CANADIAN PACIFIC HOTELS LTD v. *BANK OF MONTREAL* [1988] 40 D.L.R. (4th) 385

Canadian Pacific Hotels Ltd. v. *Bank of Montreal*[1] examined the customer/banker relationship and duties arising thereunder. An analysis of this case and the relationship with which it deals serves to illustrate what Gleeson C.J. has recently described as:

> the sometimes competing aspects of justice; the need for certainty in the law, and the requirement that the law be adequately responsive to the dictates of fairness in a given situation.[2]

The facts may be briefly stated. An accounting officer of Canadian Pacific (the appellant) forged some twenty-three cheques between April 1976 and July 1977. He subsequently concealed these forgeries (which should have become apparent on receipt of daily bank statements) by manipulation of the appellant's bank reconciliation and the internal accounting records on which this was based. Forged cheques to the value of $219,644.92 were paid out by the Bank of Montreal (the respondent).

Canadian Pacific brought an action against the Bank for recovery of the money under the alternate grounds of conversion and money had and received. It also relied on s. 49(1) of the *Bills of Exchange Act* R.S.C. (1970) to the effect that as the signatures were forged, the respondent had no authority to pay the cheques and accordingly could not debit the appellant's account.[3] Montgomery J. at the first instance[4] and the Ontario Court of Appeal[5] accepted the respondent's defence that the appellant was "precluded" from sustaining this argument under the proviso of s. 49(1):

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[1] (1988) 40 D.L.R. (4th) 385.

[2] "Clarity or Fairness: Which is more important?" (Preface) *Sydney Law Review*, vol. 12, no. 2/3.

[3] This statutory provision codifies the common law. See *Paget's Law of Banking*, (9th edition), 1982, p. 380.

[4] 122 D.L.R. (3d) 519.

[5] 139 D.L.R. (3d) 575.

> . . . unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority.

The litigation considered the exact scope of the duty a customer owed its bank, breach of which would "preclude" that customer under s. 49(1). In the result, the Supreme Court upholding Canadian Pacific's appeal, differed from the lower courts in its assessment of the scope of that duty. In short, it held that the duties contended for by the respondent did not exist, therefore there could be no question of a breach and no basis upon which Canadian Pacific could be precluded from succeeding under s. 49(1).

The duty contended for by the respondent included two specific incidents—(i) a customer had a duty to examine its bank statements with reasonable care at least on a monthly basis and report any discrepancies to its bank within a reasonable time and (ii) a customer also had a duty to maintain a system of internal controls and supervision to prevent and/or minimize loss through forgery. The appellant countered with the argument that the duty a customer owes its bank is limited by well-settled authority to (i) a duty to take care in the drawing of cheques (the *Macmillan*[6] duty) and (ii) a duty to notify a bank promptly upon actual knowledge that a cheque has been forged (the *Greenwood*[7] duty). The appellant argued that to recognize either of the duties contended for by the respondent would be neither consonant with precedent nor the policy which originally recommended such narrowly drawn (and interpreted)[8] duties. In accepting this argument, the Canadian Supreme Court followed the orthodoxy that had prevailed in *Tai Hing Cottom Mill Ltd* v. *Lui Chong Hing Bank Ltd*[9] a Privy Council appeal from the Supreme Court of Hong Kong.[10]

This note considers the legal basis for the Supreme Court's rejection of the respondent's submissions. It then seeks to critically evaluate the "Greenwood" and "Macmillan" duties as endorsed in *Canadian Pacific*. It questions both the desirability of confining a customer's liability according to the limits denoted in those cases and the continuing validity of the policy assumptions underpinning those decisions. Finally it considers the approach an Australian court might take if confronted with similar arguments to those posited in the instant case.

The first point to note is that the case was argued in contract and not in tort.[11] No doubt counsel, in framing their case, were guided by dicta of the Privy Council in *Tai Hing*:[12]

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[6] *London Joint Stock Bank* v. *Macmillan* [1918] A.C. 777.

[7] *Greenwood* v. *Martins Bank Ltd.* [1933] A.C. 51.

[8] See below.

[9] [1985] 2 All E.R. 947.

[10] [1984] 1 Lloyd's Law Reports 555.

[11] (1988) 40 D.L.R. (4th) 432.

[12] [1985] 2 All E.R. 947 at 957.

> Their Lordships do not believe that there is anything to the advantage of the law's development in searching for a liability in tort where the parties are in a contractual relationship.

The Privy Council's advice is somewhat curious in light of the trend towards concurrent liability in tort and contract,[13] let alone the recent suggestion of Deane J.[14] that tort may be the true and proper basis for analysing relationships such as that which exists between a banker and customer.[15] The Privy Council's eschewing of any analysis in tort may have been based upon a perception of the highly anomolous result which would follow (given the rejection of a wider duty). As Hunter J.A. observed in *Tai Hing*:[16]

> Counsel was unable to suggest any other situation in modern jurisprudence where such a selective duty, or where a duty of care short of one to take such care as was reasonable in all the circumstances, had been imposed by law, and none has come to my mind.

The Privy Council's strong advice that argument should, in such cases, be confined to the realm of contract is perhaps even more curious when one observes that many of the cases in the "Greenwood" line of authority identify that particular duty as arising independently of any contractual relationship.[17]

Notwithstanding such objections, and reserving comment on the desirability of a general duty of care, the argument in contract raised the principles as stated in *Lister* v. *Romford Ice and Cold Storage Ltd*[18] and *Liverpool City Council* v. *Irwin*[19] in relation to implied terms in particular classes of contract. Le Dain J., delivering the leading judgment in Supreme Court, after reviewing[20] the views of Lord Cross and Lord Denning to the contrary, concluded that the basis for implying terms was one of necessity, so that, in the instant case, the Court had to consider whether the duties contended for by the Bank of Montreal were necessary (as opposed to reasonable) incidents of the banker/customer relationship. The same question arose for consideration in *Tai Hing*.

In that case, Cons J.A. identified[21] two possible views of necessity—one in the sense of "absolutely essential". The other in the sense of

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[13] See Jane Swanton, "The Convergence of Tort and Contract", (1989), 12 *Sydney Law Review* 40 at 46.

[14] *Hawkins* v. *Clayton* (1988) 164 C.L.R. 539 at 583-6.

[15] The solicitor/client relationship (with which *Hawkins* v. *Clayton* was concerned) was likened to that of banker/customer by Lord Devlin in *Hedley Byrne* v. *Heller* [1964] A.C. 465 at 530.

[16] [1984] 1 Lloyds Law Reports, 555 at 576.

[17] See Le Dain J. in *Canadian Pacific Hotels* (1988) 40 D.L.R. (4th) 385 at 410 ff.

[18] [1957] A.C. 555.

[19] [1977] A.C. 239.

[20] *Canadian Pacific Hotels* (1988) 40 D.L.R. (4th) 385 at 424 ff.

[21] [1984] 1 Lloyds Law Reports 555 at 560.

"practical necessity". His Honour justified his support for the latter interpretation by considering[22] the facts of the London City Council case and concluded that while it was not "absolutely essential" to have lifts, lights on the stair case and garbage chutes in a high rise apartment, it was, nevertheless, a practical necessity and certainly one which warranted the implication of terms into the tenancy agreement in that case.

Following this approach and applying Lord Salmon's[23] converse formulation of the necessity test—'would a transaction be futile, inefficacious and absurd without the inclusion of the implied terms sought?'—Cons J.A. concluded[24] on facts and arguments closely analogous to *Canadian Pacific*:

> For my part, I can think of little more futile than for the operator of an active bank account to throw his monthly statements in the waste paper basket without even bothering to look at them; little more inefficacious than to leave the operation of that account to a clerk whose work is never checked; and little more absurd than to expect the bank to insure the honesty of the customer's clerk when the customer deliberately puts into the clerk's hands the weapons with which he can plunder and rob the bank.

The current writer finds the cogency and commonsense of this conclusion highly persuasive (though it entails a rather more circuitous route to a destination more readily achieved by the simple imposition of a general duty of care).

The Privy Council in *Tai Hing* was not attracted by Cons J.A.'s reasoning, however, perhaps inclining to the "absolutely essential" interpretation of necessity. Le Dain J.[25] in *Canadian Pacific* cited with approval Lord Scarman's conclusion that Cons J.A. had stated the correct test but reached the wrong decision. In following this approach in the instant case, Le Dain J. was influenced by three factors militating against necessity: (i) "Banks in this country have seemed to get along without it (the broader duty) for a very long time";[26] (ii) it was open to the banks to conclude verification agreements with their customers;[27] (iii) any increased protection for the banks should be provided by the legislature.[28]

As to the first factor, Le Dain J.'s view was not shared by Montgomery J. at first instance[29] or Cons J.A. in *Tai Hing*[30] who doubted

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[22] *Ibid.*

[23] *Liverpool City Council* v. *Irwin* [1977] A.C. 239 at 261.

[24] [1984] 1 Lloyds Law Reports 555 at 560.

[25] [1988] 40 D.L.R. (4th) 385 at 426.

[26] *Ibid.*, at 431.

[27] *Ibid.*, 432.

[28] *Ibid.*

[29] 122 D.L.R. (3d) 528.

[30] [1984] 1 Lloyds Law Reports 555 at 563.

the usefulness of deciding modern-day cases in accordance with principles evolved seventy-five years ago in the context of a very different commercial milieu. It is worth recalling the observation of Lord Reid, uttered in a different context, that "the common law must be developed to meet changing economic conditions and habits of thought"[31] and the wise extra-judicial counsel of Mason C.J., that:

> Respect for received solutions to problems presented by recurring social phenomena must be balanced against a recognition of the inevitable movement and diversity of society.[32]

With regard to the verification "option" open to the banks, described by Tyree as "completely unsatisfactory",[33] at least three comments may be made. First, the general reluctance of the courts[34] to give effect to limitation or exclusion clauses will generate uncertainty (ironic in light of one of the traditional justifications for the narrowly drawn duties a customer owes its bank[35]) and is bound to promote litigation (especially in light of consumer protection legislation).[36] Secondly, the insertion of draconian terms in such verification agreements, if upheld, may cast more onerous responsibilities on customers than would be imposed by the two duties contended for in the instant case. The traditional protection afforded to a customer in this area of the law (as, for example, codified in s. 49 [1])[37] could be not only lost but in fact reversed. A customer acting reasonably, on the other hand, would not stand to lose any protection if the duties contended for by the respondent were implied or imposed. Thirdly, according to Hunter J.A. in *Tai Hing*,[38] who unfortunately does not elaborate, "the Canadian experience has shown this approach to be much less attractive in practice than it may have appeared in prospect".

As to the third factor impinging against implication by necessity, it is submitted that the possibility of recourse to the legislature simply does not address the issue of whether the terms sought to be implied were necessary incidents of the banker/customer relationship.

For completeness, it should be noted that, for similar reasons, Le Dain J. declined to imply the terms as deriving from "custom or usage"

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[31] *Myers* v. *Director of Public Prosecutions* [1965] A.C. 1001 at 1021-2.

[32] The Hon. Sir Anthony Mason and S. J. Gajeler, "The Contract", pp. 1-34 at 31 in P. D. Finn (ed.), *Essays on Contract* (1987).

[33] (1985) *Banking Law Bulletin*, vol. 1, no. 3, at 37.

[34] See *Tai Hing* [1985] 2 All E.R. 947 at 959 where Lord Scarman speaks of an "undoubtedly rigorous test".

[35] I.e. Certainty (see discussion below).

[36] E.g. *Trade Practices Act* (1974) C'wth—On this point, see R. Edwards, "The Rights of Banks to Contract Out of Common Law Liabilities Arising in the Banker-Customer Relationship", (1989), 63 A.L.J. 237 at 248/9.

[37] *Bills of Exchange Act* R.S.C. (1970). See also *Cheques and Payment Orders Act* (1986) C'wth. s. 31.

[38] [1984] 1 Lloyds Law Reports 555 at 579.

in the banking industry or as being necessary to lend "business efficacy" to the contractual relationship.[39]

To the criticisms levelled against Le Dain J.'s approach in the contractual analysis set out above, one may add the inherent deficiencies found in what have been earlier referred to as the "Macmillan" and "Greenwood" duties which *Canadian Pacific* endorsed as the *only* duties a customer must observe in dealings with its bank. Both these duties are very narrowly drawn.

The duty to draw one's cheques in a form "clear and free from ambiguity"[40] only treats negligence which is "in the transaction, that is in the mode of drawing the instrument".[41] The justification for restricting a customer's "actionable negligence" to "the transaction" is found in the judgment of Parke B. in *Bank of England* v. *Evans' Trustees*:[42]

> If such negligence could disentitle the Plaintiffs, to what extent is it to go? If a man should lose his cheque book or neglect to lock the desk in which it is kept, and a servant or stranger should take it up, it is impossible in our opinion to contend that a banker paying his forged cheque would be entitled to charge his customer with payment.

One may ask—"why it is impossible to so contend?"—especially where the loss of the cheque-book was a result of the carelessness of the drawer who then failed to advise the bank of his loss. Indeed, on the current law, even the grossest negligence on his part would not prevent liability falling exclusively on the bank. As Hunter J.A. put it in *Tai Hing*, "a customer's duty of care is limited to the drawing of the cheque. Beyond that he can be as careless as he likes".[43] Notwithstanding this undesirable lacuna, both the Privy Council in *Tai Hing* and the Supreme Court in *Canadian Pacific* confirmed that the "Macmillan" duty was confined to negligence "in the transaction".

As regards the so-called "Greenwood" duty to inform the bank upon knowledge of forgery, Le Dain J. in *Canadian Pacific* was insistent, notwithstanding the contrary view of the learned authors of *Paget*,[44] that this duty was limited to cases of actual as opposed to imputed knowledge.[45] The weakness of this approach (one not followed in the United States) was pinpointed by Harlan J. in *Leather Manufacturers' Bank* v. *Morgan*:[46]

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[39] [1988] 40 D.L.R. (4th) 385 at 430-1.

[40] *London Joint Stock Bank* v. *Macmillan* [1918] A.C. 777 at 819.

[41] See *Canadian Pacific* [1988] 40 D.L.R. (4th) 385 at 403.

[42] (1855) 5 H.L.C. 389.

[43] [1984] 1 Lloyds Law Reports 555 at 576.

[44] *Paget, op. cit.* 393.

[45] [1988] 40 D.L.R. (4th) 385 at 410.

[46] (1885) 117 U.S. 96 at 115-6.

> . . . principles governing these relations ought not to be so extended as to invite or encourage such negligence by depositors in the examination of their bank accounts.

It is difficult to detect the commonsense or redeeming virtue that may have informed a view which states "it is of no importance that the customer has so conducted his business as to render forgery by a clerk easy".[47] A law which operates so as to encourage or at least protect an employer keeping his head buried ostrich-like in the sand would seem ripe for revision.

At the heart of the narrow drawing and continued support for the "Macmillan" and "Greenwood" duties is the policy conviction that banks are best able to sustain the loss caused by the third party rogues. As Bray J. opined in *Kepitigalla Rubber Estate Ltd.* v. *National Bank of India*:[48]

> The truth is that the number of cases where bankers sustain losses of this kind are infinitesimal in comparison with the large business they do, and the profits of banking are sufficient to compensate them for this very small risk. To the individual customer, this loss would often be very serious; to the banker it is negligible.

The Privy Council in *Tai Hing* described this as a "convincing statement".[49]

The fundamental weakness in this justification is that it operates to afford "special protection to customers who neglect elementary precautions".[50] Further, it may be[51] that the Robin Hood-like assumptions underpinning this policy are somewhat incongruous, at least where large sophisticated commercial customers are concerned.

The attraction of implying a general reciprocal duty of care in tort[52] is that it would overcome one of the key stumbling blocks for implying the terms sought in the instant case—namely, that while such terms might be appropriate for sophisticated corporate clients, they were inappropriate for ordinary cutomers for whom the original "Kepitigalla" policy justification dictating a limited duty was still forceful. The scope of any duty of care in tort would be determined in accordance with what was reasonable in the circumstances of each case (including the size and capacity of the customer to detect fraud) and not according to any *a priori* notions of a sophisticated corporate customer (an approach rightly rejected in *Canadian Pacific*).[53]

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[47] *Columbia Gramophone Co.* v. *Union Bank of Canada* (1916) 38 O.L.R. 326 at 332.

[48] [1909] 2 K.B. 1010 at 1026.

[49] [1985] 2 All E.R. 947 at 956.

[50] *Tai Hing* [1984] 1 Lloyds Law Reports 555 at 579.

[51] *Ibid.*, Hunter J., "It is questionable whether all these factual assumptions were justified then or now".

[52] Pursuant to the approach outlined in *Anns* v. *Merton London Borough Council* [1978] A.C. 728.

[53] [1988] 40 D.L.R. (4th) 385 at 429.

The perceived weakness of this approach was articulated in the brief judgment of La Forest J.[54] in the case under consideration:

> The line between carelessness and negligence . . . can be extremely hard to draw, and there is a need for more precise boundaries in this area.

In response to this, one may note the ironic uncertainty which, it is suggested, would flow from resort to verification agreements, as observed above. Further, one American commentator,[55] while supporting the need for certainty in this area, does not see the imposition of a general duty of care on customer as inconsistent with this goal.[56] One argument against the efficacy of imposing a duty of care on a customer is that causation of any loss, in the event of a forgery and given the non-application of principles of contributory negligence in this field,[57] may generally be said to flow not from a customer's breach but rather the bank's failure to detect a forged signature.[58]

It remains to briefly consider whether the decisions of the Supreme Court of Canada in *Canadian Pacific* and the Privy Council in *Tai Hing* would be followed in Australia. Certainly neither of these decisions are binding, and both are "useful only to the degree of the persuasiveness of their reasoning."[59]

The leading Australian case in this area is *Commonwealth Trading Bank of Australia* v. *Sydney Wide Stores*[60] which confirmed the "Macmillan" duty in relation to the drawing of a cheque. In *Tai Hing*,[61] it was argued[62] that this decision represents not merely an application of *Macmillan* but an extension of the principle found in that case. The joint judgment rejected an earlier Privy Council decision[63] on the basis that:

> This view does not conform to modern notions of the duty of care and the standard of care expected of the reasonable man. It is now well settled that the reasonable man should in appropriate circumstances take account of the possibility that others will break the law and act accordingly.[64]

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[54] *Ibid.*, at 434.

[55] J. T. White, "The Scope of the Depositor's Duty to Prevent and Discover Alteration and Forgeries of His Checks", [1963] 16 Vanderbuilt Law Review 1201.

[56] *Ibid. passim.*

[57] *Wilton* v. *Commonwealth Trading Bank* [1973] 2 N.S.W.L.R. 644.

[58] See e.g. *Westpac Banking Corporation* v. *Metlej* (1987) Australian Torts Reports 80-102.

[59] *Cook* v. *Cook* (1986) 68 A.L.R. 353 at 362-3.

[60] *Commonwealth Trading Bank of Australia* v. *Sydney Wide Stores P/L* (1981) 35 A.L.R. 513.

[61] [1984] Lloyds Law Reports 555 at 579.

[62] Apart from view of Murphy J. (1981) 35 A.L.R. 513 at 521—"In terms of social policy, there is a real question whether it would be better to let the loss continue to fall on the banking industry."

[63] *Marshall* v. *Colonial Bank of Australasia* [1906] A.C. 559.

[64] (1981) 35 A.L.R. 513 at 519-20.

In so doing, their Honours clearly evinced a consciousness of changed and modern conditions in the context of banking. It is unfortunate, however, that they did not elaborate as to the meaning of "appropriate circumstances".

On a more general level, dicta in *Hawkins* v. *Clayton*[65] suggest that the High Court in a case such as *Canadian Pacific* would (a) not confine itself to a contractual analysis[66] and (b) even if it did so, would adopt a flexible approach as to the implication of terms.[67]

For completeness, it should be noted that *Tai Hing* has been briefly considered in the New South Wales Court of Appeal in the case of *Westpac Banking Corporation* v. *Metlej*[68] where, as in *Canadian Pacific*, a wider duty on the part of a bank's customer was contended for. While the Court found it unnecessary to decide the validity of this submission, it offered tentative support, Priestley J.A. acknowledging "some force in the approach contended for"[69] and posing the obvious, difficult questions which suggest themselves whenever the narrowly drawn "Macmillan" and "Greenwood" duties are discussed:

> It seems rather strange that two duties and two only could spring from the banker-customer relationship: why those two? What gave rise to them?[70]

The resolution of this conundrum lies, it is submitted, in the path traversed by the Hong Kong Court of Appeal in *Tai Hing* and rejected by the Canadian Supreme Court in *Canadian Pacific*. It is to be hoped that Australian courts prefer that path.

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[65] (1987-8) 164 C.L.R. 539.
[66] *Ibid.* 583-6.
[67] *Ibid.* 573.
[68] (1987) Australian Torts Reports 80-102.
[69] *Ibid.*
[70] *Ibid.*