BANK OF MONTREAL (PLAINTIFF).....APPELLANT;

AND

O. NORMANDIN (DEFENDANT).....RESPONDENT.

1925

*May 27.
*June 18.

ON APPEAL FROM THE COURT OF KING'S BENCH, APPEAL SIDE, PROVINCE OF QUEBEC

Promissory note—Bank and banking—Composition between creditor and debtor—Note endorsed by third party to guarantee payments—Transfer by debtor to creditor for general collateral security—Knowledge of creditor—Holder in due course.

H. being indebted to a bank for $74,327.49 proposed to T., representing the bank, to settle the indebtedness by paying one half of the debt by monthly payments of $1,000 each and to give security for the other half. The last ten monthly payments were to be guaranteed to the bank's satisfaction. This proposal was accepted by the bank and a formal deed of composition was entered into. With the view of fulfilling his obligation, H. obtained the respondent's endorsements to five notes of $500 drawn in favour of the bank and payable on certain dates coinciding with five of the last ten monthly payments, but he was unable to obtain security for the balance of the $10,000. When H. had made only three of the monthly payments, T., acting for the bank apparently not considering H. to be in default, demanded and obtained from H. the transfer of the respondent's notes with a letter hypothecating the notes "as a general and continuing collateral

*PRESENT:—Anglin C.J.C. and Duff, Mignault, Newcombe and Rinfret JJ.

1925

BANK OF MONTREAL v. NORMANDIN.

security for the due payment of all advances made or to be made to" H by the bank. T., at the time of the transfer, knew that the purpose of the respondent's endorsements was to secure in part the last ten payments under the deed of composition and also knew that H. had failed to obtain security for the balance of the last ten monthly payments.

Held that, as T. knew that H. had no right to hypothecate generally the respondent's notes and to convert what was a specific security into a general security, which was a breach of faith towards the respondent, the bank had no right of recovery as not having taken the notes in good faith and therefore not being a holder in due course.

APPEAL from the decision of the Court of King's Bench, appeal side, province of Quebec, reversing the judgment of the Superior Court and dismissing the appellant's action for $2,010.16, amount of four promissory notes endorsed by respondent.

The material facts of the case and the questions at issue are fully stated in the above head-note and in the judgment now reported.

Hague K.C. for the appellant.

Lafleur K.C. and *J. C. Lamothe K.C.* for the respondent.

The judgment of the court was delivered by

MIGNAULT J.—This is an appeal from a judgment of the Court of King's Bench reversing, Greenshields and Guerin JJ. *dissentientibus,* the judgment of the Superior Court, Archer J., which had maintained the appellant's action.

The facts which gave rise to the litigation may be briefly stated.

In February, 1921, the commercial firm Hoerner, Williamson & Co., furriers of Montreal, were heavily indebted to The Merchants Bank of Canada, so much so that the bank had decided to force them into liquidation unless they furnished additional security. For that purpose Mr. Thompson, who was in charge of the discount accounts of the bank, and who throughout acted for the bank, sent Mr. Hart, an authorized trustee under the Bankruptcy Act, to see them, and Mr. Hart, finding that they were hopelessly insolvent, and that a forced liquidation would not realize more than a few cents on the dollar, advised the bank not to put them into bankruptcy, but rather to make a composition with them. He then submitted to the bank, through Mr. Thompson, a proposition

on behalf of the firm in the form of a letter signed by the latter. This letter made an offer of composition on the basis of fifty cents on the dollar. The firm's indebtedness to the bank was then $74,327.49, and the proposal was that the firm would pay one-half of this sum by instalments of $1,000 monthly, with interest at five per cent, the last ten payments to be guaranteed to the bank's satisfaction. Instead of paying the balance, Hoerner and Williamson were to furnish the bank with life insurance policies for $25,000 each, running for twenty years, the premiums of which they obliged themselves to pay. They were also to hypothecate properties belonging to them in Montreal and Winnipeg, and they agreed that failure on their part to make these payments and to pay the insurance premiums would give the bank the right to demand immediate payment of their full indebtedness. The bank was to continue to discount the approved trade paper of the firm. After some negotiations, the bank accepted this proposition, which was put in the shape of a notarial agreement, dated the 23rd of February, 1921.

With the view of fulfilling their obligation to guarantee to the bank's satisfaction the last ten monthly payments of $1,000 each, Hoerner, Williamson & Company obtained the respondent's endorsement to five notes of $500 each, drawn in favour of the bank, and payable respectively on June 12, August 12, September 12, November 12, 1923, and January 12, 1924, the due date of which coincided with five of these last ten monthly payments. Notwithstanding their efforts, however, Hoerner, Williamson & Company were unable to obtain further endorsements, so that to the extent of $7,500 these last ten payments were never guaranteed. Of the fact that the respondent had endorsed these five notes to carry out the undertaking of Hoerner, Williamson & Company to guarantee to the bank's satisfaction the last ten monthly payments, as well as of the inability of the firm to obtain security for the balance of these payments, the bank was fully advised.

When the respondent endorsed these five notes, he stipulated with Hoerner, Williamson & Company that they would not use his endorsement or hand over the notes to the bank unless and until they had obtained security or endorsement from other parties for the balance of the last

1925

BANK OF MONTREAL v. NORMANDIN.

Mignault J.

ten monthly payments. The learned trial judge found that the bank had no knowledge of this condition.

Hoerner, Williamson & Company made only three of the monthly payments, and apparently they were not considered by the bank to be in default when, on June 15, 1921, after several demands, the bank obtained from the firm the transfer of the notes which the respondent had endorsed. These notes were transferred to the bank by a letter of hypothecation signed by the firm, which hypothecated the notes,

> as a general and continuing collateral security for the due payment of all advances made or to be made to us (the firm) by the said bank (and all legal expenses incurred by the said bank in relation to our account or advance), and to be realized by them in such manner as may seem to them advisable in the event of any default in the payment of said advance.

In May, 1922, Hoerner, Williamson & Company went into bankruptcy, being still heavily indebted to the bank. The appellant having acquired all the assets, subject to liabilities, of the Merchants Bank, brought action against the respondent claiming payment of four of these notes, which had then matured. At the hearing in this court, the appellant's counsel admitted that the appellant was not in a better position to demand payment of the notes than the Merchants Bank would have been, so that the right of action, if any, of the latter is the sole subject of the controversy.

The question to be determined, briefly stated, is therefore whether the Merchants Bank under these circumstances could claim payment from the respondent of the notes endorsed by him.

The evidence does not show that the bank was aware of the condition stipulated by the respondent that the notes endorsed by him would not be handed over to the bank until Hoerner, Williamson & Company had succeeded in having the balance of the last ten monthly payments fully guaranteed by other endorsers. On the other hand, it appears clear that in handing these notes to the bank on its demand, and more particularly in transferring them as a general and continuing collateral security for all advances made or to be made by the bank, Hoerner, Williamson & Company were guilty of a breach of faith towards the respondent. There is no doubt that Thompson knew

that the respondent had endorsed these notes in order to guarantee, *pro tanto,* the last ten payments. He so admits.

As above stated, the learned trial judge, finding that the bank had no notice of the condition stipulated by the respondent when he endorsed the notes, gave judgment in favour of the appellant. This judgment was set aside by the majority of the learned judges of the Court of King's Bench on the ground that Hoerner, Williamson & Company, in handing over the notes to the bank, had violated the promise they had made to the respondent, and had committed a breach of faith. They also held that the negotiation of the notes as a collateral security was a defective negotiation, *entachée d'un vice,* with the consequence that it was incumbent on the bank to show that it was a holder in due course, to wit, that it had taken these notes for value, in good faith, and in ignorance of the defect in Hoerner, Williamson & Company's title. The learned judges relied on sections 56, 58 and 74 of the Bills of Exchange Act.

The learned trial judge and, I think, the learned judges of the Court of King's Bench, were concerned chiefly with the question whether the bank had sufficient notice of the condition stipulated by the respondent that the notes endorsed by him would not be handed over to the bank unless and until Hoerner, Williamson & Company had completed the securing of the last ten payments.

It was for the respondent to prove this, and, as I read the evidence, there is nothing to show that Thompson was aware of this condition. He did know that Normandin had endorsed these notes as part of the security for the last ten payments, but, while both Hoerner and Williamson state that they informed Thompson (and he admits that he knew) that the endorsement was in partial fulfilment of their undertaking to secure the last ten payments, they do not pretend that they mentioned the special condition alleged by the respondent, and which they state they agreed to. So far, therefore, as this condition is concerned, and although the negotiation of the notes was a breach of this condition, the position of the bank has not been successfully assailed.

1925

BANK OF MONTREAL v. NORMANDIN.

Mignault J.

On the other hand, Thompson knew that the purpose of the respondent's endorsement was to secure, in part, the last ten payments to be made under the deed of composition, but he took the notes under a letter of hypothecation, hypothecating them as a general and continuing collateral security for the due payment of all advances made or to be made to Hoerner, Williamson & Company. This would entitle the bank, in case the latter made these last ten payments, to retain the notes for any other advances made by it. Thompson knew that Hoerner, Williamson and Company had no right to thus hypothecate these notes, and he knew that converting what was a specific security into a general security was a breach of faith towards the respondent. It is true that the deed of composition was made for the whole indebtedness of the bank and that the last ten payments were a part of this indebtedness. But, as I have said, the letter of hypothecation goes much further than this. As effected, the transfer of these notes to the bank was to Thompson's knowledge made without right by the debtors of the bank.

Under these circumstances and for this reason I think the judgment appealed from can be sustained. It is quite an elementary proposition that a person who takes notes must, to be a holder in due course, take them in good faith. As stated by Lord Herschell in *London Joint Stock Bank* v. *Simmons* (1),

> regard to the facts of which the taker of such instruments had notice is most material in considering whether he took in good faith. If there be anything which excites the suspicion that there is something wrong in the transaction, the taker of the instrument is not acting in good faith if he shuts his eyes to the facts presented to him and puts the suspicions aside without further enquiry.

Here it was not merely a question of suspicion but of knowledge that Hoerner, Williamson & Company had no right to convert this specific security into a general security. Under all these circumstances the bank was not a holder in good faith and in due course, and has no right of recovery.

No argument was addressed to us on the point whether the bank, being the payee of these notes, could be considered as a holder in due course, and it is not intended to express any opinion on the abstract question. It suffices

(1) [1892] A.C. 201 at p. 221.

to hold that the bank did not take the notes in good faith and this of course is conclusive against it whether it be regarded as a holder of the notes or as a creditor under a contract of suretyship.

The appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: *Meredith, Holden, Heward & Holden.*

Solicitors for the respondent: *Lamothe, Gadbois & Charbonneau.*