1965
*Mar. 3, 4
Apr. 6

WELDWOOD - WESTPLY LIMITED (*Plaintiff*) ..... APPELLANT;

AND

DOUGLAS N. CUNDY (*Defendant*) ..... RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF ALBERTA, APPELLATE DIVISION

Contracts—Novation—Agreement to assume third party liability to extent of specific amount—Covenant to continue to do business with third party—Further extension of credit later refused—Whether failure of consideration—Justification in withholding further credit.

On May 11, 1962, the plaintiff company entered into an agreement with the defendant whereby the defendant agreed to assume $20,000 of the liability owing by company B to the plaintiff in consideration of certain covenants and in particular in consideration of the plaintiff continuing to do business with B. The defendant undertook to pay the $20,000 on or before August 11, 1962, and, following the execution of the agreement, he had B issue in his favour forty $500 post-dated cheques. The defendant endorsed and delivered these cheques to the plaintiff. After ten cheques were paid, three were dishonoured by non-payment when presented. The plaintiff then refused to extend further credit to B. It credited the defendant with the $5,000 received and after August 11, 1962, brought action for the balance of $15,000. The trial judge held that the plaintiff was justified in refusing to continue to extend credit after the three cheques were dishonoured. The Appellate Division reversed the trial judge on the basis that there had been an entire failure of consideration, thus relieving the defendant of his liability for the balance of the $20,000. An appeal was brought to this Court.

Held: The appeal should be allowed and the judgment at trial restored.

Per Curiam: It was beyond question that the defendant assumed the liability of B to the extent of $20,000 and the plaintiff released B to the extent of this amount. That constituted a novation. *Commercial Bank of Tasmania v. Jones,* [1893] A.C. 313, referred to.

It was held that there was no failure of consideration. Business was carried on as usual after May 11th and credit was extended until it became apparent on the three cheques being dishonoured that B was finding it impossible to pay its liabilities as they became due. The plaintiff was justified in withholding further credit in the situation as it then developed. *Royal Bank of Canada v. Salvatori,* [1928] 3 W.W.R. 501, discussed; *Royal Bank of Canada v. Mills,* [1932] 3 W.W.R. 283, applied.

Per Spence J.: The defence that there could not be a novation of only part of the old debt failed. *Re Abernethy-Lougheed Logging Co., Attorney-General for British Columbia v. Salter,* [1940] 1 W.W.R. 319, distinguished; *Hodgson v. Anderson* (1825), 3 B. & C. 842; *Fairlie v. Denton and Barker* (1828), 8 B. & C. 395, referred to.

* PRESENT: Martland, Judson, Ritchie, Hall and Spence JJ.

The further defence that the plaintiff's covenant to continue to do business with B was a condition precedent to the defendant's covenant to pay to the plaintiff the sum of $20,000, and that the plaintiff in breach of that covenant failed to continue to do business with B and freed the defendant from his covenant was also rejected. In the circumstances, there was no breach of the condition precedent.

APPEAL from a judgment of the Appellate Division of the Supreme Court of Alberta allowing an appeal from a judgment of Kirby J. Appeal allowed.

G. H. Steer, Q.C., for the plaintiff, appellant.

W. K. Moore, for the defendant, respondent.

The judgment of Martland, Judson, Ritchie and Hall JJ. was delivered by

HALL J.:—On May 11, 1962, an agreement was entered into between the appellant and the respondent as follows:

> WHEREAS Four Square Lumber (Buildings) Ltd., hereinafter referred to as "Four Square" a body corporate carrying on business in the City of Calgary, in the Province of Alberta, is indebted to Weldwood for an amount exceeding $20,000.00.
>
> AND WHEREAS Weldwood is concerned at the amount of the indebtedness of Four Square and has asked Four Square and Cundy for further and better security as a consideration of Weldwood continuing to do business with Four Square.
>
> AND WHEREAS Cundy has agreed to assume $20,000.00 of the liability owing by Four Square to Weldwood.
>
> NOW THIS AGREEMENT WITNESSETH that in consideration of the covenants herein expressed and in particular in consideration of Weldwood continuing to do business with Four Square which will be to your direct advantage as Cundy being an officer and/or shareholder thereof, it is mutually agreed between the parties hereto as follows:
>
> 1.—CUNDY hereby agrees to assume and promises to pay to Weldwood $20,000.00 of the indebtedness owing by Four Square to Weldwood.
>
> 2.—WELDWOOD hereby releases and discharges Four Square from any liability on the present indebtedness in the sum of $20,000.00.
>
> 3.—CUNDY promises to pay to Weldwood the sum of $20,000.00 on or before the 11th day of August, A.D. 1962 at the offices of Weldwood at 5707—3rd Street South East, Calgary, Alberta, to bear interest at the rate of 6% on the unpaid balance.
>
> 4.—Paragraph 3 hereof shall be considered a Promissory Note payable by Cundy in which the consideration is presumed.
>
> 5.—The parties hereto agree to execute such further documents and assurances to give effect to this Agreement.
>
> This Agreement shall be binding on the parties hereto, their executors and successors or assigns.

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The circumstances leading up to the execution of this agreement may be summarized as follows. Between September 1957 and June 1962 Western Plywood Company Limited and its successor, Weldwood-Westply Limited, the appellant, supplied lumber and other building materials on a large scale to Four Square (Alberta) Lumber and its successor, Four Square Lumber (Buildings) Ltd. Throughout the most of this period the latter companies enjoyed and were allowed from sixty (60) to ninety (90) days to pay for the materials supplied, and at times enjoyed credit to the extent of $48,223.

In the fall of 1961 Western Plywood Company Limited was taken over by American interests and the company name emerged as Weldwood-Westply Limited. Immediately following the takeover by American interests, Allan H. Young, the manager of Weldwood-Westply Limited, the appellant herein, expressed concern to the respondent, a director and substantial creditor of Four Square Lumber (Buildings) Ltd., about the indebtedness of such company to Weldwood-Westply Limited. Young requested the respondent to guarantee the indebtedness of Four Square Lumber (Buildings) Ltd. The respondent refused to execute a guarantee.

In the spring of 1962, Four Square Lumber (Buildings) Ltd. decided to expand its business and was desirous of enjoying the same credit facilities with the appellant as they had in the past. The appellant, through its manager Young, indicated that such credit would be extended, if the respondent Cundy personally undertook to assume some responsibility for the Four Square Lumber (Buildings) Ltd. account. Cundy agreed to pay on or before August 11, 1962, the sum of $20,000 at the offices of the appellant in Calgary, the said payment to be credited to the account owing by Four Square Lumber (Buildings) Ltd. to the appellant, provided that the appellant extended the same credit facilities to Four Square Lumber (Buildings) Ltd. as it had done in the past. Accordingly, the foregoing agreement was executed. It is beyond question that the respondent Cundy assumed the liability of Four Square Lumber (Buildings) Ltd. to the extent of $20,000 and the appellant released Four Square Lumber (Buildings) Ltd. to the extent of the said amount. That constituted a novation (see *Commercial*

Bank of Tasmania v. Jones[1]). The respondent became indebted to the appellant in the sum of $20,000. At that time the appellant could not have brought action against Four Square Lumber (Buildings) Ltd. for the $20,000. The account of Four Square Lumber (Buildings) Ltd. was actually credited with the payment of $20,000 as of the date of the agreement, leaving the sum of $2,322.92 owing by Four Square Lumber (Buildings) Ltd. to the appellant at that time.

So far the transaction appears as a simple one. However, the respondent alleges that the said agreement was subject to the condition precedent that the respondent would become liable for the $20,000 on August 11, 1962 only if the appellant continued to do business and to extend credit to Four Square Lumber (Buildings) Ltd. as had been done in the past and he relies on the paragraph of the agreement which reads:

> NOW THIS AGREEMENT WITNESSETH that in consideration of the covenants herein expressed and in particular in consideration of Weldwood continuing to do business with Four Square which will be to your direct advantage as Cundy being an officer and/or shareholder thereof, it is mutually agreed between the parties hereto as follows:—

The appellant did continue to do business with Four Square Lumber (Buildings) Ltd. and extended credit for such materials as were ordered by Four Square Lumber (Buildings) Ltd. during the balance of the month of May and throughout the month of June 1962, but on or about July 1, 1962, the appellant refused to extent further credit to Four Square Lumber (Buildings) Ltd. At that time credit to the extent of some $7,600 had been extended. The reason credit was refused on and after July 1st was because three cheques of Four Square Lumber (Buildings) Ltd. for $500 each in the hands of the respondent had been dishonoured on being presented for payment during the last days of June 1962. These cheques came into being in the following circumstances. The respondent, having made himself liable to the appellant for the $20,000 which he undertook to pay on August 11, 1962, had Four Square Lumber (Buildings) Ltd. issue to him 40 $500 cheques post-dated four to five days apart. He endorsed and delivered them to the appellant. These cheques, if honoured on presentation, would have relieved him of the liability he had personally assumed,

[1] [1893] A.C. 313.

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though in a much longer period than to August 11, 1962. In this manner the respondent was actually having Four Square Lumber (Buildings) Ltd. use its working capital to discharge the liability that he had assumed to the appellant and this in May and June 1962 which was a slack time for Four Square Lumber (Buildings) Ltd. Ten of these $500 cheques were honoured prior to the first of the three cheques being dishonoured. The appellant credited the respondent with the $5,000 thus received and after August 11, 1962, brought this action for the balance of $15,000. The respondent defended, alleging:

> 6. The Defendant states that it was expressly understood and a condition precedent to the Agreement of the 11th day of May, A.D. 1962 that the Plaintiff would extend credit to Four Square Lumber (Buildings) Ltd. in the same manner as credit had previously been extended to Four Square (Alberta) Lumber Ltd. but that the Plaintiff repudiated the Agreement by calling off credit as agreed, thereby releasing the Defendant from any obligation to the Plaintiff.
>
> 7. In the alternative, the Defendant states that the Plaintiff persuaded the Defendant to sign the Agreement dated the 11th of May, A.D. 1962 conditional upon the Plaintiff continuing to do business with and extend credit to Four Square Lumber (Buildings) Ltd. and as the Plaintiff failed to satisfy this condition the Plaintiff is now estopped from claiming against the Defendant, Cundy.

The appellant claims that it had the right to refuse to extend further credit when the three $500 cheques were dishonoured and were not taken care of.

The action was tried by Kirby J. in the Supreme Court of Alberta who held that the appellant was justified in refusing to continue to extend credit after the three cheques were dishonoured. The Appellate Division of the Supreme Court of Alberta reversed the trial judge on the basis that there had been an entire failure of consideration, thus relieving the respondent of his liability for the balance of the $20,000. The Appellate Division purported to follow *Royal Bank of Canada v. Salvatori*[1]. I am unable to see that this case assists the respondent. In it their Lordships of the Privy Council held that there was a total failure of consideration in that the bank failed to perform the covenant to continue to deal with the debtors, Antoni Brothers, and that the guarantor, Salvatori, had not received the whole of the consideration upon which his covenant was based. In my view, a case much more in point is *Royal Bank of Canada v.*

[1] [1928] 3 W.W.R. 501.

Mills[1], where on a guarantee identical with the document in the *Salvatori* case the Appellate Division of the Supreme Court of Alberta held that there was no such failure of consideration where the bank continued to carry on a normal banking business with the debtor after the guarantee had been given. In the present case business was carried on as usual after May 11th and credit was extended until it became apparent on the three cheques being dishonoured that Four Square Lumber (Buildings) Ltd. was finding it impossible to pay its liabilities as they became due. In my view the appellant was justified in withholding further credit in the situation as it then developed.

I would allow the appeal with costs in this Court and in the Appellate Division of the Supreme Court of Alberta and restore the judgment of Kirby J.

Spence J.:—I have had the opportunity of reading the reasons for judgment of my brother Hall and I agree with both his reasons and the conclusions set out thereunder.

I desire, however, to add some comments in reference to two defences advanced by the respondent. Firstly, that there was no novation because the old debt was not extinguished. Certainly, the old debt was extinguished as to $20,000 thereof and therefore the defence must be that there could not be a novation of only part of the old debt. I have been unable to find any authority for that proposition and *Re Abernethy-Lougheed Logging Company, Attorney-General for British Columbia v. Salter*[2], cited by counsel for the respondent, is not in my view such an authority, as in that case the whole of the debt was subject to novation and the word "complete" used by Sloan J.A. at p. 326 had no reference to a purported novation of part of the debt. I have found that Williston in vol. 6 of the revised edition of his authoritative work on contracts, at p. 5241 states:

> Novation necessarily involves the immediate discharge of an old debt or duty, *or part of it,* and the creation of a new one.

thereby implying that the novation may be of part only of the original debt. In my view, *Hodgson v. Anderson*[3], and *Fairlie v. Denton and Barker*[4], are authorities for that proposition.

[1] [1932] 3 W.W.R. 283, 4 D.L.R. 574.
[2] [1940] 1 W.W.R. 319.
[3] (1825), 3 B. & C. 842, 107 E.R. 945.
[4] (1828), 8 B. & C. 395, 108 E.R. 1089.

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Secondly, the respondent urged as a defence that the appellant's covenant to contine to do business with Four Square Lumber (Buildings) Limited was a condition precedent to the respondent's covenant to pay to the appellant the sum of $20,000, and that the appellant in breach of that covenant failed to continue to do business with Four Square Lumber (Buildings) Limited and freed the respondent from his covenant.

This argument was successful in the Appellate Division of the Supreme Court of Alberta. Macdonald J. A., giving judgment for the Court, said:

It is clear that the cheques given by the appellant Cundy were not substituted for his covenant in the agreement of May 11th, 1962. We are satisfied that such cheques were voluntary payments in advance of the due date of the covenant to pay.

On the evidence it seems clear to us that the appellant has not received the consideration, that is, the whole of the consideration, upon which his covenant is based as the respondent breached the agreement by refusing and thereby failing to continue to do business with Four Square Lumber (Buildings) Ltd.

By reason of that failure, the appellant is not bound to perform his covenant. See *Royal Bank of Canada v. Salvatori* [1928] 3 W.W.R. 501 at 509.

On the evidence we are satisfied that the appellant did not instruct the respondent to desist from supplying goods to Four Square Lumber (Buildings) Ltd.

We would allow the appeal with costs.

I am in agreement with my brother Hall that *Royal Bank of Canada v. Mills*[1] is applicable to the situation. On the evidence, the appellant did continue thereafter to do business with Four Square Lumber (Buildings) Limited as before. As Harvey C.J. said in that case at p. 286:

Its . . . business . . . was carried on after the guaranty exactly as . . . before.

Although it is true that the orders given by Four Square to the appellant in the months which followed the delivery to the appellant of the agreement of May 11, 1962 were much smaller than had been delivered previously, what caused the appellant to refuse to continue to do business further with Four Square was the fact that three cheques of the said Four Square company for $500 each made in favour of the respondent, and by him endorsed and delivered to the appellant, were dishonoured in the space of a few weeks. These cheques were delivered to the appellant by the

[1] [1932] 3 W.W.R. 283.

respondent in the fashion and for the purpose set out by my brother Hall and in fact were prepayments, had they been honoured, of the respondent's convenant under the agreement. The appellant would not have been justified in refusing further to do business with Four Square because such cheques in prepayment had been dishonoured. But the appellant by the fact that such cheques, being cheques of the Four Square debts, were dishonoured had notice that that company was ceasing to do business and to pay its creditors in the ordinary fashion. The covenant to continue to do business cannot be interpreted as requiring the appellant to continue to supply credit to an insolvent purchaser. As Kirby J. said in his judgment at trial:

> In my mind, it has just boiled down to that, and I would think that Weldwood-Westply would be very poor businessmen if they continued to do business.

There was, therefore, no breach of the condition precedent and the refusal under these circumstances of the appellant to continue to do business with Four Square Lumber (Buildings) Limited cannot be relied upon as a defence freeing the respondent from his covenant.

For these reasons, and those given by my brother Hall, I would allow the appeal with costs in this Court and in the Court of Appeal, and restore the judgment at trial.

Appeal allowed with costs and judgment at trial restored.

Solicitors for the plaintiff, appellant: Woolliams, Kerr, Korman & Moore, Calgary.

Solicitors for the defendant, respondent: MacDonald, Cheeseman, Moore & Atkinson, Calgary.