The Bank of Montreal (*Defendant*) *Appellant*;

and

The Attorney General of the Province of Quebec (*Plaintiff*) *Respondent.*

1978: March 16; 1978: December 5.

Present: Martland, Ritchie, Spence, Pigeon, Dickson, Estey and Pratte JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR QUEBEC

Bills of exchange — Cheque — Forged endorsement — Knowledge of forgery — Notice — Period of one year — Bills of Exchange Act, R.S.C. 1970, c. B-5, s. 49(3), (4).

Crown — Prescription — Prerogatives — Contractual liability — Civil Code, arts. 2215, 2263.

Banks — Banking contract — Obligations of parties — Customary clauses — Legislative regulation — Civil Code, arts. 983, 1017, 1024 — Bills of Exchange Act, R.S.C. 1970, c. B-5, s. 49(3), (4).

Respondent (the government) is claiming from appellant (the bank) the amount of a cheque: the endorsement of the latter had been forged and it had been debited to the government's account. The government learned of the existence of the forgery in late 1968 but did not give the bank notice of it until July 1972, when it claimed from the latter reimbursement of the amount of the cheque. When the bank refused, the government took action to recover it. The bank pleaded essentially that it was not indebted to the government because the latter had failed to give notice of the forged endorsement within a year of the time the government learned of it, in accordance with subss. (3) and (4) of s. 49 of the *Bills of Exchange Act*. As for the government, it invoked the rights and prerogatives of the Crown and maintained that it was not bound by this section. The Superior Court and the Court of Appeal considered this claim to be well-founded and they allowed the government's action. Hence the appeal to this Court.

Held: The appeal should be allowed.

The lower courts were wrong to consider this matter as if the question at issue was as to the extent to which the Crown was bound by an Act that imposed an obligation on it or affected its prerogatives. The question that arises is rather whether the Crown was bound by a contract to which it gave a valid consent. In the case at bar, when the government opened a bank account, it entered into a contract with its banker. In a contract of

this type the parties are usually silent as to the contents; they rely on commercial custom (art. 1017 *C.C.*) and the law. By enacting subss. (3) and (4) of s. 49 of the *Bills of Exchange Act*, the legislator has regulated certain aspects of banking contracts. The rule is that a cheque paid upon a forged endorsement is held to have been paid in due course unless the client has given notice within one year after he learns of it. Unless notice is given, there is no claim. There is thus no question of a time for prescription. The obligations resulting from these enactments are binding on the parties and, by application of art. 1024 *C.C.*, they must be considered as obligations arising from a contract rather than from the operation of the law solely. In matters of contractual liability, the Crown is not governed by any special provision: the Crown is bound by a contractual obligation in the same manner as an individual, whereas as a general rule it is not bound by an obligation resulting from the law alone unless it is mentioned in it. The rights and prerogatives of the Crown therefore cannot be invoked to limit or alter the terms of a contract, which comprises not only what is expressly provided in it but also everything that normally results from it according to usage or the law. The government's claim against the bank is based on a contract; to be entitled to it, the government had to comply with the agreed terms. It did not do so.

Joachimson v. Swiss Bank Corporation, [1921] 3 K.B. 110; *Ross v. Dunstall* (1921), 62 S.C.R. 393; *Banker* (1700), 14 How. St. Tr. 1; *Windsor and Annapolis Railway Co. v. The Queen* (1886), 11 A.C. 607; *Verreault & Fils v. Attorney General of Quebec*, [1977] 1 S.C.R. 41: *The Exchange Bank of Canada v. The Queen* (1886), 11 A.C. 157; *R. v. Murray et al.*, [1967] S.C.R. 262, referred to.

APPEAL against a decision of the Court of Appeal[1], affirming a judgment of the Superior Court[2]. Appeal allowed.

Alex Paterson, Q.C., for the appellant.

Joseph R. Nuss, Q.C., for the respondent.

The judgment of the Court was delivered by

PRATTE J.—The facts that gave rise to this litigation are straight-forward and are not in dispute.

[1] [1976] C.A. 378.
[2] [1974] C.S. 374.

In April 1968 respondent (the government) drew on the appellant (the bank) with which it had an account a cheque to the order of "Sheedo Construction Co. Ltd. et Gadbois Roland Notaire" for $77,375, in partial payment of the compensation for expropriation owing to Sheedo Construction Co. Ltd. (Sheedo). The government sent the cheque to notary Gadbois, who was asked to prepare the necessary documents and to whom it gave appropriate instructions regarding the delivery of the cheque to Sheedo. Notary Gadbois did not follow these instructions; he forged Sheedo's endorsement and, in early August 1968, deposited the cheque in his account at the Caisse Populaire of Verdun, which forwarded the cheque to the bank for payment; on August 5, 1968, the bank paid the cheque to the Caisse Populaire of Verdun, and, at the same time, debited the account of the government with the sum of $77,375.

At the end of 1968 the government learned that Sheedo's endorsement on the cheque had been forged; in early 1969 it received evidence that none of the proceeds of the cheque had been paid to Sheedo.

It was not until July 1972 that the government gave the bank notice of the forgery, when it claimed from the latter reimbursement of the amount of the cheque, $77,375, plus interest from the date of disbursement, namely $15,170, for a total of $92,545.

When the bank refused to reimburse the amount claimed, the government took action to recover this sum of $92,545, which it subsequently increased to $94,461.62.

Against the action the bank pleaded essentially that it was not indebted to the government because the latter had failed to give written notice of the forged endorsement within a year of the time the government learned of it; the defence of the bank was based on s. 49(3) and (4) of the *Bills of Exchange Act*, which reads as follows:

49. (3) Where a cheque payable to order is paid by the drawee upon a forged endorsement out of the funds of the drawer, or is so paid and charged to his account, the drawer has no right of action against the drawee for the recovery of the amount so paid, nor any defence to any claim made by the drawee for the amount so paid, as the

case may be, unless he gives notice in writing of such forgery to the drawee within one year after he has acquired notice of the forgery.

(4) In case of failure by the drawer to give such notice within the said period, such cheque shall be held to have been paid in due course as respects every other party thereto or named therein, who has not previously instituted proceedings for the protection of his rights.

As for the government, it invoked the rights and prerogatives of the Crown and maintained that it was not bound by the obligations under this section.

By judgment of July 3, 1974, the Superior Court for the district of Montreal (Batshaw J.) allowed the government's action against the bank for the amount of the cheque, $77,375, plus the sum of $1,960.84, representing interest at the rate of 5 per cent from July 4, 1972, the date on which the bank was first notified of the forgery.

In a unanimous decision the Court of Appeal (Casey, Rinfret and Turgeon JJ.A.) upheld the judgment of the Superior Court. Speaking for the Court, Turgeon J.A. said, *inter alia*:

[TRANSLATION] In a well-written judgment, the trial judge held, citing authorities in support, that s. 49(3) of the *Bills of Exchange Act* did not apply to the Crown.

He also held that the Crown could not be liable for the negligence of its officers or employees.

Respecting art. 2263 *C.C.*, he concluded that it did not have the effect of altering the thirty-year prescription provided for in art. 2215 *C.C.* and making the Crown subject to the one-year prescription contained in s. 49(3). I am fully in agreement with the trial judge on these points.

In short, the Court of Appeal, like the Superior Court, came to the conclusion that s. 49(3) could not be used against the government because it would have the effect of infringing on certain prerogatives of the Crown.

With respect, I think that it was wrong to consider this matter as if the question at issue was

as to the extent to which the Crown was bound by an Act that imposed an obligation on it or affected its prerogatives; the Courts below were mistaken as to the source of the parties' rights and obligations; the question that arises is rather whether the Crown was bound by a contract to which it gave a valid consent.

A person who opens a bank account enters into a contract with his banker. Paget's *Law of Banking*, 7th ed., at p. 55, states the following:

> The relationship of banker to customer is one of contract, though until relatively recently this way of looking at the matter seems not to have attracted much attention in the courts.

In the frequently cited decision of *Joachimson v. Swiss Bank Corporation*[3], Bankes L.J. said at p. 117:

> In the ordinary case of banker and customer their relations depend either entirely or mainly upon an implied contract.

In his *Law of Banking*, 6th ed., Lord Chorley wrote at p. 25:

> This debtor and creditor relationship is the basic principle of the law of banking. It does not, however, provide a sufficiently wide formula for the solution of all the problems, or the understanding of all the business of modern banking. Even at the time of *Foley v. Hill* it was found necessary to add that there was also the obligation "arising out of the custom of bankers to honour the customer's drafts." This "superadded obligation" is however contractual in its nature. There are in modern banking other implied contractual obligations upon the banker, such as that of collecting his customer's cheques, for which purpose it is considered that the customer by implication appoints the banker his agent, and it appears to be most consonant with the present-day position to regard the relationship of customer and banker as based upon an implied contract of a complicated nature, and containing a number of terms, the first and most fundamental of which is that by which the banker undertakes to borrow from his customer such amounts as the latter chooses to lend, and to repay upon demand by honouring the customer's drafts.

[3] [1921] 3 K.B. 110.

See also Rodière and Rives-Langes, *Précis de droit bancaire*, at pp. 96 and 388; Ripert, *Droit commercial*, 8th ed., Vol. 2, No. 2278, at p. 269.

Sections 45 and 47 of the *Finance Department Act* (R.S.Q. 1964, c. 64) authorize the government to open bank accounts and draw cheques:

> 45. All public moneys paid in to the credit of the Minister of Finance shall be deposited in such bank as he indicates.
>
> 47. All expenditure of public moneys shall be made by official cheque on some bank, upon a warrant of the Lieutenant-Governor.
>
> Such cheque shall be signed by the Minister or the Deputy Minister of Finance and countersigned by the Provincial Auditor.

Thus, when the government opened an account with the bank it entered into a contract whose object was necessarily to govern relations between the parties. It is to this contract that reference must be made in order to determine the rights and obligations flowing therefrom.

However, bank contracts, such as the one between the government and the bank, are somewhat special in that they are usually silent as to their contents; the parties rely on commercial custom and the law. It is therefore appropriate to apply art. 1017 C.C., which reads as follows:

> 1017. The customary clauses must be supplied in contracts, although they be not expressed.

There is no doubt that a banking contract between a banker and his client includes an obligation on the part of the banker not to pay a cheque to one who is not entitled to it. This obligation on the part of the banker toward his client is clearly contractual in nature. What happens if the banker, in defiance of this obligation, pays a cheque on a forged endorsement? What then is the sanction for the banker's breach of his contractual obligation toward his client? This is what the legislator intended to specify by enacting subss. (3) and (4) of s. 49. The rule is that a cheque paid upon a forged endorsement is nevertheless held to have been paid in due course unless the client has given his banker written notice of the forgery within one

year after he learns of it. Notice is essential to the creation of a claim against the banker; unless notice is given, there is no claim. The mere payment of a cheque on a forged endorsement does not give rise to any right against the banker; it is further necessary that the prescribed notice be given within the time limit.

Thus, section 49(3) and (4) does not establish a time for the prescription: a right that has not yet come into existence cannot become prescribed or extinguished. This section instead determines the nature and extent of the client's right against his banker where the latter, contrary to the obligation he has implicitly assumed, pays a cheque on a forged endorsement. According to the terms of these provisions, the obligation to reimburse exists only if notice was given within the year in which the forgery became known; the two are inseparable since one is in a sense the counterpart of the other.

By enacting subss. (3) and (4) of s. 49, the legislator has effectively regulated certain aspects of banking contracts, as is the case with several other types of contract such as sale, exchange, rental and loan. By specifying the extent and nature of the obligations resulting from a breach of a banking contract the legislator has, as a consequence, defined the extent and nature of the obligations arising from the contract itself (see Mazeaud and Tunc, *Traité théorique et pratique de responsabilité civile*, 6th ed., Vol. 1, No. 101. at p. 107). The agreed contents of a banking contract therefore necessarily include subss. (3) and (4) of s. 49, since these determine some of the obligations and rights flowing from the contract itself or from its breach.

Aubry and Rau (6th ed., Vol. 4, No. 346, at p. 479) observe:

[TRANSLATION] Agreements create obligations not only with respect to what is formally expressed in them but also with respect to all the consequences that must, according to equity, custom or the law, be considered as having been included in them to all intents and purposes.

Planiol (*Traité élémentaire de droit civil*, Vol. II, 3th ed., No. 454, at p. 164) says:

[TRANSLATION] Parties who enter into a contract of a specified type accept the obligations which the law

implies in such a contrast, unless they demonstrate a contrary intention. For example, a sale comprises an obligation to guarantee; the parties accept it if they do not insert in the contract a clause excluding the guarantee. The judge must therefore analyse the nature of the concluded contract to determine, according to the type of contract, the legal obligations flowing from it.

Our art. 1024 *C.C.* is categorical:

1024. The obligations of a contract extend not only to what is expressed in it, but also to all the consequences which, by equity, usage or law, are incident to the contract, according to its nature.

It thus seems to me that the obligations resulting from s. 49(3) and (4) must, by application of art. 1024, be considered as obligations arising from a contract rather than from the "operation of the law solely" (art. 983 *C.C.*). It matters little in this regard whether s. 49(3) and (4) be mandatory or directory; art. 1024 *C.C.* makes no distinction, and there is no reason to do so. But these provisions, even assuming that they were mandatory, create obligations only for the parties who have agreed to contract, with the result that it is really because of the contract that the parties are obligated. In a comment on the decision of this Court in *Ross v. Dunstall*[4], Professor René Demogue wrote (1923, 22, *Revue trimestrielle de droit civil,* 645, at p. 657):

[TRANSLATION] Contractual faults are those resulting from a breach of the terms of the contract and also those resulting from any law which gives the contract a certain effect. There are numerous cases where legal provisions, mandatory or directory, ascribe certain effects to a contract. It does not matter that as soon as they decided to enter into the contract the parties cast it in this legal mould through their silence or despite themselves. All the rules contained in the provision are incorporated into the contract (Rappr. Chironi, *op. cit.*, 2nd ed., I, at p. 63, note 18).

Discussing this same problem in relation to the contract of sale, Rodière (*Droit des transports*, 1960, Vol. 3, No. 1193, at p. 49) says:

[TRANSLATION] The vendor is obliged to guarantee the purchaser against any eviction through his own action. He cannot both sell and reserve the right to dispute his purchaser's title. The contract nevertheless remains a free one, since he is not obliged to sell to that purchaser.

[4] (1921), 62 S.C.R. 393.

When the contract is formed, it includes certain consequences without which the law feels it would be meaningless. When the law expresses these consequences, no one would think of denying that the contracting party's obligation is a contractual one.

See also Mazeaud, *ibid.*, No. 103, note 2, at p. 110; No. 154, at p. 195 and No. 171 at p. 224, to the same effect.

These rules apply to the banking contract between the government and the bank; first, this contract is silent on the point that is the subject-matter of s. 49(3) and (4); in addition, the Crown is not governed by any special provision in such matters.

Even when the rights and prerogatives of the Crown were much more extensive than they now are, it was recognized that the Crown was bound by the contracts it had entered into (*Banker* decision[5]). In 1886, in Windsor and Annapolis Railway Co. v. The Queen[6], Lord Watson said at p. 613:

Their Lordships are of opinion that it must now be regarded as settled law that, whenever a valid contract has been made between the Crown and a subject, a petition of right will lie for damages resulting from a breach of that contract by the Crown. ... A suit for damages, in respect of the violation of contract, is as much an action upon the contract as a suit for performance; it is the only available means of enforcing the contract in cases where, through the act or omission of one of the contracting parties, specific performance has become impossible. In *Tobin v. The Queen* Chief Justice Erle, whilst affirming the doctrine that the Sovereign cannot be sued in a petition of right, for a wrong done by the executive, took care to explain that "claims founded on contracts and grants made on behalf of the Crown are within a class legally distinct from wrongs."

In a recent decision (*Verreault & Fils v. Attorney General of Quebec*[7]), this Court held the Crown liable in damages as a result of the breach of a building contract.

[5] (1700), 14 How. St. Tr. 1.
[6] (1886), 11 A. C. 607.
[7] [1977] 1 S.C.R. 41.

The principle of the Crown's contractual liability is thus no longer open to dispute.

The rules respecting the liability of the Crown therefore differ depending on whether the source of the obligation is contractual or legislative. The Crown is bound by a contractual obligation in the same manner as an individual, whereas as a general rule it is not bound by an obligation resulting from the law alone unless it is mentioned in it. This also means that subject possibly to a limited number of exceptions which would not apply here in any event, the rights and prerogatives of the Crown cannot be invoked to limit or alter the terms of a contract, which comprises not only what is expressly provided in it but also everything that normally results from it according to usage or the law.

Article 1024 cannot lead to any other conclusion. This article, like the entire Code, moreover, applies to the Crown (*The Exchange Bank of Canada v. The Queen*[8]); the contractual obligations of the Crown extend to all the consequences flowing from the contract "by . . . law".

This solution seems to me all the more inescapable since it is now accepted (*The Queen v. Murray et al.*[9], Martland J., at p. 267) that the Crown cannot rely on its prerogatives to avoid the application of a legislative provision aimed at limiting the liability of the party who by his delict caused a damage. If this is true of legislation respecting the contents of the obligation resulting from a delict, I do not see why the same principle would not be valid in the case of a law of general application specifying the contents of an obligation under a contract.

In the case at bar the government cannot escape the consequences of its failure to give the bank written notice of the forged endorsement in the year following the date when the government learned of it. The government's claim against the bank is based on a contract; to be entitled to it, the government had to comply with the agreed terms. It did not do so.

[8] (1886), 11 A.C. 157.
[9] [1967] S.C.R. 262.

The Court of Appeal, like the Superior Court, relied on two passages from Chitty's *The Law of the Prerogatives of the Crown* (1820 ed.), the first at p. 379 and the second at p. 380:

. . .

From the earliest periods of English Law, it has however, been a maxim that "*nullum tempus occurit Regi*"; a maxim grounded on the principle that no laches can be imputed to the sovereign, whose time and attention are supposed to be occupied by the cares of government, (*ardua regni pro bono publico*) nor is there any reason that the King should suffer by the negligence of his officers, or by their compacts or combination with adverse party.

. . .

It seems that if a Bill of Exchange or promissory note comes into the hands of the Crown before it be due, the non-presentment of it when due and omission to give notice of dishonour are not material.

Whatever weight should be given to these two opinions of Chitty, it seems to me that they cannot apply to the case at bar.

The principle whereby "The King should [not] suffer by the negligence of his officers, or by their compacts or combination with adverse party" has no place in matters of contractual liability; accepting it would amount to negating, for all practical purposes, the principle of the contractual liability of the Crown, since the latter acts only through mandataries or agents. As for the maxim *nullum tempus occurit Regi*, it is aimed at preventing a claim from being extinguished by prescription which, under the *Civil Code*, is a means of extinguishing obligations. Clearly, this maxim has no application to claims that do not yet exist or cannot be used as to alter the terms of a contract by making the time limits for performing certain acts inapplicable to the Crown.

Concerning the second passage, the citations given by Chitty in footnotes indicate that he was not referring to cases where the Crown had itself issued a bill of exchange or was a party to it, but

rather to cases where the Crown had obtained possession of a bill, the property of its debtor, by means of a seizure effected by a writ of extent, which was a special procedure available to the Crown to recover certain debts owing to it (Chitty, *Bills of Exchange*, 11th ed., at pp. 252 and 314; West, *On Extents*, at pp. 28 and 29).

I am therefore of the opinion that the appeal should be allowed, the decision of the Court of Appeal and the judgment of the Superior Court both set aside and the government's action against the bank dismissed, the whole with costs throughout.

Appeal allowed with costs.

Solicitors for the appellant: McMaster, Minnion, Patch, Hyndman, Legge, Camp & Paterson, Montreal.

Solicitors for the respondent: Ahern, Nuss & Drymer, Montreal.