability of an endorser on a dishonoured instrument is only established when certain qualifications are met by the person seeking redress. In order to claim from an

endorser when an instrument is dishonoured, the holder must serve notice of dishonour on the endorser before the end of the next business day. In very limited circumstances (in Québec or if a negotiable instrument requires payment in a country different from where it was drawn), a more formal type of notice, called “protest,” must be given, which is done before a notary public.

Forms of Endorsement

Other objectives are accomplished through the type of endorsement affixed to a negotiable instrument. As a result many different forms of endorsement have been developed. The following is a summary of the different forms of endorsement:

1. Endorsement in blank. This is a simple signature and will change an order instrument into a bearer instrument.
2. Special endorsement. This endorsement, in addition to the endorser’s signature, also specifies the name of the party to whom the instrument is being negotiated; the instrument remains an order instrument.
3. Restrictive endorsement. This endorsement contains the endorser’s signature as well as some restriction on the further negotiation of the instrument, for example, “Pay to B. R. Gatz only” or “For deposit only.” This type of endorsement renders an instrument no longer negotiable.
4. Qualified endorsement. By including the words “without recourse,” the endorser can eliminate the liability that such an endorsement would normally impose on the endorser in the event it is dishonoured. In the same way, endorsers can eliminate the requirement that they be notified right away upon such dishonour by including the words, “protest waived,” in their endorsement.
5. Conditional endorsement. Although a negotiable instrument cannot be conditional, the same is not true of an endorsement. Thus, if Jackson endorses an instrument, “Pay to J. Galati only if car properly repaired,” this is a valid endorsement, and if the instrument is dishonoured and the holder seeks payment from the conditional endorser, Jackson will only have to pay if the condition has been met by having the car properly repaired.
6. Accommodation endorsement. Although the process of endorsement normally takes place in conjunction with the negotiation of an instrument, there are some circumstances in which it may be appropriate to have another endorser who has been neither a holder of the instrument nor a party to it add his or her credit. Such an accommodation endorser incurs all of the liabilities of an endorser to a holder in due course.²²

Two other situations may appear to be endorsements but do not impose the same responsibilities. Often, there may be some question as to the identities of the parties or endorsers on a note and some other trusted person will be asked to verify that identity. This is done by the third party verifying the identity by so stating on the back of the instrument. Such an “identifying endorser” only assumes liability for the correctness of the identification, not for payment of the instrument itself if it is dishonoured.

Second, it is normal bank practice to require a cheque given to a teller to be signed on the back before they take it. When a holder takes the cheque to their own bank, which will then arrange payment from the original bank it is drawn on, that signature is an endorsement, and the bank becomes a holder in due course. As a holder in due course the bank can turn back to that endorser and demand payment if the cheque is dishonoured. But where the cheque is presented to the actual bank it is drawn on, that bank only has the choice to pay it or dishonour it. When they have the presenter sign the back of the cheque, this is not an endorsement and does not impose liability on that presenter if the bank makes a mistake and honours a cheque where their customer is, for example, overdrawn. The signature on such an instrument, if anything, is merely an acknowledgement of receipt of the money, and in the event of a problem, the bank must look to their client, the drawer of the instrument, not the presenter.

The Drawee

The person on whom a bill of exchange is drawn (the drawee) or, in the case of a cheque, the bank, has no liability to the payee or holders of the instrument. The only direct relationship is between the drawee and the drawer, and it is because of that relationship and the arrangements that have been made between them that the instrument is honoured. And where an instrument is dishonoured by the drawee in contravention of such an arrangement, that drawee is answerable to the drawer only and not the payee or holder unless it has been certified or accepted. This is the reason a drawer can stop payment on a cheque, and the bank does not hesitate to do so. By the same logic, if the drawee honours the instrument by mistake, their only recourse is against their customer, the drawer, not against the presenter or any party who has held it or endorsed it, and this liability is limited only to those situations where the instrument itself was valid. Where it has been forged, altered, or is otherwise defective and they mistakenly honour it, as a rule, they cannot collect from their customer, the drawer. For this reason, banks and other financial institutions usually make it a provision of their agreement with their customers that any such incorrect payout has to be brought to the attention of the bank within a set period of time (e.g., 30 days). This puts the onus back on the customer, and if the drawer/customer fails to detect the forgery, the funds will be deducted from their account.

*Kelly Funeral Homes Ltd. v. Canadian Imperial Bank of Commerce*²³

This case is another example of a trusted employee taking advantage of that trust and defrauding their benefactor. Mr. Larken was not only employed by but also lived as a member of the family with Mr. Kelly, the founder of the Kelly Funeral Homes Ltd. organization. Mr. Larken eventually became general manager, and over a period of eight years, in a series of transactions, defrauded the Kelly Funeral Homes organization of over \$240 000, using a variety of methods, including drawing cheques on Kelly made payable to Mr. Larken's creditors and also drawing cheques made payable to other payees (some of which were fictitious) then forging endorsements and depositing them in his account.

When the fraud was finally discovered and Kelly Funeral Homes Ltd. looked to their bank, which had failed to detect the forgeries and other irregularities, for reimbursement.

The bank refused. This action is brought by Kelly to recover from the Canadian Imperial Bank of Commerce (CIBC).

There is always considerable risk of this sort of thing happening, and because the bank is in the best position to detect such forgery and fraud, they normally are responsible when such a forged or irregular instrument gets past them. To reduce this liability, it is common practice among banks to require that their customers enter into an agreement to carefully examine their accounts and returned cheques and notify them within a short period (in this case 30 days) of any irregularities. In this case, the agreement stated that if no such irregularities were reported, "...it shall be finally and conclusively settled and agreed as between the Bank and the Customer that the amount of the balance shown in such statement is true and correct, that the said cheques and vouchers are genuine, that all amounts charged in the said account are properly chargeable to the Customer, that the Customer is not entitled to be credited with any amount not shown on the said statement and that Bank is released from all claims by the Customer in respect of any and every item in the said statement." Over that period of time in question, no such notification was given. The problem for the court was to decide whether this agreement between Kelly and the bank shifted the responsibility for the loss back to Kelly.

The court carefully looked at the agreement as well as other factors, including the fact that Kelly at one stage indicated to the bank that two signatures would be required on their cheques, a practice that was not followed on many of the cheques in question. After looking at the agreement and the practices at Kelly that contributed to the ease with which Mr. Larken committed these frauds, the court found that Kelly Funeral Homes Ltd. was responsible for the loss, and their action against the bank failed.

There are a number of other cases involving "pay roll padding," such as this where the banks have been held responsible, including the recent Supreme Court of Canada decision, *Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce*.²⁴ In that case, the cheques, because of their unique nature, were treated like chattels, and when the bank, because of the forgeries and irregularities, deposited them into an unauthorized account, that was found to be a wrongful conversion of the instrument (conversion is an actionable tort), and the bank was liable to their customer for that conversion. Note that the contributory negligence of their customer, the drawer, is not a defence to an action for conversion.

What Should a Business Consider?

This case and the others referred to emphasize the importance that businesses know that the position and risk assumed by the bank in such circumstances can be and usually is modified by agreement. Records must be checked and the bank notified of any problems, and failure to do so will cause any loss to be that of the customer rather than the bank. Business people must take care to understand just what they have agreed to and then take care to check the records and notify the bank where required to do so.

The position of the drawee dramatically changes when a bill of exchange is presented for acceptance or a cheque for certification. Now, the drawee has assumed the primary obligation to pay, creating a direct relationship with those claiming on the instrument. No

longer can the drawer stop payment or countermand the instrument, although he still remains liable on it if the acceptor fails to pay. Even if there were problems with the instrument including questions about validity of a signature or fraud, duress, or other problems between the original drawer and payee, the drawer, now the acceptor, will be liable because they have assumed the primary obligation on the instrument by their acceptance or certification.

What Should a Business Consider?

As business people become more involved with the electronic transfer of funds, there is a danger they will forget the advantages and pitfalls associated with the use of negotiable instruments. When we pay for an item or service by cheque or sign a promissory note, we are committing to pay that sum to whoever presents the instrument for payment. If the job is not done or the product provided unsatisfactory, we cannot be sure of avoiding payment on that grounds. Once that instrument gets into the hands of an innocent holder in due course, including the other party's bank, we can be held responsible to that holder. Yes, it is possible to stop payment on a cheque or refuse to honour the note, but the obligation remains if it has gotten into the hands of a holder in due course, and that holder can sue to enforce the instrument.

Just as we must remember the liability we face when we create a negotiable instrument, so also we must not forget the other side of the equation. A cheque or a promissory note is not like cash. It is no better than the person who made it in the first place, and if he has no money to pay, it is worthless in our hands. A note or a post-dated cheque does not take the place of collateral security. It is just another promise to pay, and while it does have some advantages, it is not all that much more valuable than the original promise.

CONSUMER BILLS AND NOTES

The fact that negotiable instruments bestow better rights on innocent third parties than on the original party has led to considerable abuse, especially in the area of consumer transactions. The problem developed out of the practice of merchandise being sold to consumers through a conditional sales agreement that included, as part of the transaction, a promissory note signed by the consumer. The merchant would then discount this right or claim against the customer to a financing company that would then collect the payments. This arrangement poses no problem as long as there is no defect in the product, but if the customer is dissatisfied in some way, he or she cannot refuse to pay, since the financing company can demand payment on the promissory note as a holder in due course despite any contractual dispute between the customer and the merchant. Soon finance companies and merchants worked together, using the promissory notes to ensure payment, no matter what the dissatisfaction. The *Bills of Exchange Act* was amended by the addition of a section dealing with consumer bills and notes to prevent this type of abuse.²⁵

A consumer note is a promissory note signed by a person purchasing goods or services for a non-commercial purpose (not for resale or use in any business). A

consumer bill is any bill of exchange or cheque given for the advancement of credit in such a consumer transaction. Cheques used for payment are not covered, but a cheque post-dated for more than 30 days is also included as a consumer bill. This legislation is designed to protect consumers by requiring that all such instruments be stamped on their face as consumer bills or notes. This provides notification that these notes are different, and the effect is to remove the advantage given to holders in due course of a negotiable instrument. By this amendment, a consumer who was the original drawer or maker of the instrument can still raise the normal contract defences, such as fraud or breach of contract even where payment is being demanded by a holder in due course.

This would defeat the main advantage of negotiable instruments, their free transferability, if it were not for the fact of the notification provided by requiring that all such instruments be stamped as consumer bills or notes on their face.

Failure on the part of the merchant to properly stamp the instrument “consumer purchase” is a serious offence, since it allows the instrument to be a normal negotiable instrument with all the advantages to the holder in due course. By such failure, the merchant is subject to prosecution and the payment of a significant fine and is liable to compensate the drawer for damages.

For example, Degraaf purchased a used car from Galer’s Fine Cars Ltd. signing a promissory note for \$5000. Galer’s Fine Cars Ltd. then negotiated that note to Quinn’s Finance Company. If Degraaf had been the victim of fraudulent misrepresentation by Galer’s, prior to 1970, he still would have to pay Quinn’s Finance Company, assuming they qualified as a holder in due course. But if the same transaction took place after 1970, Galer’s Fine Cars Ltd. would have been obligated to stamp the note “consumer purchase,” and when Degraaf discovered the fraud, he would not only have an action against Galer’s but also a good defence against Quinn’s Finance Company when they presented the note for payment. In the event that Galer’s failed to stamp the note “consumer purchase,” assuming Quinn’s Finance was innocent of any wrongdoing, Quinn’s could collect as a holder in due course, but Degraaf would have recourse against Galer’s, which would also face prosecution.

LETTERS OF CREDIT

*69971 Manitoba Ltd. v. National Bank of Canada*²⁶

Mr. Barrin imported various items of produce from foreign countries through Barrin Produce (the numbered company above). In this case, they were importing oranges from a Spanish company and required an international letter of credit from their bank, the National Bank of Canada, in order to facilitate the transaction. The arrangement was that the Spanish company would transport the oranges directly to Barrin Produce, but the bill of lading for the oranges would be transferred through a Spanish bank to the National Bank of Canada and subsequently to Barrin Produce. The standard practice would be that when the National Bank received the appropriate documentation, including the bill of lading, and released it to Barrin Produce, title to the oranges would transfer, and then the National Bank would become obligated on the letter of credit to pay the Spanish exporter. Payment would be made by the National Bank, when satisfied the documentation they had received was correct.

When the documents were delivered to the National Bank by the Spanish bank, they included the completed bill of lading and a bank draft requesting payment as required under the letter of credit. Unfortunately, the documentation received was not correct. There were several errors, including an important one on the bill of lading that listed the goods delivered as oranges and lemons instead of just oranges as required. The bank was aware of this discrepancy but failed to bring it to Mr. Barrin's attention when they transferred the bill of lading to Barrin Produce.

When Mr. Barrin discovered the problem and the defective nature of the produce, he asked his bank not to honour the letter of credit and not pay out on the bank draft. His bank refused, and paid out the amount owing to the Spanish supplier. The National Bank took the position that as soon as they released the proper documentation, including the bill of lading to Barrin Produce, this transferred ownership in the goods to Barrin Produce and committed the bank to honour their international letter of credit. The money was paid to the Spanish supplier, and the Barrin Produce account at the Bank was debited accordingly. An action was brought by Mr. Barrin against the National Bank for wrongfully honouring the international letter of credit.

The principle is quite clear that such letters of credit have to be honoured if the documentation required pursuant to it is properly submitted and correct on the face of it. In this case, it was not correct on the face of it, the money should not have been paid out, and therefore the bank was liable to Mr. Barrin for their error. It is interesting to note, however, that the actual damages that were paid by the bank to Mr. Barrin was not the amount debited against the account, but the actual losses he suffered in the transaction. This case nicely illustrates the nature of letters of credit and how they are used. It also shows how they are used in conjunction with bank drafts and bills of lading and how they have become extremely important in international trade.

In international trade, the bill of exchange or draft and other forms of negotiable instruments are still extensively used, but today, it is becoming more common to use a letter of credit. The letter of credit is a guarantee from the importer's bank that the price stated will be paid upon presentation of appropriate documentation confirming delivery, thus giving assurance from the financial institution to the seller that they will be paid by their customer. This letter of credit is normally delivered to the exporter by the importer, who, upon delivery of the goods, submits the appropriate documentation to the importer's bank and receives payment. Sometimes, especially when the importer's bank is in a foreign country, the exporter will require that a bank that they have confidence in, usually in their own country, becomes involved as a confirming bank. The exporter's chosen confirming bank then receives the letter of credit directly from the importer's bank and commits to the exporter that they will honour it upon receiving the appropriate documentation. The confirming bank plays a role very much like that of endorsing a negotiable instrument in that they add their guarantee to the letter of credit. The exporter then simply submits the appropriate documents indicating performance to their bank and receives payment.

If Chan were exporting pianos from Hong Kong to Weiss in Canada, to satisfy Chan, Weiss might ask the Royal Bank to generate a letter of credit to support this transaction. The letter of credit would guarantee payment to Chan of a specific amount (for example, \$200 000) upon the production of certain documentation. This required documentation might include a proof of insurance, bill of lading, customs declaration, and invoice. It

might even require a certificate of inspection from some third party to indicate that the goods are as expected. The letter of credit would be given to Weiss by the Royal Bank, and Weiss would deliver it to Chan, who would, upon shipping the goods, present the appropriate documents, including the letter of credit, and collect the money from the bank.

More likely than not, however, Chan would want his own bank involved in the transaction. If he only involves his bank in an advising capacity where it assumes no liability, it is referred to as an advising bank, but where Chan wants his bank to guarantee payment, it is called a confirming bank. If he were to choose the Hong Kong bank as the confirming bank, he would inform Weiss of this requirement at the outset, and when making arrangements for the letter of credit with the Royal Bank, Weiss would also provide the Royal Bank with the particulars of the Hong Kong Bank as the confirming bank. The Royal Bank contacts the Hong Kong Bank directly, making arrangements for the confirmed letter of credit. The Hong Kong Bank then sends a confirmed letter of credit to Chan, who then ships the pianos. Chan then submits the appropriate documents confirming delivery to his bank, the Hong Kong Bank, which, after careful inspection and if satisfied, makes the appropriate payment. These documents are then sent to the Royal Bank, which pays the Hong Kong Bank and appropriately debits the account of Weiss.

This may seem like a very complex process, but it is really quite simple in that the two traders choose banks that they trust to hold and transfer the funds. The effect is quite similar to that of a bank draft, but this process is often more convenient and more flexible. The case used to open this discussion illustrates the process and what should happen when incorrect documentation is submitted to the bank on which the letter of credit is drawn. In that case, as held by the court, the National Bank of Canada should have withheld payment because of the bill of lading stating that oranges and lemons were delivered rather than just oranges.

Often, drafts are used in conjunction with this process, the letter of credit authorizing the creditor to obtain payment by drawing a draft on the issuing or confirming bank. In the above example, Chan, upon presenting the appropriate documentation showing that the pianos were shipped, would then draw a bill of exchange (a draft) naming the Royal Bank as the drawee and himself or his bank as the payee, which he could then give to his bank for collection.

Letters of credit are primarily used in international trade, but they are very flexible and because of this quality, it is not uncommon to find them being used in domestic business transactions as well. Letters of credit are also used in other ways, for example, to guarantee, in effect, that one party to a contract will properly perform. If there is a breach, the victim has recourse to the bank that has issued the letter of credit. This is referred to as a standby letter of credit.

SUMMARY

Negotiable instruments

- Freely transferable
- Effective substitute for money

- Method of advancing credit
- Regulated by *Bills of Exchange Act*

Holder in due course

- Innocent holder of a negotiable instrument acquires better rights than the immediate parties

Types

- Promissory notes—a maker promises to repay a payee
- Bills of exchange or drafts—a drawer orders a drawee to pay a payee
- Cheques—bills of exchange drawn on a bank, payable on demand
- Certified cheque—similar to an accepted bill of exchange

Negotiation

- Accomplished by endorsement and delivery if it is an order instrument but by delivery alone if it is a bearer instrument

Qualifications

- Instrument must be signed and contain an unconditional commitment to pay a fixed amount of money at a fixed time or on demand.
- Instrument must be delivered, and the whole instrument must pass.

Holder in due course

- A person must have received the instrument for value
- Instrument must be complete and regular on its face
- Received through negotiation, before it was due and payable
- Received in good faith and without knowledge of any defect of title or notice of dishonour
- Only real defences can be used against a holder in due course, whereas real defences and defect of title defences can be used against other holders.

Endorser

- Liable on default by the original drawer only if properly notified of the default

Consumer notes

- Must be clearly stamped as such by the merchant
- Act has been amended so that negotiable instruments used to extend credit in consumer transactions did not convey the same rights as regular negotiable instruments

Letters of credit

- Method of transferring funds where one bank issues a letter of credit on behalf of their client to a confirming bank that guarantees payment to a creditor of the first bank's client

QUESTIONS

1. What two important characteristics of negotiable instruments have led to their prevalent use in business activities today?
2. What is the difficulty associated with the assignment of contractual rights that is overcome when a negotiable instrument is used? Explain how the position of a holder in due course differs from that of an assignee of contractual rights.
3. Describe how negotiable instruments differ from money. Describe how negotiable instruments are similar to money.
4. Describe the *Bills of Exchange Act* and how it came about as a Canadian statute. Which level of government passed it and has jurisdiction in this area?
5. What is meant by a bearer instrument? Compare this with an order instrument. Indicate how an order instrument can become a bearer instrument.
6. Explain what is meant by negotiation of a negotiable instrument and how this is accomplished. What qualifications must an instrument meet to be negotiable?
7. What are the differences among a bill of exchange, a promissory note, and a cheque? Give an example of situations when each would be used and examples of two other kinds of instruments that sometimes qualify as negotiable instruments.
8. What is the process of acceptance of a bill of exchange and the significance of acceptance? What types of bills of exchange would you probably see presented for acceptance? Explain the nature of the relationship before acceptance between the payee and the drawee. How does this change once acceptance has taken place?
9. What is meant by the dishonour of a negotiable instrument? What obligation falls on the holder of that instrument when such dishonour takes place with respect to prior holders of the instrument?
10. When a payee presents a bill of exchange for acceptance to the drawee and it is accepted, how does this acceptance affect the position of the drawer of the instrument?
11. Under what circumstances will the authority of a bank to pay out on a cheque be terminated?
12. Will a bank honour a stop payment order made against a certified cheque?
13. What is the primary purpose of promissory notes?
14. Distinguish among real defences, defect of title defences, and mere personal defences. Indicate the circumstances in which these distinctions can be significant when dealing with negotiable instruments.
15. Define what is meant by a holder in due course, the characteristics this person must have to qualify, and the significance of being so designated. Explain how the knowledge of a holder of a negotiable instrument can affect his or her right to claim to be a holder in due course.
16. When a person does not qualify as a holder in due course but acquires the instrument through a holder in due course, what defences are available to the original maker or drawer of the instrument?
17. Explain the significance of the 1970 amendments to the *Bills of Exchange Act* creating consumer notes.
18. Explain how a letter of credit differs from a negotiable instrument.
19. Distinguish between a standby letter of credit and a normal letter of credit.

20. Explain the role of a confirming bank when letters of credit are involved.

CASES

1. *Eastern Elevator Services Ltd. v. Wolfe*

Wolfe was dissatisfied with his employment and discussed the possibility of working with another employer, Pace. An agreement was worked out, whereby a separate company, Eastern Elevator Services Ltd., would be incorporated and employ Wolfe. But Wolfe had to give Eastern a \$5000 cheque to show how sincere he was, the understanding being that the cheque would not be cashed unless Wolfe failed to honour the agreement and did not take up his new position of employment. The deal fell through, Wolfe did not become an employee, and he stopped payment on the cheque. Eastern sought a court order that Wolfe be required to pay out on the cheque.

Explain the arguments available to Wolfe as to why he should not be required to honour the cheque and why he should not be required to pay the \$5000. Would your answer be any different if the cheque had got into the hands of an innocent third party who was a qualified holder in due course?

2. *A. E. LePage Real Estate Services Ltd. v. Rattray Publications*

In 1985, Rattray agreed to lease certain premises from A. E. LePage on Yonge Street. Pursuant to that agreement, Rattray delivered a cheque to LePage for \$20 825.89 as a deposit. It was drawn on a branch of the CIBC. A. E. LePage was acting for London Life, the owner of the property. The offer was taken by LePage to London Life for their signature. Rattray changed his mind and stopped payment on the cheque, but because of a mistake at the CIBC branch, the stop payment order was ignored when the cheque was brought in for certification by a representative of LePage. The cheque was subsequently deposited in LePage's trust account at the Toronto Dominion Bank, but when it was sent to the CIBC branch, they refused to honour it.

Indicate the arguments on both sides of this case as to whether or not A. E. LePage should be able to require the bank to honour this cheque. Explain Rattray's position. Would your answer be any different if the cheque had been certified by Rattray in the first place and then presented to LePage?

3. *Stienback Credit Union Ltd. v. Seitz*

Mr. Seitz was a businessman in Winnipeg who agreed to provide bridge financing for the Winnipeg Lions Club to cover the expenses for a fundraising concert it was planning. He wrote a \$100 000 cheque and gave it to the Lions Club which presented it to the Royal Bank for deposit. Before crediting the Lions Club account with the money, the bank phoned Seitz's credit union to confirm that it would honour the cheque, even though there were not quite enough funds in the account. The credit union assured the bank that the cheque would be guaranteed and that it was unnecessary to certify it. It turned out later that the concerts were a disaster, and Mr. Seitz tried to stop payment on the cheque. Explain the arguments available to both parties.

4. *Canadian Imperial Bank of Commerce v. Burman and MacLean*

On May 4, 1979, the defendant, Burman, bought a car from the defendant, MacLean, for \$3700. Burman made two cheques totalling this amount payable to MacLean to cover the price. Both were dated May 6, 1979. About 6:30 p.m. on May 4, MacLean took these two cheques to CIBC at Sydney River, where he had an account. The cheques were drawn on the Bank of Montreal. CIBC took the cheques and gave MacLean \$3700 for them. It turned out that MacLean had fraudulently misrepresented the nature of the vehicle. Instead of having 53 100 kilometres on the odometer, it had 136 800 kilometres. Burman went to the Bank of Montreal and issued a stop payment order before the bank opened on May 7, 1979.

CIBC, in this action, is seeking to force Burman to honour the cheques for \$3700. Explain the arguments available to Burman and the likely outcome.

5. *Enoch Band of the Stony Plain Indian Reserve No. 135 v. Morin*

Morin worked as an employee of the Enoch Band, and one of her responsibilities was to requisition cheques for the payment of students who were members of the band in various schools. Eventually, these students would cease to be eligible for the band supplements, but Morin kept on making out the cheques, forging the students' endorsements on the cheques, when necessary, and depositing them in her own account. All of the cheques were properly drawn on the band, signed by the band's authorized signing officers, and made payable to the existing individuals, but they were intercepted, cashed, and deposited by Morin. When the cheques came back to the band, they were honoured.

The scheme was eventually discovered, Morin was fired, and this action was commenced against the Bank of Montreal by the band, seeking repayment of the monies debited from their account, representing the cheques with the forged endorsements.

Explain the arguments available on both sides. Which one of these two innocent parties should be the one to bear the loss? Would your answer be different if you knew that when the Enoch Band learned of the problem, they neglected to give written notice to the Bank of Montreal of the forgeries, as required under the *Bills of Exchange Act*, until the action commenced, a delay of over a year?