69. 1930

No. 1 of 1930.

In the Privy Council.

ON APPEAL
FROM THE SUPREME COURT OF CANADA.

BETWEEN—
THE BANK OF MONTREAL (Defendant)
Appellant
— AND —
DOMINION GRESHAM GUARANTEE & CASUALTY COMPANY (Plaintiff) *Respondent.*

CASE for the RESPONDENT.

CASE FOR RESPONDENT.

RECORD.

1. This is an appeal by special leave from a judgment of the Supreme Court of Canada (Duff, Newcombe, Lamont and Smith JJ. —Rinfret J. dissenting) dated the 27th May, 1929, reversing the judgment of the Court of King's Bench Appeal Side, Province of Quebec, dated the 16th April, 1928, which had confirmed the Judgment of the Superior Court, District of Montreal, dated the 5th May, 1927. p. 215. p. 135. p. 130.

The Judgments of the Superior Court and Court of Appeal had dismissed the Respondent's action and that of the Supreme Court maintained it for the full amount, the quantum of which was not disputed. pp. 130-5. p. 215-16. p. 217 ll. 13-17.

2. The Appellant was the banker of Willis Faber & Company of Canada Limited (hereinafter called the customer) and the banking authority is contained in a resolution of July 8th, 1912, delivered to the Appellant and continually in its possession, whereby it was resolved that any two of the following persons, namely, p. 14.

Mr. Raymond Willis, President, Mr. O. W. Dettmers, Director, Mr. E. N. Mercer, Director, and K. V. Rogers, Accountant, be thereby authorised to make, draw, sign, accept or endorse bills of exchange, promissory notes, cheques, orders for payment or other commercial paper on behalf of the customer and that Mr. Raymond Willis, President, Mr. O. W. Dettmers, Director, and Mr. E. N. Mercer, Director, and either of them singly be thereby authorised to make all contracts and engagements other than the foregoing for and on behalf of the customer.

pp. 38-41.

3. The Respondent was the insurer of the customer to the extent of Five Thousand Dollars ($5,000.00), of the fidelity of K. V. Rogers, the customer's chief accountant, and paid it a claim with incidental expenses amounting to Seven Thousand Five Hundred and Sixty-five Dollars and Sixty-one Cents ($7,565.61), as being part of defalcations of K. V. Rogers between the 10th of October, 1919, and the 10th of January, 1922. The Respondent took subrogation from the customer and sued the Appellant for damages for conversion of the customer's funds.

p. 32, l. 20 to p. 37.

p. 44, l. 31 to p. 47.

pp. 60-61.

p. 108, ll. 2-17.

4. K. V. Rogers, the customer's Chief Accountant, during the whole period had charge of the account books, cash book, cheque book, journal and banking and had power by the resolution to sign cheques with one other Signing Officer (Mr. Dettmers or Mr. Mercer). The customer carried on extensive insurance operations and there were on the customer's books three very large accounts, namely, Canadian Government Merchant Marine, Johnson and Higgins, New York, and Willis Faber & Company of London, which Rogers principally manipulated.

p. 14.

p. 89, ll. 8-14.

p. 89, l. 25.

p. 89, l. 30, p. 91, l. 35.

5. It was the habit of the customer to make frequent remittances by draft, the rate of exchange on which was variable. The method adopted was for Rogers to telephone the Appellant for the rate of exchange, make up a cheque payable to the Appellant Bank for the approximate amount required to cover the indebtedness and the exchange and to have the cheque signed by two of the Signing Officers.

p. 89, l. 45; p. 90, l. 47.

6. These cheques were procured by Rogers upon a statement, which he would place before one of the other Signing Officers, indicating the amount of indebtedness to be met. He would then invite the other Signing Officer to sign the cheque. Rogers, having signed the cheque himself, would then take the cheque to the Appellant Bank and have it accepted.

p. 20, l. 20; p. 21, l. 1. p. 22, l. 25; p. 23, l. 30; p. 26. l. 1; p. 28, l. 25.

7. On one of the Appellant's own requisition forms Rogers, with his own hand, would write an application for a draft on New

York or London in favour of the customer's creditor when the transactions were *bona fide* but frequently in his own favour. He would write in the customer's name as the applicant, but without any signature. He would then take the accepted cheque and the requisition to the Exchange Department of the Appellant Bank.

8. In the latter case the Exchange Department would make out the drafts in Roger's favour, hand them with the cheque to the Exchange Teller, who would hand out the drafts to Rogers "without "enquiring or endeavouring to identify to whom they were handed "or to whom they were payable." If the cheque were for a little more than was required the change would be included; otherwise, the difference would be demanded and received. It is stated by the Appellant's accountant that it would be the duty of the Exchange Department to know who Rogers was before delivering a draft to him of any kind. p. 121, l. 35. p. 124, l. 11; p. 124, l. 31; p. 125, l. 2. p. 122, l. 35. p. 66, l. 35; p. 72, l. 46; p. 73, l. 2; p. 73, l. 18;

9. Rogers having cashed the drafts for his own benefit, would then manipulate his book entries according to the method indicated in the Auditor's report. As he had complete control of the books it was a simple matter. p. 30, l. 35 to p. 37.

10. The customer's books were audited every two or three months at no stated intervals; the Auditors would come in unexpectedly. They checked the book entries and examined the returned cheques but did not examine the returned drafts which were in the Appellant's possession and they did not go to the Appellant Bank to verify if the entries in the books were correct. They took it for granted that as the cheques were payable to the Appellant there was sufficient to ensure that the funds would go to the right parties. It is submitted that it would have been impracticable to go through the Appellant's books and that to do so forms no part of an Auditor's duties. p. 94, ll. 10-16. p. 117 ll. 6-14. p. 117, ll. 38 ff. p. 94, ll. 30-36. p. 118, l. 26.

11. The informal requisitions for drafts were not returned to the customer, nor were the drafts themselves. They were all filed away in bundles and never reached the customer, nor had the customer any opportunity of checking them. p. 72, l. 5; p. 94, l. 25.

12. Rogers had actual authority, by the resolution, to sign cheques, but the cheques being made in favour of the Appellant, the Appellant was not the holder in due course and, consequently, had to wait for further authority from the customer before it disposed of the funds. Rogers had been allowed to indicate to the Appellant the names of the customer's creditors as payees on the drafts, but it is submitted that he had neither actual nor ostensible authority to appropriate the proceeds of the cheques for his own benefit, nor p. 14, l. 1.

had he any general authority to direct the application of the proceeds of the cheques.

13. It is submitted that Rogers, in requesting the Appellant to put the proceeds within his own control, did not purport to act as an agent of the customer, but as a principal, acting on his own behalf.

p. 124, l. 11 ff. p. 125, l. 10 ff. **14.** The Appellant did not rely on any ostensible authority vested in Rogers, because the Foreign Exchange Department did not concern itself either in respect of the identity or authority of the person who wrote the customer's name on the requisitions. The mere possession of the cheque was regarded as a sufficient p. 76, l. 15. credential. It does not appear that either the terms of the resolution, Rogers' position nor the usual course of dealing was in any way considered.

p. 132, l. 31. **15.** The trial Judge, Duclos J., found that the customer had held Rogers out as its trusted agent and the Appellant had every p. 132, l. 41. reason to believe that he was acting with authority; that the requisition notes could have been signed by both the authorised Signing Officers, and that some officers of the customer could have examined the drafts and ascertained that they were made payable p. 132, l. 48. to the proper payee and debited to his account; that the books were audited several times each year and that the Auditors never thought of going to the Appellant to examine the requisition notes and satisfy themselves that they corresponded with the entries in the p. 133, l. 20. customer's books; that the customer never objected or demurred to the improper use of the cheques by Rogers and gave no notice to the Appellant of irregularity.

16. It is submitted that without suspicion or reason for suspicion neither the Auditors nor the customer could reasonably have been expected to do any of the things suggested by the learned Judge.

p. 133, l. 25. **17.** Duclos J. finds that, even if the Appellant's suspicions should have been aroused when Rogers first requested it to issue drafts to his order, repetition on fifteen different occasions, spreading over a period of eighteen months, without objection or notice, was of a nature to allay Appellant's suspicion, and, as authority for this p. 133, l. 30, (p. 173, l. 42). proposition, he cites *Morrison's case* (1914) 3 K.B. Page 356. It is submitted that Morrison's case is directly against the Appellant's contentions and if Appellant's suspicions should have been aroused at the time of the first fraudulent transaction repetition should have intensified its suspicions.

p. 134, l. 27. **18.** Duclos J. says that "the mere fact that Rogers, ... "entrusted with possession of a cheque, requested the Defendant

"Bank to issue a draft to his order, was not sufficient in itself to put "the Bank upon its inquiry", and in support of this considerant cites *Corporation Agencies vs. Home Bank* (1927) A.C. 318. It is submitted that that case has no application whatever to the present circumstances. p. 134. l. 31, (p. 177, l. 20 *et seq.*)

19. It is submitted that in the Court of King's Bench the reasons given by Letourneau J. justify the maintenance of the action. Tellier J. merely suggests that the customer could have given the Appellant instructions otherwise than through the mouth of Rogers and that the effect of the transactions was to say to the Appellant "do what Rogers tells you." p. 142 to 143, l. 30 p. 136, l. 2.

20. Bernier J. finds that Rogers was the person who paid all accounts, did the banking business, was the representative of the customer, kept the books, placed before the President of the customer the accounts or statements which had to be paid and that in allowing Rogers the possession of the cheques the customer put him in the position of going to buy merchandise and paying for it; that the merchandise was delivered to Rogers as any other merchandise; that each time Appellant was telephoned to it knew that Rogers was going to get merchandise. These suggestions we submit are contrary to the decision of the House of Lords in *R. E. Jones Limited vs. Waring & Gillow Limited* (1926) A.C. 670. Bernier J. also holds that if an employee signed a cheque as agent payable to himself, his doing so would imply notification that the agent had a restricted authority to sign and that the owner of the account would be bound only if the agent in signing were acting within the limits of his authority, and he cites Section 51 of the Bills of Exchange Act. p. 137, l. 38. p. 139, l. 44. (p. 182, l. 10). p. 140, l. 38.

21. Letourneau J. finds negligence on the part of the Appellant but puts his judgment squarely on ratification. It is submitted however, that one cannot ratify what one does not know. He says that he would have agreed with the Respondent if the litigation had reference to the defalcations of the first three months; that the Appellant should have acted within the resolution of the 8th of July, 1912; that it paid no attention whatever to that resolution in giving Rogers drafts to his own order; that the only apparent or ostensible authority that Rogers had was to get drafts in favour of the creditors of the customer; that the Appellant went beyond this apparent or ostensible authority; that the Appellant failed in its duty to its customer, had neither tacit or formal authorisation to act as it did, nor had the customer given any reason to believe that Rogers had the powers he asserted; that the customer was entitled to rely strictly on its instructions to the Appellant; that the p. 142 to p. 143, l. 30. p. 143, ll. 30, 40; p. 144, l. 20.

Appellant could not excuse itself because of good faith (Civil Code of Lower Canada, Article 1730) and must establish authority or find it in the law.

22. Letourneau J. further says that, in respect of the first offences, he can find nothing which would reasonably lead the
p. 142, ll. 22, 43. Appellant to believe that Rogers, being authorised to acquire drafts payable to third parties, should suddenly be allowed to become the beneficiary, and that, there being nothing within the limits of the specific or tacit authority, it was upon the Appellant to satisfy the Court that the customer had given it reasonable ground to believe that Rogers had become suddenly authorised to put the funds of the
p. 143, l. 32. customer within his own control. He then states that the audit of the books took place every three months; that the Appellant was justified in assuming, for example, at the end of 1920, the audit not having revealed anything indicating that it had made a mistake in placing its confidence in Rogers, that Rogers' mandate extended to procuring drafts to his own order; that the Appellant could not assume that there had been an erroneous audit, for that was because of the additional frauds of Rogers in manipulating the books, and in respect of that the Appellant had no responsibility; that the irregularities only having been discovered in January 1922, the Appellant was reasonably entitled to believe that the moneys which Rogers had fraudulently received after the 23rd of May 1921 were merely repetitions of the previous acts acquiesced in by the customer. It is submitted, however, that the Appellant cannot rely upon audits to detect frauds which without its own negligent acts and omissions could not have been perpetrated.

23. Cannon J. bases his judgment on the statement that the
p. 146, l. 25. whole matter can be summarised in the answer to the question, "Did "the customer give the Appellant reason to believe that Rogers was "authorised to fill in on behalf of the customer, requisition forms "indicating the names of the payees of the drafts?" He answers this question in the affirmative and finds that the Appellant, under the circumstances, was entitled to consider the requisition form and the cheque as forming one single document. It is submitted that so long as Rogers was acting on behalf of the customer it was bound, but when he asked for the proceeds of the cheques for himself he ceased to be acting on behalf of the customer and was acting for himself as a principal.

24. It is not suggested by the Appellant that either the customer or the Auditors ever had suspicion or grounds for suspicion. An Auditor is not bound to approach his work with suspicion: "he

"is a watch dog but not a blood hound". Provided he took reasonable care he was justified in believing a tried servant in whom the customer had placed confidence and in assuming that he was honest. If he had found anything to incite suspicion he was bound to probe it to the bottom, otherwise to be only reasonably cautious. (p. 147, l. 30).

25. In the Supreme Court of Canada, Duff J. spoke for the majority. He found that the "doctrine of holding out" had no application; that the Appellant was not acting under any belief of the existence of any general authority and was not misled by such belief; that the officials of the Foreign Exchange Department did not concern themselves about either the identity or authority of the person who attached the customer's name to the requisitions; that the teller who handed the drafts to Rogers did not direct her attention to the matter of his authority, the possession of the cheque was sufficient credential. p. 217-222. p. 219, ll. 10 ff. p. 221, l. 31.

26. Duff J. also finds that the Appellant knew that Rogers was invested with no general authority to execute documents of any description in the name of the customer, except as one of two signatories and that he, in fact, had no general authority to direct the application of the proceeds of the cheques "actual authority, "therefore, Rogers had none, to direct the Bank to charge any of the "moneys in dispute against their customer's account, nor had he "actual general authority to do any class of acts within which such "a direction would fall"; and that on the evidence it was not open to suppose that in acting on the latest of Rogers' directions the Bank officials were influenced by any considerations in addition to those which influenced them at the inception of the frauds. "Neither the "terms of the Resolution nor Rogers' position, nor the course of "business was adverted to". "What I have just said seems to be "also a complete answer to the contention that the Bank was misled "by the negligence of the Appellants" namely, the present Respondent. p. 217. p. 218, l. 33. p. 219, l. 2. p. 219, l. 5. p. 221, l. 46. p. 222, l. 2.

27. Rinfret J. dissenting, puts his dissenting judgment on the absence of negligence on the part of the Appellant. He finds that both the trial judge and the Court of King's Bench unanimously found that the Bank acted without negligence. The Respondent submits that there is no such finding either in the Superior Court or in the Court of King's Bench, but, on the contrary, the first Court has inferred negligence on the part of the Appellant at the inception of the transactions and Letourneau J. in the Court of King's Bench clearly indicates his view that for the first several months the Appellant was negligent. Martineau J., who heard the p. 223. p. 225, l. 37. p. 52, ll. 18, 36.

original action by the customer against the Respondent finds negligence on the part of the Appellant.

p. 226, l. 29. **28.** Rinfret J. finds that the resolution of the 8th of July, 1912, had no application to the case. We respectfully submit that it has every application. He then finds that the cheques were
p. 226, l. 39. regular on their face and properly chargeable against the account, but that the drafts were not charged to the customer, did not represent funds belonging to the customer, but were orders for payment by the Appellant out of its own funds; that the Appellant dealt with these drafts as a merchant with his goods and sold the drafts which the customer purchased, issued and delivered to it, in
p. 227, l. 1. consideration of the respective cheques; that Appellant stood in the same position as if the cheques had been drawn upon some other
p. 227, l. 20. Bank and that Appellant should not be held responsible for the misappropriation by Rogers of the drafts sold to the customer. It is submitted that this reasoning is highly erroneous. The drafts were not sold to the customer, they were sold to Rogers, acting as a principal and if they were paid for out of the Appellant's funds it reimbursed itself out of the customer's account. If we adopt the reasoning of Rinfret J. we find that Appellant, having sold some merchandise to Rogers, instead of asking him to pay for it, appropriated the customer's funds for this purpose; a highly improper thing to have done.

We submit the principle adopted in *Lloyd's Bank Limited vs.*
(p. 186, l. 49). *Chartered Bank of India* (1929) 1 K.B.40 should be applied to this case and that for the following reasons your Lordships should humbly advise His Majesty that the appeal should be dismissed with costs:—

REASONS.

1. Because the Resolution of the 8th July, 1912, clearly defines the authority of Rogers and such authority was ignored by the Appellant.
2. Because the customer did not hold out to the Appellant that Rogers had authority to use the customer's money for his own benefit.
3. Because the Appellant was not a holder in due course of the cheques, but was a holder of the customer's funds represented thereby and could only deal with them within the actual or ostensible authority granted to Rogers.

4. Because Rogers did not purport to act as an agent or representative of the customer but as a principal acting in his own behalf and the Appellant had no legal right to use customer's funds to pay the purchase price of the drafts sold to Rogers.

5. Because the customer did not know, nor could it reasonably be held to have known, of the frauds and consequently did not and could not ratify the Appellant's acts.

10 6. Because the Appellant did not rely upon any apparent or ostensible authority vested in Rogers.

7. Because the Appellant negligently and unlawfully converted the customer's funds.

8. For all the reasons in the Judgment of Letourneau J. in the Court of King's Bench (except that a regular audit should have detected the frauds and that the Appellant was justified in assuming that there would be such an audit at least once a year) and of the majority of the Supreme Court Judges.

20 9. Because Respondent stands in the rights of the customer and is therefore entitled to recover the customer's funds so unlawfully and negligently converted by Appellant.

J. A. MANN.

FRANK GAHAN.

In the Privy Council.

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— AND —

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CASE FOR RESPONDENT.

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