Ontario Supreme Court
Metroland Printing, Publishing & Distribution Ltd. v. C.I.B.C.
Date: 2001-05-03

Metroland Printing, Publishing and Distribution Ltd., Plaintiff

and

The Canadian Imperial Bank of Commerce, The Bank of Nova Scotia and The Toronto-Dominion Bank, Defendants

Ontario Superior Court of Justice [Commercial List] Lederman J.

Heard: March 30, 2001

Judgment: May 3, 2001

Docket: 00-CL-4048

Reid Lester, for Plaintiff/Moving Party

William J. Burden, for Defendants/Respondents

Lederman J.:

Background

[1] The plaintiff, Metroland, moves for summary judgment against the defendants, Canadian Imperial Bank of Commerce (the "CIBC" or "drawee bank"), and against the defendants, Toronto-Dominion Bank (the "TD Bank") and the Bank of Nova Scotia ("the collecting banks"). The dispute involves a number of unauthorized cheques that were created by one of the plaintiff's employees, Sandra Latiff ("Latiff"). Latiff was the plaintiff's Corporate Accounts Payable Supervisor from 1989 until 1996. She was not an officer or director of the plaintiff and at no time had signing authority with respect to cheques drawn by the plaintiff. As a payroll clerk, Latiff would regularly enter data into the plaintiff's computer system for the purpose of meeting the plaintiff's payroll obligations. The computer would then generate cheque forms containing the relevant payee names and amounts. One of the plaintiff's accounting clerks, (i.e. not Latiff) would feed these cheque forms through a machine which would imprint an authorized facsimile signature on each cheque. Generally, only cheques over $10,000.00 required manual signatures.

[2] From 1991 to her dismissal for cause in 1996, Latiff effected a fraudulent scheme as follows. She entered incorrect data into the plaintiff's computer system, which caused the

computer system to draw cheques bearing legitimate signatures, albeit in respect of non-existent obligations. She then stole the fraudulent cheques and negotiated them.

[3] The majority of the cheques were negotiated in two ways. Latiff gave or sold a portion of the cheques to a retail store, Modern Linens, which then deposited these cheques to an account at the Bank of Nova Scotia. Latiff herself negotiated another portion of the cheques through her own account at the TD Bank. The remainder of the cheques were negotiated at the Royal Bank; however, these cheques do not form part of the current claim,

[4] Each bank placed their endorsements on the back of each cheque and submitted them through the cheque-clearing process for collection from the CIBC, who in turn debited the plaintiff's account. The plaintiff suffered losses in the amounts of $153,556.51 in respect of the Bank of Nova Scotia cheques, and $229,794.89 in respect of the TD cheques.

[5] The plaintiff discovered the existence of Latiff's fraudulent scheme in November 1996 and very shortly thereafter, the plaintiff learned of the existence of the fraudulent endorsements on the stolen cheques. The plaintiff provided to the defendant banks notice of both the loss and of the existence of the forged endorsements on the stolen cheques, on or about November 15, 1996 (to the TD Bank), December 17, 1996 (to the Bank of Nova Scotia), and December 18, 1996 (to the CIBC). The plaintiff supplied full particulars of the stolen cheques to all the banks by February 1997.

[6] After the fraud was discovered, Latiff was charged criminally, but the criminal case did not proceed as she subsequently committed suicide. The plaintiff has obtained a judgment against Latiff's estate for the full amount of the loss, but no recoveries have been made. An action is also pending against Modern Linens, but there has been no resolution of that proceeding so far.

The Plaintiff's case

[7] The plaintiff is claiming against both the drawee bank, i.e. its bank, the CIBC, and the collecting banks, i.e. the TD Bank and the Bank of Nova Scotia. It is helpful at the outset to focus on each of these claims separately.

The Drawee Bank (the CIBC)

[8] With respect to the CIBC, the plaintiff has two claims. The first claim is that the CIBC has debited the plaintiff's account without authorization and is thusliable to the plaintiff for these amounts. This claim is pursuant to subsection 49(1) of the *Bills of Exchange Act,* R.S.C. 1985, c.B-4 (the "*BEA*") which states that:

> (1) Where a bill bearing a forged or an unauthorized endorsement is paid in good faith and in the ordinary course of business by or on behalf of the drawee or acceptor, the person by whom or on whose behalf the payment is made has the right to recover the amount paid from the person to whom it was paid or from any endorser who has endorsed the bill subsequent to the forged or unauthorized endorsement if notice of the endorsement being a forged or an unauthorized endorsement is given to each such subsequent endorser within the time and in the manner mentioned in this section. (emphasis added)

[9] Neither under the common law, nor under the provisions of the *BEA* does a drawee bank have the right to debit a customer's account in respect of a cheque bearing a forged endorsement. Where a bank debits its customer's account for a cheque bearing a forged endorsement, the drawer is entitled to recover the face value of the debited cheques from the drawee bank, so long as the drawer gives notice to the drawee bank of any forged endorsement within one year after he/she has discovered the forgery. In the instant case, it is not disputed that the plaintiff provided timely notice to the banks.

[10] There are certain defences that a drawee bank may rely on. In its defence of the case at bar, the CIBC primarily relies on its Operation of Account Agreement, dated March 19, 1976 (the "Verification Agreement"). This agreement, signed by the plaintiff, required that the plaintiff notify the bank within thirty days of the receipt of each bank statement of any errors or irregularities. Unless notice was given to the bank within this time, the agreement stipulated that it would then be "finally and conclusively settled" that the bank statement was true and correct. However, the Verification Agreement explicitly did not apply to "forged or unauthorized endorsements".

[11] In order to rely on the Verification Agreement, the CIBC must demonstrate that this is not a case concerning *forged endorsements* but rather a case where the cheques themselves were forged. If the cheques were forged, then they would thus not be valid bills of exchange. If the cheques were not valid bills of exchange, then the Verification Agreement would provide

a complete defence to the action against the CIBC as no errors in the bank statements were brought to the attention of the CIBC within the requisite time period. The major support for this proposition is the Supreme Court of Canada decision in *Arrow Transfer Co. v. Royal Bank* (1972), 27 D.L.R. (3d) 81 (S.C.C).

[12] *Arrow Transfer* involved a claim against a drawee bank, Royal Bank, in respect of a number of forged cheques. The cheques were prepared by the plaintiff's chief accountant, who forged the signatures of the plaintiff's officers on the cheques. The plaintiff and the Royal Bank had a verification agreement very similar to the one in the case at bar. The agreement specified that it was the responsibility of the drawer to verify the accuracy of all bank statements and notify the bank of any errors or omissions within 30 days of the receipt of the statements. If no such notification was given, the bank would then be free from any claims against it in respect of the account. The verification agreement explicitly did not apply, as in this case, to "forged or unauthorized endorsements".

[13] Martland J., for the majority, held that the forged cheques paid by the Royal Bank were not payments made on forged endorsements, but rather that the cheques themselves were forged. As a result, he found at p. 84 that "the verification agreement provided Royal with a complete defence to the action." As the plaintiff had not provided timely notice to the bank as per the verification agreement, the plaintiff therefore had no action against the banks.

[14] As a result, if the cheques are found to be forged cheques and not simply forged endorsements, then as per *Arrow Transfer,* the verification agreement would bar any claim made by the plaintiff unless timely notice had been made.

[15] The plaintiff's second claim is that the CIBC is liable for the tort of conversion. This claim is essentially the same as between the plaintiff and the collecting banks, and is discussed below.

The Collecting Banks (the TD Bank and the Bank of Nova Scotia)

[16] With respect to both the CIBC and the collecting banks, the plaintiff alleges the tort of conversion. In Crawford and Falconbridge, *Banking and Bills of Exchange,* 8th Ed. (Toronto: Canada Law Book, 1986) volume 2, it is noted at p. 1386 that:

> …[A] bank that collects a sum of money under an instrument for a person not entitled to it is treated as having converted the instrument. It has been repeatedly held that a bank converts an instrument by dealing with it under the direction of one not authorized, either by collecting it, or *semble* (although this has not yet actually been decided) by paying it, and in either case, making the proceeds available to someone other than the person rightfully entitled to possession.

[17] The tort of conversion is a strict liability tort. As a result, it does not matter whether the banks were innocent dupes. Furthermore, the defendants cannot argue any possible negligence or contributory negligence on the part of the plaintiff.

[18] The fact that the cheques in this case were signed by facsimile or mechanical signatures also does not distinguish this case from cases where cheques were manually signed. In *Royal Bank v. Concrete Column Clamps (1961) Ltd.* (1976), 74 D.L.R. (3d) 26 (S.C.C.), Pigeon J., discussing whether a distinction should bedrawn between situations where cheques were mechanically signed and situations where cheques were manually signed, stated at p. 48:

> I cannot see any valid reason for making such a distinction. On the contrary, in an age when cheques are processed by computer, it is even more necessary to avoid facilitating fraudulent operations.

[19] There are, however, a number of possible defences to the tort of conversion that could be raised by the banks. First, the defendants have argued that the cheques in question were not valid bills of exchange. If the cheques were not valid bills of exchange, then no conversion would been made out, as banks cannot be liable for converting “worthless pieces” of paper. In *Arrow Transfer, supra,* Martland J. noted at p. 87 that “the claim for conversion has to be based upon the conversion of a valuable instrument of the appellant.”

[20] Secondly, even if the cheques were valid bills of exchange, the banks submit that they were made out to “fictitious payees”, and that they are thus payable to bearer and were properly negotiated and paid by the defendant banks.

Issues:

[21] As a result, there are essentially two issues:

[22] 1) Were the cheques in question valid bills of exchange? This issue relates both to the question of whether the CIBC's Verification Agreement applies, and as a possible defence to the tort of conversion.

[23] 2) Does the defence of the 'fictitious or non-existing payee' exonerate the defendant collecting banks from liability for conversion?

Issue #1: Were the cheques valid bills of exchange?

[24] Subsection 48(1) of the *BEA* states:

> Subject to this Act, where a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the **forged or unauthorized signature** is wholly inoperative, and no right to retain the bill or give a discharge therefor or to enforce payment thereof against any party thereto can be acquired through or under that signature, 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. (emphasis added)

[25] The defendants argue that where a wrongdoer forges a signature or places the signature on the face of a cheque without authorization, the cheque is not a valid bill of exchange. As a result, in respect of the allegation of conversion, the defendants argue that the three banks have no liability for converting worthless pieces of paper. In respect of the plaintiff's claim against the CIBC pursuant to section 49 of the *BEA,* the CIBC argues that it is completely protected by the terms of its Verification Agreement with the plaintiff.

[26] The defendants rely on three cases for this proposition: *No. 10 Management v. Royal Bank* (1976), 69 D.L.R. (3d) 99 (Man C.A.); *Arrow Transfer Co. v. Royal Bank, supra,* and *Soma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce* (1996), 140 D.L.R. (4th) 463 (S.C.C.).

[27] In *Number 10 Management,* the fraudulent individual forged his employer's signature onto a number of cheques. The Manitoba Court of Appeal held that where a fraudulent person forges his employer's signature to cheques drawn on one bank, pays them into his own account in another bank, and misappropriates the proceeds, the collecting bank is not liable to the employer for conversion, as the forged cheques are worthless.

[28] In *Arrow Transfer,* the office manager forged the signing officers' signatures on company cheques and subsequently negotiated these cheques. Martland J. at p. 87 held that these were not valuable instruments because the signatures of the authorized signers were forgeries.

[29] Both *Number 10 Management* and *Arrow Transfer* deal with situations where the cheques in question bore forged signatures and were accordingly not valid bills of exchange. Neither case is particularly helpful here, as the cheques in this case bore valid signatures.

[30] The defendants argue that the cheques were not valid bills of exchange as they were not authorized by the plaintiff. Latiff was only authorized to have cheques issued in respect of valid obligations. She did not have the authority to create cheques for payment of non-existent obligations. Thus, it might appear to logically follow that these cheques were not valid bills of exchange. However, this view runs counter to Iacobucci J.'s analysis in *Boma,* which the plaintiff submits is a complete answer to this question.

[31] In *Boma,* an employee of two companies defrauded her employer in a manner similar to the case at bar. The employee, Alm, was a bookkeeper, and had signing authority over the companies' bank accounts, but was neither an officer nor a director of either company. Further, it was understood that Alm was to sign cheques only when the two directors of the companies were unavailable, and only with respect to the companies' valid obligations. Over a period of five years, Alm created 155 cheques payable to a number of persons connected with the appellants. 146 of these cheques were signed by Alm; nine cheques were signed by the president of the company, Boris Mange. All of these cheques were deposited into Aim's account at the CIBC.

[32] In finding that the cheques in question were valid bills of exchange, Iacobucci J. stated at p. 479:

> I note in passing that in this case, we are not within the realm of *Number 10 Management, supra,* where the Manitoba Court of Appeal held that a cheque with a forged signature is not a bill of exchange. In this case, the cheques were signed by authorized signatories, albeit for non-existent obligations, and were bills of exchange.

[33] In *Boma* as in the case at bar, the cheques that were created by the wrongdoer were made out to non-existent obligations. Neither Alm in *Boma* nor Latiff in the instant case had

the authority to cause cheques to be drawn to meet these non-existent obligations. However, in both cases, the cheques were signed with an authorized signature. In my opinion, the case at bar cannot be distinguished from *Boma* in this regard. In the instant case, while the stolen cheques were generated pursuant to a fraudulent scheme, these cheques were not in and of themselves forgeries because the signatures placed on all such cheques on behalf of the plaintiff were legitimate and authorized. As a result, as in *Boma,* the cheques in this case were valid bills of exchange.

Issue #2: Does the defence of "fictitious or non-existing payee" apply?

[34] If the cheques in question are found to be valid bills of exchange, then the banks are *prima facie* liable for the tort of conversion, subject only to certain defences. As noted above, this tort is a strict liability tort—it is irrelevant whether the plaintiff was contributorily negligent. The primary defence relied on by the defendants is that of the *"fictitious or non-existing payee".* Pursuant to subsection 20(5) of the *BEA:*

> Where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer.

[35] If a cheque is payable to bearer, it can be processed by the collecting bank and drawee bank without liability to the drawer.

Fictitious or non-existing payee

[36] Latiff's usual practice was to enter into the plaintiff's computer systems the names of the plaintiff's truck drivers who supplied services to the plaintiff, but she would reverse the order of the first and last names. As she was defrauding the plaintiff, Latiff clearly never intended for the named parties to receive the cheques. Furthermore, at all times, the plaintiff intended to create cheques only in respect of existing obligations. It is also questionable whether these payees existed as a matter of fact, as the names were "made up" by Latiff. For these reasons, the defendants claim that the payees were non-existing and fictitious.

[37] The difficulty with advancing this defence is that it runs contrary to the majority's analysis in *Boma.* As noted above, in *Boma,* Alm created a number of fraudulent cheques to persons associated with her employer's business, including a contractor named Van Sang Lam. The majority of the illicit cheques were made out to a "J.R. Lam" or "J. Lam". This name

was not the name of her employer's contractor, but was intended to mimic the name of Alm's husband, John R. Alm.

[38] In considering whether the fictitious payee defence applied, Iacobucci J. began by surveying the relevant case law and authorities. The important threshold question in determining whether a payee is fictitious or non-existing is who was the drawer of the cheque. In *Boma,* Iacobucci J. noted at p. 484 that the key issue was "*whether the drawer intended the payees to receive payment,* which itself raise[d] the question of who the drawer [was]." Iacobucci J. then wrote that it was important to distinguish between the signatory and the drawer of the cheque. He found that in this case, the drawer was Alm's employer company, and that Alm was simply a signatory, not the drawer of the cheque. Iacobucci J. concluded at p. 485 that "it is the intention of the appellant companies, as the drawer, that must be determined."

[39] Iacobucci J. noted the four propositions with respect to determining whether a payee is fictitious or non-existing, put forward by Falconbridge in *Banking and Bills of exchange,* which have been applied by the Supreme Court. The final two propositions are of most relevance to the case at bar:

> In the case of a bill drawn by Adam Bede upon John Alden payable to Martin Chuzzlewit, the payee may or may not be fictitious or non-existing according to the circumstances:
>
> …
>
> 3) If Martin Chuzzlewit is the name of a real person known to Bede, but Bede names him as payee by way of pretence, not intending that he should receive payment, the payee is fictitious, but is not non-existing.
>
> 4) If Martin Chuzzlewit is the name of a real person intended by Bede to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that Bede has been induced to draw the bill by the fraud of some other person who has falsely represented to Bede that there is a transaction in respect of which Chuzzlewit is entitled to the sum mentioned in the bill.

[40] After summarizing two cases dealing with fictitious payees, *Concrete Column Clamps, supra,* and *Fok Cheong Shing Investments Ltd. v. Bank of Nova Scotia,* [1982] 2 S.C.R. 488

(S.C.C.), Iacobucci J. stated at pp. 485-6 that pursuant to Falconbridge and the Supreme Court decision in *Concrete Column Clamps:*

> …[W]here a drawer is fraudulently induced by another person into issuing a cheque for the benefit of a real person to whom no obligation is owed, the cheque is to be considered payable to the payee, and not to a fictitious person… In this case, as in *Concrete Column Clamps, supra,* the drawer was fraudulently induced by an employee into issuing cheques for the benefit of real persons to whom no obligation was owed. In this case, then, the cheques payable to actual persons associated with the appellants were not payable to fictitious persons, and could not be treated by the CIBC as payable to bearer.

[41] The question that remained, however, was whether this would apply despite the fact that many of the cheques in *Boma* were made out to J.R. or J. Lam, a person that was not known to either the employer or Alm. In this regard, Iacobucci J. wrote at p. 486:

> Many of the cheques, however, were made payable not to actual persons associated with the companies, but to “J. Lam” and “J.R. Lam”. The appellants had no dealings with any persons of such names. According to the criteria set out in Falconbridge, *supra,* such a person would be categorized as “non-existing”, and hence, fictitious. But in my view, it seems that [Alm’s employer] was reasonably mistaken in thinking that “J. Lam” or “J.R. Lam” was an individual associated with his companies, [He] knew that one of the subcontractors retained by the companies was a “Mr. Lam”. He did not recall Lam’s first name, which, incidentally, was Van Sang. However, when [Alm’s employer] approved the cheques to “J. Lam” and “J.R. Lam”, he honestly believed that the cheques were being made out for an existing obligation to a real person known to the companies.

[42] Iacobucci J. thus held that the scenario in *Boma* accorded with the fourth proposition as set out by Falconbridge. As a result, even though there was no such person as J.R. or J. Lam, the Supreme Court nonetheless held that the defence of fictitious or non-existing payee did not apply in the *Boma* case.

[43] Applying the reasoning in *Boma* to the case at bar, the court must first ask who is the drawer of the cheques in question: Latiff or Metroland? In this case, it is clear that Latiff was not an officer or director of Metroland. Furthermore, she did not even have signing authority over Metroland’s accounts. She was simply an employee authorized to use Metroland’s

computer system to create a number of cheques in respect of its payroll obligations. As a result, the true drawer of the cheques in question was the plaintiff, Metroland.

[44] The next question which must then be answered is what was the intention of the drawer of the cheques. Here, the plaintiff honestly expected that the cheques in question were being created in respect of valid obligations and being paid out to real individuals, i.e. the plaintiff's truck drivers. The fact that the names were created in reverse does not necessarily mean that these individuals were non-existing or fictitious. Rather, as the names on the cheques were essentially the same names as those of real drivers employed by the plaintiff, it follows that the plaintiff would have honestly believed that these cheques satisfied actual obligations. As a result, the defence of fictitious payee would not apply.

[45] It is true that in the case at bar, as in *Boma,* the cheques were made out to non-existent persons, and neither Latiff nor Alm ever intended that the payees indicated on the cheques receive the cheques. Nonetheless, the plaintiff Metro-land, the real drawer of the cheque, did believe that the cheques were being made out for existing obligations to real persons. As a result, following *Boma,* these payees are not fictitious, and subsection 20(5) of the *BEA* would not apply.

Conclusion

[46] I find that the cheques, fraudulently created and negotiated by Latiff, are valid bills of exchange. As a result, the plaintiff has a valid claim against the CIBC, the drawee bank, pursuant to section 49 of the *BEA.* This claim is not precluded by the Verification Agreement, as the Verification Agreement expressly does not operate in situations concerning *forged endorsements.*

[47] Furthermore, the plaintiff also has a valid claim against all three banks for the tort of conversion. This claim is not precluded by either the 'worthless paper' defence, as the cheques were valid bills of exchange. As well, this claim is not precluded by the 'fictitious or non-existing payee' defence.

Disposition

[48] The plaintiff is, therefore, entitled to summary judgment against the defendant CIBC for $383,351.40; against the defendant TD Bank for $229,794.89; and against the defendant

Bank of Nova Scotia for $153,556.51, subject to whatever the credits the defendants might be entitled to by virtue of the plaintiff's other recovery efforts.

[49] The plaintiff will have its costs of the action including this motion. If the parties cannot agree upon the amount, this issue may be addressed by way of written submissions.

Action allowed.