**Université de Montréal**

Cette thèse est intitulée:

# BA'S -THE PRACTICE AND LAW OF BANKERS' ACCEPTANCE

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*À Karen*

*Tu m'as toujours encouragé et supporté à travers mon cheminement.*

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## Résumé

Au cours d'une transaction portant sur une acceptation bancaire (ci-après «BA» tel que dénommée dans le jargon juridique) différents types de relations peuvent s'établir entre les parties impliquées, certaines plus directes que d'autres. Dans une transaction donnée, à part le client et la banque, on peut trouver une ou plusieurs banques participantes et un ou plusieurs investisseurs, qui deviennent détenteurs de BA. La situation peut devenir complexe et les relations légales risquent de devenir assez compliquées. Cependant, il est important d'identifier si la relation s'est établie à travers l'instrument de BA, si elle existe par le biais d'une relation contractuelle ordinaire ou encore, si elle existe par le fait de la loi. Une bonne analyse des circonstances entourant la transaction, des facteurs connexes à la transaction et des droits et obligations qui existent entre les parties, sera nécessaire pour déterminer laquelle de la loi provinciale ou fédérale s'appliquera, et dans quelle mesure.

Une fois accordée, la BA est gouvernée par la *Loi sur les lettres de change*. Toutes solutions apportées à un problème qui implique des BA, doivent, en principe, respecter la nature inhérente de la BA en tant qu'effet de commerce, gouverné par la loi fédérale. En matière de BA, c'est, soit la *Loi sur les lettres de change* soit la *Loi sur les lettres et billets de dépôt (Depository Bills and Note Act)* qui s'appliqueront à l'acte. Comme il existe des lois fédérales applicables à la BA, l'objet de notre étude est de déterminer si, et dans quelle circonstance la loi de la province, tel que le *Code civil du Québec*, trouvera application et éclaircira dans certains cas la disposition contenue dans

la *Loi sur les lettres de change*, notamment lorsque les dispositions de ladite loi sont silencieuses ou ambiguës.

La solution la plus simple serait d'appliquer la loi provinciale aux matières qui ne sont pas traitées dans la loi, étant donné que les lois provinciales apportent souvent un complément à la législation fédérale. Cependant, la *Loi sur les lettres de change* contient des dispositions spéciales, tel que l'article 9 qui stipule :

> 9. Les règles de la common law d'Angleterre, y compris en droit commercial, s'appliquent aux lettres, billets et chèques dans la mesure de leur compatibilité avec les dispositions expresses de la présente loi.

Cette disposition a crée une certaine confusion relativement à l'application du droit civil du Québec en matière de Lettres de change. En effet, il existe un doute quant à savoir si l'application de l'article 9 est une incorporation par référence qui exclue totalement l'application du droit civil. Cette question continue de se poser inexorablement dans la doctrine et la jurisprudence. Elle a en effet donné lieu à une série de théories quand au degré d'application de la common law en matière de lettres de change. Une revue de la jurisprudence dominante nous permet de conclure que les tribunaux ont accepté l'application du droit provinciale dans certaines questions impliquant les lettres de change.

La question essentielle traitée lors de notre analyse est la suivante: lorsqu'un litige prend naissance dans une transaction de BA, quelle est la règle qui devra s'appliquer? Quel sera le droit qui gouvernera les problèmes émergeant dans une BA, celui du *Code Civil du Québec* ou celui de la common law d'Angleterre?

Étant donné le nombre de cas qui sont portés devant les cours de justice en rapport avec des transactions de BA, comprendre quelle sera la loi applicable est d'une importance fondamentale. Pour répondre à cette question, nous commencerons par un examen de l'historique, du développement et de l'évolution de la BA. Afin de mieux comprendre la BA, nous débuterons par un bref survol des origines de cet instrument juridique. Dans le deuxième chapitre, nous analyserons la nature et le caractère légal de la BA. Cela constituera le cadre aux travers duquel nous pourrons identifier les règles et les principes qui s'appliquent aux différents aspects de la transaction de BA. Le chapitre trois fera l'objet d'un examen détaillé des mécanismes de l'opération de BA tout en étudiant de près les exigences imposées par la législation applicable.

Après avoir examiné l'aspect légal de la BA, nous procéderons au chapitre quatre, à l'étude de l'applicabilité de la loi provinciale relativement à certains aspects de la transaction de BA. A cet effet, nous examinerons les différentes approches de compréhension de la *Loi sur les lettres de change* et plus particulièrement la problématique rencontrée à l'article 9. Nous étudierons aussi l'application et l'interprétation de cette loi par les tribunaux du Québec au cours du siècle dernier. Les juges et les juristes se sont penchés sur les sens qu'a voulu donner le législateur lorsqu'il a stipulé dans l'article 9 « *Le règles de la* common law *d'Angleterre, y compris en droit commercial, s'appliquent aux lettres, billets et chèques dans la mesure de leur compatibilité avec les dispositions expresses de la présente loi* ». Cette section doit-elle être appliquée à la lettre, nous obligeant à appliquer la *common law* d'Angleterre à chaque problème qui peut se poser en relation avec les lettres et les billets? Le Parlement a-t-il l'intention que cette disposition s'applique également au Québec, dont le droit privé

est basé sur le système du Code Civil? Notre étude portera sur les différentes approches d'interprétation qui offrent une diversité de solutions au problème posé par l'article 9.

Finalement, compte tenu des nouveaux développements législatifs, au chapitre cinq, nous proposons une méthode en vue de déterminer la loi applicable aux différents aspects de la transaction de BA. Notre analyse nous a conduit à adopter la solution proposée par la majorité des juristes, à la différence que notre approche de l'article 9 est basée sur des raisons de politique. Nous avons donc adopté la stricte dichotomie (en tant qu'effet négociable d'une part, et d'une sorte de contrat et de propriété de l'autre) en prenant en compte les difficultés inhérentes à déterminer quand l'un finit et l'autre commence.

En conclusion, selon notre opinion, il existe deux solutions. Premièrement, il y a la possibilité que l'article 9 puisse être écarté. Dans ce cas, toutes les matières qui ne sont pas expressément évoquées dans la loi tomberont dans la compétence de la loi provinciale, comme c'est le cas dans d'autres types de législations fédérales. Dans ces situations, le droit civil du Québec joue un rôle supplétif dans les applications d'une loi fédérale au Québec.

Deuxièmement, modifier l'article 9 plutôt que d'en écarter son application offre une autre possibilité. Incorporer la large stricte dichotomie dans l'article 9 nous semble être une solution préférable. La disposition pourrait se lire comme suit: «*Les règles de la* common law *d'Angleterre incluant le droit commercial dans la mesure ou elles ne sont pas incompatibles avec les dispositions expresses de la Loi, s'appliquent aux lettres,*

*billets, et chèques au sens stricte. Pour plus de certitude, les lettres et les billets au sens strict, incluent la forme, la délivrance et l'émission des lettres, billets, et chèques.*»

Ce type de changement se révèlera être un pas important dans le but de clarifier la loi et déterminer l'équilibre à trouver entre l'application des lois fédérales et provinciales en matière de BA.

***Mots clés***

*Acceptation*
*Acceptation bancaire*
*Banque correspondante*
*Banque émettrice*
*Banque payante*
*Banques*
*Banques participantes*
*Billets*
*Billets de dépôt*
*Cautionnement*
*Cession*
*Code civil du Québec*
*Contrat d'acceptation bancaire*
*Contrat de crédit*
*Contrat de vente*
*Contrat participatif*
*Conventions*
*Délégation*
*Échéance*
*Effets de commerce*
*Escompte*
*Exportation*
*Importation*
*Lettres de change*
*Lettres de crédit*
*Loi d'Harmonisation No 1 du droit fédéral avec le droit civil*
*Loi d'interprétation*
*Loi sur la Banque du Canada*
*Loi sur les banques*
*Loi sur les lettres de change*
*Loi sur les lettres et billets de dépôt*
*Mandat*
*Novation*
*Obligation à taux renouvelé*
*Opération bancaire*
*Opérations*
*Prêt*
*Stipulation pour autrui*

## Résumé

When dealing with a BA transaction several types of relationships may develop, some more direct than others. In any given transaction, aside from the customer and bank, there may be one or more participating banks, investment dealers, or multiple investors, who become holders of the BA. The situation may be complex and the legal relationships may become quite intricate. However, it is important to identify whether the relationship is established through the BA instrument, or whether it exists by ordinary contractual relationship or by operation of law. Proper analysis of the surrounding circumstances, the connecting factors, and the obligations and the rights which exist between the parties, will be necessary in determining whether or not the contractual rules of the provinces, or federal law rules apply, and to what extent.

Granted, the BA instrument is clearly governed by the Bills of Exchange Act. Any solution introduced to a problem involving a BA must, in principle, respect the inherent nature of the BA as a negotiable instrument, governed by federal law. In the case of BAs, either the Bills of Exchange Act or the Depository Bills and Notes Act will apply to the instrument. Since there are applicable federal rules to BAs, the purpose of our study is to determine if, and under what circumstances, provincial law, such as the Civil Code of Quebec, would find application with respect to BAs and complement the provisions of the Bills of Exchange Act where the statute is silent or ambiguous.

The simple solution would be to apply provincial law to those matters not addressed in the Act, as provincial law typically compliments federal legislation. However, the Bills of Exchange Act contains a peculiar provision, namely section 9, which provides:

> 9. The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques.

This provision has created confusion as to the appropriate application of Quebec civil law to matters of bills of exchange. Indeed, there is doubt as to whether section 9 is in fact an incorporation by reference that effectively precludes the application of civil law. The problem continues to be a contentious issue in the doctrine and jurisprudence. The "inexorable character" of the problem created by the interpretation of this provision has given rise to a number of diverse theories regarding the extent of the applicability of common law to matters of bills of exchange.

As we can clearly conclude from a review of the jurisprudence, the courts, for the most part, have been conciliatory to the application of provincial law in issues involving bills of exchange. The majority of judges express a hesitance to jeopardize the integrity of the provincial law as complimentary law in order to accommodate the idea that Parliament's desire was to enact an extensive and far-reaching law of bills and notes. The position of most doctrinal writers is very much the same.

The essential question of our analysis is which rules will govern the issues, which emerge within BAs – the Civil Code of Quebec or the common law of England? From a Canadian perspective, understanding which law is applicable to BAs is of paramount importance, since courts are dealing with an increasing amount of banker's acceptance transactions.

To answer this question, we will begin with an examination of the origin and evolution of the banker's acceptance. In Chapter Two, we will also analyze the nature and legal character of the BA. This will establish the framework through which we can identify the rules and principles that apply to the various aspects of the BA transaction. In Chapter Three, we examine the mechanics of the BA operation step-by-step, paying close attention to the requirements imposed by legislation. We look at the laws applicable to the BA and describe the various agreements pertaining to the BA. Having examined the legal nature of the BA as being a negotiable instrument governed by federal law and a contract and moveable pursuant to the Civil Code of Quebec, we will proceed in Chapter

Four to consider the applicability of provincial law to aspects of the BA transaction. To this end, we examine different approaches to understanding the Bills of Exchange Act, particularly the problematic section 9, as well as the applicable law as understood in Quebec jurisprudence during the past century. Judges and jurists alike have attempted to understand what was meant when the legislator stated in section 9, "[t]he rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques."[1] Is this section to be interpreted literally, requiring us to apply English common law to every issue that might arise in connection with bills and notes? Does Parliament intend this provision to apply equally to Quebec, whose private law is based on the civil law system? Our study will look to interpretive approaches offering a variety of different solutions to the problem of section 9.

Finally, given new legislative developments, in Chapter Five, we offer a proposed method to determine the law applicable to various aspects of the BA transaction. Our analysis has lead us to adopt the result advocated by the majority of jurists, but with the recognition that our approach to section 9 is based on reasons of policy. We have adopted the strict/wide dichotomy, (as a negotiable instrument on the one hand, and as a specie of contract and property on the other hand) realizing the difficulties inherent in determining where one ends and the other begins.

Therefore, in our opinion there exist two solutions. Firstly, there is the possibility that section 9 could be repealed. In this case, all matters not expressly dealt with in the Act would fall to be governed by provincial law, as is the case with other federal legislation. In these situations, Quebec civil law takes on a suppletive role in applying a federal law in Quebec. Secondly, there is the possibility of modifying rather than repealing section 9. Incorporating the strict/wide dichotomy into section 9 itself seems to us to be a more preferable solution. The provision could read, "The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with

[1] R.S. 1985, c. C-5, s. 9.

the express provisions of this Act, apply to bills, notes and cheques in a strict sense. For greater certainty, bills and notes in a strict sense include the form, issue, negotiation and discharge of bills, notes and cheques." Alternatively, a Law Reform Commission could draft an Act that defines section 9 according to the strict /wide dichotomy.

These types of changes would prove to be an important step to clarifying the law, and strike the appropriate balance between the application of federal and provincial law to bankers' acceptances.

***Keywords***

*Acceptance*
*Agreements*
*Assignment*
*BA*
*BA Agreement*
*BA Drafts*
*Banker's Acceptance*
*Bank Act*
*Bank of Canada Act*
*Banks*
*Bank Transaction*
*Bills*
*Bills of Exchange*
*Bills of Exchange Act*
*Civil Code of Quebec*
*Contract of sale*
*Correspondent Bank*
*Credit Agreement*
*Delegation*
*Depository Bills*
*Depository Bills & Notes Act*
*Discount*
*Exportation*
*Guarantee*
*Federal Law – Civil Law*
*Harmornization Act, No 1*
*Importation*
*Interpretation Act*
*Issuing Bank*
*Letters of credit*
*Loan*
*Mandate*
*Maturity*
*Notes*
*Novation*
*Participation Agreement*
*Participation Banks*
*Paying Bank*
*Roly Poly*
*Stipulation for another*
*Transactions*

# Introduction

In the international business community, letters of credit are the common method of paying suppliers overseas. The problem, however, is that payment is often made on terms that require it immediately, before the delivery of merchandise. To help in these structures, banks introduced the bankers' acceptance (BA), a bill that expedites payment. BAs[2] have progressively become a more attractive means of financing for corporate borrowers. BAs are bills of exchange, but what sets BAs apart from other bills of exchange is that they are drawn on a bank. A BA is a bill of exchange drawn on and accepted by a bank, whereby the drawer orders the bank to pay a named person or the payee, a specified sum of money on a specified date.[3] The bank thus acts as drawee and acceptor of the draft.[4] "The principal use of the bankers' acceptance is to permit the drawer to use the credit of the bank as a means of obtaining money."[5] Because the bank's liability is engaged, money can be raised at a more favorable rate.[6]

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[2] "Bankers' acceptances", "acceptances", "bills" and "BA" will be used interchangeably throughout the text.

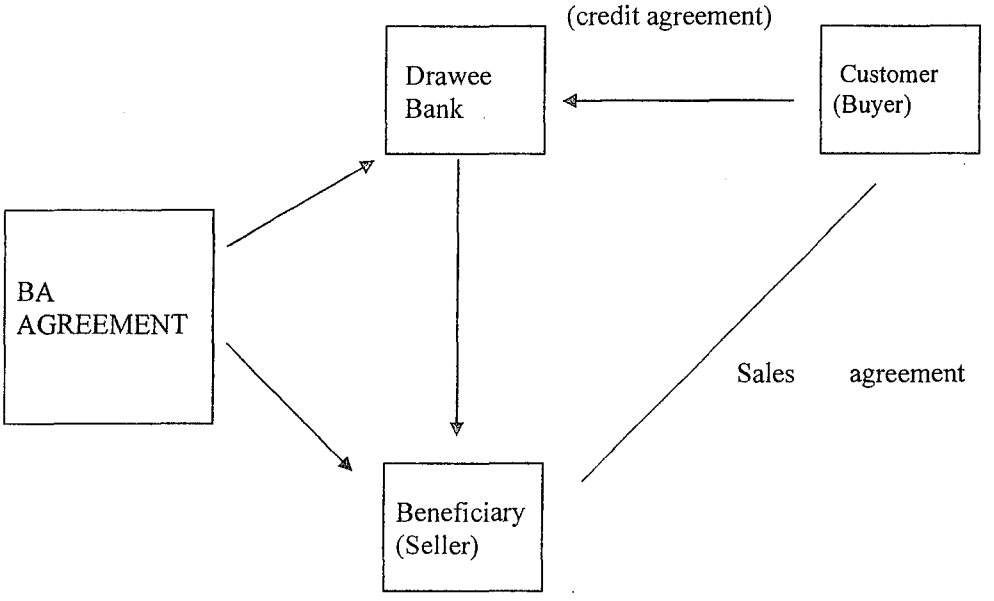
[3] See Margaret H. OGILVIE, *Canadian Banking Law*, 2nd ed., Scarborough, Carswell, 1998, p. 426; Edmund M.A. KWAW, "Debt Financing", (1998) 17 *Nat'l Banking L. Rev.* p. 17, 21

[4] A BA, and bill of exchange generally, is referred to as a draft prior to acceptance, and a bill after acceptance. See Operation of a Bankers' Acceptance Transaction, *infra*.

[5] E.M.A. KWAW, *loc. cit.*, note 3, p. 22. See also, Reade H. RYAN, Jr., "Bankers' Acceptances" in Reade H. RYAN, Jr. (ed.), *Letters of Credit and Bankers' Acceptances*, New York, Practicing Law Institute, 1988, p. 221.

[6] See Jacob ZIEGEL, Benjamin GEVA and Ronald C.C. CUMING, *Commercial and Consumer Transactions: Cases, Text and Materials*, 3rd ed., vol. 2, Toronto, Emond Montgomery, 1995, p. 24.

## PROCEDURE TO A BA AGREEMENT



Negotiable instruments have been a means of circulation since the earliest of times. The first transaction ever recorded is found in the Bible, where in Genesis (Chapter 23) it says that Abraham purchased land from Ephron with a negotiable instrument having a value of four hundred shekels. One of the earliest usages of bankers' acceptances was in Babylon, approximately 1600 B.C.[7] There; traders would defer payment by making a promise to pay at a later date. The Babylonian Talmud makes references to bills of exchange at the time of the Sura school (circa 247 C.E.). Instruments that more closely resemble the modern BA were in use in the Middle Ages in Italy and Spain, but bankers' acceptances in their modern form first appeared some three hundred years ago, in the financial circles of London, England. Merchants sought to add the name of other reputable merchants to their trade bills. Some of these merchants evolved into full-fledged merchant banks, while others become investment banks.[8]

Having gained increased acceptance through the 1960s, BAs are relatively new to Canada. They serve a different purpose here than their American counterparts. Originally, bankers' acceptances in the United States and England were used to finance international trade either as an independent source of financing or in conjunction with letters of credit transactions. On the other hand, BAs introduced in Canada during the early 1960s were being traded as commercial paper in an attempt to develop an active domestic money market.[9] Since the early 1980s, BAs have taken on a very important role in Canada's

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[7] Philip G. BEVANS, "Canadian Bankers' Acceptances" in Richard MINER (ed.), *Current Issues in Canadian Business Law*, Toronto, Carswell, 1986, p. 507 at page 534, citing S. SARPKAYA, *op. cit.*, note 17, p. 60. See also, Désiré GIROUARD, *Essai sur les lettres de change et les billets promissoires*, Montreal, John Lovell, 1860, p. 7 *ff.*, for a discussion of the various opinions on the origins of bills of exchange.

[8] Brian J. TERRY, "Banker's Acceptances", in Brian J. TERRY, (ed.), *The International Handbook of Corporate Finance*, 3d ed., New York, AMACOM, 2000, p. 701 at page 704.

[9] See Daryl MERRETT, "The Evolution of Bankers' Acceptances in Canada", (1981) *Bank of Canada Review*, 3, 3

money market.[10] Indeed, "[t]he market for BAs in Canada has grown dramatically over the last 30 years and continues to account for the bulk of the growth in the Canadian short-term paper market."[11] Where BAs are used to finance business activity, they are more popular as a method of generating short-term finance than as a means of financing a particular commodity transaction.

Numerous scenarios exist. The following is an example in which BA financing will apply:

> Montreal-based "BASE International" recently exported a large shipment of sweaters to France. Usually, the company is paid cash on delivery (C.O.D.). Exceptionally, the company has agreed to grant the French customer 90 days to make payment. This three-month period is confirmed by a letter of credit issued by the French buyer's bank located in New York City. The bank guarantee provides assurance that the payment will be effected, though payment is only expected in three months time.
>
> Four weeks prior to the maturity of the term, a long-time, valued customer in Spain orders a larger quantity of the same sweaters for delivery in 45 days. BASE International does not have sufficient resources in stock to complete the order, nor does it have sufficient funds to purchase those resources because its cash flow is tied-up in the French deal. If BASE International cannot fill the order, its Spanish customer will go elsewhere, and the company risks losing a valued customer.
>
> The bank has rejected a request for a line of credit and the BASE International's fabric supplier will not consent to terms for payment. Moreover, the workers are demanding double time for the overtime they will have to work to complete the order in time for shipment.

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[10] See Ely RAZIN, «Two Are Better Than One: Bankers' Acceptance Participation Financing in Canada», (1992) 7 *B.F.L.R.* p. 217, 218.
[11] Lisa BOULTON, "Bankers' Acceptances Smooth Canadian – US Cross-Border Credit", (1996) 15 *I.F.L.R* p. 32, 34.

BA financing appears to be an attractive option, for this case. Why would a bank agree to BA financing if they've already refused a line of credit? In truth, the BA is a very different type of instrument. The key aspect to note is that the BA is not actually a loan. The customer obtains the bank's commitment ("acceptance") to pay the holder of the bill at a future date. This commitment, i.e., the bankers' acceptance, is then sold in the market, at a discount, and the funds obtained are used to finance business activities. This arrangement plays a particularly important role in international trade,[12] and indeed, the largest proportion of BAs is created for international trade transactions.

Transactions financed by BAs will be expected to generate funds sufficient to enable the customer to reimburse the bank, who is the party obligated to pay the holder of the BA at maturity. For this reason, this transaction is said to be "self-liquidating."[13] The advantage for banks is that they can help provide funds for their customer, and earn fees – at the outset, rather than over the loan period - without incurring borrowing costs. As one writer pointed out, "[t]he total borrowing cost involved in using BAs is generally lower than borrowing at prime plus a margin. Even though banks can maintain the same spread on a BA borrowing as with a prime-based loan, their cost of funds when using BAs is generally lower."[14] Moreover, in contrast with regular loans, banks are less concerned with the liabilities generated by its engagement on the bankers' acceptance, because such liability need not have a matching deposit liability. Consequently, even

[12] See Peter NEWMAN, Murray MILGATE and John EATWELL (eds.) *The New Palgrave Dictionary of Money and Finance*, Vol. 1, New York, MacMillan Press, 1992, p. 207.
[13] E.M.A. KWAW, *loc. cit.*, note 3, p. 21.
[14] L. BOULTON, *loc. cit.*, note 11, p. 34.

when the bank purchases the acceptance itself, banks will enter the transaction at a lower yield rate.[15]

BA financing doesn't only benefit the bank; it can be an attractive option for both the customer and investor as well.[16] For the customer, BAs are an alternative to commercial paper and bank loans, because the discount rate is usually lower than (prime) interest rates; therefore, bankers' acceptances are less costly than borrowing directly from a bank.[17] Bankers' acceptances can help the customer realize significant savings over prime bank loans as an alternative source of short-term financing.[18]

A favourable discount rate will exist because the primary obligation to pay the BA at maturity rests with the bank. Therefore, it is the bank's – not the borrower's – creditworthiness that is factored into the discount rate.[19] A further advantage to the customer is that, "the use of BAs gives a borrower greater control in management of its debt because BAs allow the borrower to fix its cost of funds over the term chosen."[20]

BAs are considered to be more secure investments with fewer risks and thus an attractive place for investors to place short-term surplus funds.[21] They are considered safer because of the creditworthiness of the bank. Since acceptances are "two-name"

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[15] M.H. OGILVIE, *op. cit.*, note 3, p. 428. "One former advantage which the BA option provided to banks was that they were not required to include the full amount of BAs accepted by them in determining their liabilities for capital adequacy purposes. That has now been changed, and in calculating capital adequacy standards, Canadian banks must treat BAs which they have accepted as a direct loan." See L. BOULTON, *loc. cit.*, note 11, p. 34

[16] See B.J. TERRY, *op. cit.*, note 8, p. 720

[17] R. H. RYAN, Jr., *op. cit.*, note , p. 221; M.H. OGILVIE, *op. cit.*, note 3, p. 428.

[18] Suleyman SARPKAYA, *The Money Market in Canada: How it Works - the Arrangements, Practices and Instruments*, 4th ed., Don Mills, Ont., CCH Canadian, 1989, p. 63.

[19] L. BOULTON, *loc. cit.*, note 11, p. 34.

[20] *Id.*
"Acceptance financing is most cost effective if the borrower can specify the duration of his funding needs, and thus the life of the acceptance. If the collateral underlying an acceptance transaction were sold early, the borrower would be required to prepay the acceptance which would raise the effective borrowing cost." B.J. TERRY, *op. cit.*, note 8, p. 720.

[21] S. SARPKAYA, *op. cit.*, note 18, p. 63.

paper, both the bank and customer are liable to pay the holder of the BA at maturity. Moreover, each subsequent endorser is also liable on the bill, thus adding additional protection and security to the holder. As a result, "investors are willing to accept a slightly lower return on acceptances than they are on 'one-name' paper such as commercial paper and certificates of deposit."[22]

Some risk is nevertheless involved in creating and using bankers' acceptances for trade finance. Bankers concerned about earnings and capital identify several categories of risk associated with bankers' acceptances.[23] One form of risk is "liquidity risk" which relates to a bank's ability to meet its obligations as they become due without having to incur sizeable costs to make funds available in order to do so. Many factors will affect this risk, including the size of the accepting bank and its rating, although most bankers' acceptances carry a short-term to maturity, which helps alleviate some of the risk in this respect.

The credit risk may be lower in the BA "two-name" paper, but there is still concern about transaction and compliance risk involved with BA financing. Transaction risk is the risk that arises from "fraud, error and the inability to deliver products or services."[24] Banks seek to ensure that its clients understand the requirements of formal and transactional validity of BAs to facilitate the timely processing of the instrument. Compliance risk concerns compliance with statutory rules and regulations, and internal policies and procedures.[25] Standard forms and practice mitigate some of the risk in this

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[22] Robert K. LAROCHE, "Bankers' Acceptances", (1993) 79 *Federal Reserve Bank of Richmond Economic Quarterly* p. 75, 84.
[23] See U.S. Department of the Treasury, Comptroller of the Currency Administrator of National Banks, *Bankers' Acceptances: Comptroller's Handbook*, September 1999, online: <http://www.occ.treas.gov/handbook/baccept.pdf>
[24] *Id.*, p. 14
[25] *Id.*, p. 15

regard; the concern is greater in the U.S., however, where there is the possibility that banks will create ineligible bankers' acceptances but treat them as though they are eligible for discount by the Federal Reserve.[26]

Reputation risk, the risk of a negative impact on establishing future relationships due to pessimistic public opinion, is also at the forefront in bankers' acceptances transactions since all that the bank provides with a BA is its good name. The creditworthiness and trustworthiness of a bank will be called into question if it extends its good name to customers that are unable to fulfill their obligations.[27] Therefore, banks will only undertake to accept BA drafts from creditworthy and responsible customers. Because of reductions in stamping fees and aggressive discounting, BAs have become more competitive with commercial paper. As a result, BAs are likely to increase in popularity as more borrowers avail themselves of this means of financing.[28] It is also likely that an increase in cross-border loan activity will compel banks arrange their credit agreements so as to ensure that their customers can obtain Canadian currency through

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[26] The Federal Reserve Act (forming part of Title 12 of the United States Code) limits the Federal Reserve's open market operations. It distinguishes between 'eligible' and 'ineligible' acceptances. Eligibility refers to eligibility for discount by banks subject to Federal Reserve requirements. Eligible acceptances are those that are drawn to finance certain types of transactions. The original Federal Reserve Act limited eligibility for discount to acceptances based on the importation or exportation of goods. Eligible paper was to depend, therefore, upon the nature of the underlying transaction and not upon the form of the paper. Congress amended the Act in 1916 to include acceptances arising from the storage of readily marketable staples, from domestic shipments, and from the furnishing of dollar exchange. Until April 1974, when the current rules on eligibility for purchase went into effect, all acceptances that were eligible for discount, along with some others, were eligible for purchase. The types of private-sector credit instruments that may be purchased or sold are still significantly restricted by the views of sound banking and of the needs of commerce that were used in writing the Federal Reserve Act in 1913. The restriction today is on the form of the security - the credit instrument must be a bankers' acceptance or a bill of exchange (with some further "real bills" restrictions). See generally, David Small & James Clouse, "The Limits the Federal Reserve Act Places on the Monetary Policy Actions of the Federal Reserve" (2000) 19 Ann. Rev. Banking L. p. 553.

[27] See U.S. Department of the Treasury, Comptroller of the Currency Administrator of National Banks, *Bankers' Acceptances: Comptroller's Handbook*, September 1999, online: <http://www.occ.treas.gov/handbook/baccept.pdf>, p. 17

[28] L. BOULTON, *loc. cit.*, note 11, p. 34.

BAs.[29] BA financing offers clear advantages to the parties involved, but what might a bankers' acceptance transaction entail? Let us consider the previous scenario as an illustration of the BA operation and its implications for the parties involved.[30]

> BASE International will enter into an agreement with Bank ABC, by which the latter agrees to extend acceptance financing. A credit agreement between the parties will be signed. BASE International will then draw a draft on Bank ABC, which will accept the draft, completing the BA, pursuant to the agreement. The bank will then deliver the BA to BASE International, which will then discount (negotiate) the BA, either with Bank ABC, or another bank or dealer. BASE International will then use the funds obtained from the negotiation of the acceptance to purchase those resources it needs to complete the order for its Spanish customer. Alternatively, it may negotiate the BA to its supplier, in return for the goods it needs to fill the order (which may be more willing to accept a BA, as it contains the primary obligation of Bank ABC, rather than BASE International, which is fairly secure guarantee that it will be paid).
>
> Upon receiving payment for the order from Spain (or in fact, from its English customer) it will then be able to provide funds to Bank X, pursuant to the agreement, which will allow the bank to pay the holder of the BA at maturity. [31]

When dealing with a situation like that of BASE International, a BA transaction may develop other relationships between other parties, with some of these relationships being more direct than others. We will return to this example later on and examine the various legal issues it presents. In any given transaction, aside from the customer and bank, there may be one or more participating banks, investment dealers, or multiple

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[29] *Id.*
[30] The ABC International example will be used throughout the paper to highlight various aspects of the BA transaction and to illustrate some of the difficulties that arise from its operation.
[31] The operation is described in detail, *infra*, p. 36.

investors, who become holders of the BA. The situation may be complex and the legal relationships may become intricate. Therefore, it is important to identify whether the relationship is established through the BA instrument, or whether it exists by ordinary contractual relationship, or by operation of law. Proper analysis of the surrounding circumstances, the connecting factors, and the obligations and the rights which exist between the parties, will be necessary in determining whether the contractual rules of the provinces, or federal law rules apply, and to what extent.

Clearly, the BA instrument is governed by the *Bills of Exchange Act.* Any solution introduced to a problem involving a BA must, in principle, respect the inherent nature of the BA as a negotiable instrument, governed by federal law. In the case of BAs, either the *Bills of Exchange Act* or the *Depository Bills and Notes Act* will apply to the instrument. Since there exists federal legislation for BAs, an important element of our study is to determine if, and under what circumstances, provincial law such as the *Civil Code of Quebec* (C.C.Q.), would find application with respect to BAs and complement the provisions of the *Bills of Exchange Act* where the statute is silent or ambiguous. We wish to propose a technique that will aid us in resolving uncertainty about the law applicable to BAs. In the Canadian context, resolving such uncertainty is becoming increasingly important because the courts are facing a growing number of cases involving bankers' acceptances.

The purpose of this study is to find the law applicable to BA's, particularly when and what aspects of the BA's are to be governed by provincial law such as the CCQ. In

resolving this question , we have analyzed the doctrinal opinions and relevant jurisprudence , as well as proposing a technique to resolve the various problems that may occur when determining the law applicable to BA's.

The simple solution would be to apply provincial law to those matters not addressed in the Act, as provincial law typically complements federal legislation. However, the *Bills of Exchange Act* contains a peculiar provision, namely section 9, which provides:

> 9. The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques.

The appropriate application of Quebec civil law to matters of bills of exchange has been confused because of this provision. There is doubt as to whether section 9 is in fact an incorporation by reference that effectively precludes the application of civil law. The problem continues to be a contentious issue in the doctrine and jurisprudence. The "inexorable character" of the problem created by the interpretation of this provision has given rise to a number of diverse theories, regarding the extent of the applicability of common law to matters of bills of exchange.[32] As we can clearly conclude from a review of the jurisprudence, the courts, for the most part, have been conciliatory to the application of provincial law in issues involving bills of exchange. The majority of judges express a hesitance to jeopardize the integrity of the provincial law as complimentary law

[32] See Jean LECLAIR, "L'interaction entre le droit privé fédéral et le droit civil québecois en matière d'effets de commerce : perspective constitutionnelle", (1995) 40 *McGill L.J.* p. 691, 695.

in order to accommodate the idea that Parliament's desire was to enact an extensive and far-reaching law of bills and notes. The position of most doctrinal writers is very much the same.

Thus, the essential question we must consider throughout the study is: which rules must be applied to disputes that arise in a BA transaction? Is it the Civil Code of Quebec or the common law of England? In other words, do we apply federal or provincial private law to matters pertaining to BAs not expressly mentioned in the *Bills of Exchange Act*? From a Canadian perspective, understanding which law is applicable to BAs is a matter of increasing importance, due to its growing appearance in courts. This question is addressed in Chapter 4 of this study which focuses on reconciling federal and provincial law pertaining to bankers' acceptances. To this end, we begin in Chapter one with an examination of the history, development and evolution of the bankers' acceptance. To better understand the BA, we offer a brief overview on the origins of the instrument. In Chapter 2, we also analyze the nature and legal character of the BA. This will establish the framework through which we can identify the rules and principles that apply to the various aspects of the BA transaction. In Chapter 3, we examine the mechanics of the BA operation step-by-step, paying close attention to the requirements imposed by legislation as well as the various parties involved in a BA transaction and the relationships between them. Having examined the legal nature of the BA, we proceed to Chapter 4, the most essential part of this study , where we consider the applicability of provincial law to aspects of the BA transaction. To this end, we examine different approaches to understanding the *Bills of Exchange Act*, particularly the problematic section 9, as well as the applicable law as understood in Quebec jurisprudence during the past century.

Finally, given new legislative developments, such as the *Harmonization Act*, in Chapter 5 we propose a method to determine the law applicable to various aspects of the BA transaction. Although our method proposed is but one approach on the subject, we believe it to be a suitable one that upholds the force and value of both federal and provincial laws, when resolving the laws applicable to the BA. Still, it is hard to envision challenging a decision in which a judge offered a careful and considered judgment based on a different interpretive approach to section 9, and that in fact would derive different conclusions.

Our analysis has led us to adopt the result advocated by the majority of jurists, but with the recognition that our approach to section 9 is based on reasons of policy. The policy choice of most authors and judges seems to be that, for matters dealing with bills and notes in a strict sense, common law will apply. Civil law will apply where the matter is "contractual" or "proprietary," that is, bills and notes in a wide or broad sense.

We think therefore that incorporating the strict/ wide dichotomy into section 9 itself or in the Act that defines section 9 is preferable in striking the appropriate balance between the application of federal and provincial law to bankers acceptances.

# CHAPTER 1. The Origin of the Bill of Exchange and the Bankers' Acceptance

In this chapter, we discuss the origin of the bill of exchange and how it gave rise to the modern BA. Subsequently we will examine the evolution of the BA in Canada. [33] It was during the thirteenth century that writings obligatory writings obligatory (a type of debenture or term note) were being developed.[34] Justice Cockburn stated that:

> Bills of Exchange are known to be of comparatively modern origin, having been first brought into use, so far as is presently known, by the Florentines in the twelfth, and by the Venetians about the thirteenth century. The use of them gradually found its way into France, and into England.[35]

Since the middle of the fifteenth century, English merchants have been using bills of exchange in order to conduct their business. The seventeenth century brought recognition to the negotiable nature of a bill. . . "Before the seventeenth century, bills of

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[33] See generally, Raymond Adrien De ROOVER, *L'Evolution de la lettre de change, XIVe – XVIIIe siècles*, Paris, Librairie Armand Collin, 1953; Edward JENKS, "On the Early History of Negotiable Instruments" (1893) 9 *L. Q. Rev.* 70; James Milnes HOLDEN, *The History of Negotiable Instruments in English Law*, London, Athlone Press, 1955; James Steven ROGERS, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial* Law, London, Cambridge University Press, 1985; William Searle HOLDSWORTH, "The Origins and Early History of Negotiable Instruments, Part I", (1915) 31 *L. Q. Rev.* 12 and W.S. HOLDSWORTH, "The Origins and Early History of Negotiable Instruments Part II", (1915) 31 *L. Q. Rev.* 173; Frederick READ, "The Origin, Early History and Later Development of Bills of Exchange and Certain Other Negotiable Instruments, Part I", (1926) 4 *Can. Bar w*F. READ, "The Origin, Early History and Later Development of Bills of Exchange and Certain Other Negotiable Instruments, Part II", (1926) 4 *Can. Bar. Rev.* 665.

[34] Bradley CRAWFORD, *Crawford and Falconbridge Banking and Bills of Exchange*, 8th ed., vol. 2, Toronto, Canada Law Books, 1986, p. 1171-1172.

[35] *Goodwin* v. *Robarts*, (1875), L.R. 10 Exch. 337, aff'd 1 App. Cas. 476 (H.L.)

exchange were fairly arcane, complex devices for the transfer of capital and were little used by the general populace or even many merchants."[36]

Merchants who did use bills of exchange used them to finance long-distance trade. Bills of exchange were developed to solve a basic problem, namely, how to transport capital from one place to another, or from country to country, without having to undertake the dangerous task of hauling bullion or other valuables, thereby risking theft.[37] This early type of transaction has been described in the following manner:

> Suppose A, an Amsterdam merchant, owes money to D, a Hamburg merchant, for goods sold from D to A. Suppose B and C, as exchangers, are in what we would call today the banking business. B is in Amsterdam and C is in Hamburg. Rather than transferring the funds from Amsterdam to Hamburg *in specie*, A (the Amsterdam merchant) either gives cash to B (the Amsterdam exchanger) or has his account with him debited, and obtains from him a bill of exchange, namely a letter addressed by B to C asking C to pay D, in the sum of his debt to D. A then sends the letter to D (the Hamburg merchant) who presents the letter to C (the Hamburg exchanger) and obtains payment in discharge of A's debt to him. C then debits B's account with him.[38]

As merchants began extending their trade into foreign countries, a more complex system of settling accounts became necessary. Bills of exchange were used to facilitate trade by enabling merchants to avoid carrying money *in specie*. Instead, they could trade

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[36] Kurt EGGERT, "Held Up in Due Course: Codification and the Victory of Form Over Intent", 35 *Creighton L. Rev.* p. 363, 377.
[37] *Id.*, 377. This is the basic function of a payment mechanism. See Benjamin GEVA, "The Concept of Payment Mechanism", (1986) 24 *O.H.L.J.* p. 1.
[38] J. ZIEGEL, B. GEVA and R.C.C. CUMING, *op. cit.*, note 8, p. 4.

in their money for letters of exchange, which could be transferred to buyers or sellers, which in turn could be redeemed for money at major fairs held throughout Europe. [39]

Bankers are the ones that made it work by playing an essential role in this process. Holdsworth describes the situation as follows:

> At the great fairs, the merchants' bankers, armed with letters of exchange for the receipt of money and with money to pay off the creditors of their clients, would attend the fairs, meet together and pay each other as needed, working with the exchangers who, because their business was giving currency of one country in exchange for another, could accurately calculate the exchange rate for the debts and credits incurred in a multitude of foreign countries.[40]

Often, bankers did not have to keep large amounts of currency on hand because while they were paying bills of exchange they would also receive money on bills owed to merchants.[41]

Using bills was one of the many customs and practices of merchants that was codified. The regulation of cheques, however, had been incorporated into the *lex mercatoria* as early as the sixteenth century, when English merchants were placing valuable consideration as security with the king of England in order to manage the use of notes as payment devices. Following the Civil War of 1638, King Charles I had, unilaterally and without permission, benefited from the consideration entrusted to him. English merchants therefore lost confidence in the King and began dealing directly with

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[39] See K. EGGERT, *loc. cit.*, note 36, p. 378 citing W.S. HOLDSWORTH, «The Origins and Early History of Negotiable Instruments, Part I», *loc. cit*, note 32. The earliest fairs where such exchange occurred were held at Champagne, and when these fairs declined during the fourteenth century, fairs at Lyons, Anvers, and Genoa took over this function

[40] *Id.*

[41] *Id.*, p. 28

independent goldsmiths. Goldsmiths would also require a deposit of valuable consideration in exchange for a bill that could lawfully be used in commercial transactions.[42]

Bills of exchange played an important role in a medieval economy that did not have sufficient money currency in circulation to sustain all the on-going commerce (prior to the issuance of bank notes by the Bank of England).[43] Bills of exchange were also valued because they were easily transferred and since the holder could recover their value from a number of parties. Each endorsement created a new liability on the bill. Eventually, the customs and practices with respect to bills and notes, including the *lex mercatoria*, were codified.

The first such codification was the English *Bills of Exchange Act* in 1882, drafted by Sir Mackenzie Chalmers. Long before that, in 1462, bills of exchange were referred to in a royal ordinance issued by Louis XI, consecrating existing commercial practice.[44] In 1572, the negotiation of bills of exchange was confined to specially appointed agents in Paris.[45] The first law on bills of exchange was the Order of 1673, which was a synthesis of the usages of merchants. It has been said that this early codification crystallized French commercial law, inhibiting its absorption into the general legal system of France.[46] In the eighteenth and nineteenth century, characteristic differences were evident between English common law, and French mercantile law. One feature that distinguished them

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[42] *Id.*, p. 386
[43] *Id.*, p. 382
[44] See A.M. KEILEY, "Bills of Exchange", (1900) 6 Virginia Law Register 73, 75.
[45] *Id.*
[46] Léonie M. MITCHELL, "The British Conception of Negotiable Instruments v. The French", (1928) 10 J. of Comp. Legis & Int'l L. (3d series), 237, 240.

was that, until 1922, French bills were void if they did not bear a statement of consideration.[47]

The Canadian legislation by the same name, largely derived from the English legislation, followed soon after. The countries of continental Europe have relatively similar laws regarding bills of exchange as a result of the Geneva Convention, which emerged in the 1930s. In the United States, legislation respecting bills of exchange can be traced back to the *Negotiable Instruments Law*, drafted by J.J. Crawford in 1896 on behalf of the National Conference of Commissioners on Uniform State Laws. This draft was eventually adopted by all American states.[48]

In Canada, the law of bills and notes falls within the exclusive legislative power of the federal government by virtue of section 91(18) of the *Constitution Act* of 1867.[49] However, it was only in 1890 that the federal government exercised its power to create the first *Canadian Bills of Exchange Act.*[50] This Act basically reproduces the *Bills of Exchange Act* of 1882 in its entirety.[51] Officials believed the Act would bring uniformity to the law of bills and notes in Canada. Indeed, the Minister of Justice at that time, Sir John Thompson, said the following when introducing the Bill in session in 1889: "The object of this Bill is to render uniform in almost every respect the laws throughout the Dominion with respect to these contracts. The law under this Bill will be uniform in

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[47] *Id.*, p. 240.
[48] See B. CRAWFORD, *op. cit.*, note 34, p. 1180.
[49] 30 & 31 Vict., c. 3. (U.K.), formerly, the British North America Act, 1867.
[50] S.C. 1890, c. 33 (Royal Assent granted May 16, 1890).
[51] See Jean LECLAIR, "La Constitution par l'histoire: portée et étendue de la compétence fédérale exclusive en matière de lettres de change et billets à ordre", (1992) 33 C. de D. p. 535, 612-613. The Canadian Bills of Exchange Act did make some substantial changes to the British Act, notably, the preservation of the common law (now found at s. 9), which will be discussed at length, *infra*, p. 76.

every particular except as regards statutory holidays, in respect of which special provision is to be made as regards the Province of Quebec."[52]

In 1849, the Legislature of Canada passed a statute[53] described as, "the most comprehensive enactment relating to bills and notes passed in any part of Canada before the promulgation of the Civil Code of Lower Canada."[54] Aside from introducing many rules of English law into Lower Canada, the statute provided that the laws of Lower Canada should govern bills and notes, and if there were no laws with respect to a particular issue, then recourse would be had in the laws of England in force on May 30, 1849. In general, the statute did little to redress the doubt surrounding what law should be exercised in matters involving bills of exchange.

The first codification of Quebec law, the *Civil Code of Lower Canada* (C.C.L.C.), enacted in 1866, and included parts of the 1849 statute.[55] Pursuant to article 2340 of the C.C.L.C., where matters relating to bills of exchange were not regulated by the Civil Code, "... recourse must be had to the laws of England in force on the thirtieth day of May, one thousand, eight hundred and forty-nine...." The Canadian provinces (other than Quebec) were, however, fully governed by English law. Eventually, the *Bills of Exchange Act* of 1890 rendered inoperative all the articles of the Civil Code save for those relating to evidence affecting bills of exchange, cheques and promissory notes. Later versions of the Code did not include article 2340 or a corresponding provision.

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[52] Cited in Désiré GIROUARD and Désiré H. GIROUARD, *The Bills of exchange act, 1890 ; An act to codify the laws relating to bills of exchange, cheques and promissory notes, passed by the Parliament of Canada, 53 vic., ch. 33 with notes and comments. Also a reference to the English, American and French decisions and to all the Canadian reported cases, and appendix containing the French text of the act debates of Parliament, civil code of Lower Canada etc., and an analytical index*, Montréal : J.M. Valois, 1891, Introduction, p. VIII.
[53] 12 Vict., c.22.
[54] B. CRAWFORD, *op. cit.*, note 34, p. 1179.
[55] *Id*, p. 1180.

In the following section we will analyze the evolution and growth of the BA in Canada's money markets. This part will briefly describe the bankers' acceptance from its formative years up to the present, and see how it has evolved, from a means of financing trade to the trade of futures contracts on the BA.

## 1.2 Evolution of the BA in Canada

"[G]enerally speaking, bills and cheques are a means of transferring funds. Notes embody credit obligations. Nevertheless, functional distinctions are occasionally blurred: bills and cheques may be used as credit instruments."[56] A bill of exchange is a document like no other that has drastically evolved from is early origins. As one author stated, "Aujourd'hui, les effets de commerce servent à des fonctions différentes de celles qui ont assuré leur développement au Moyen Âge. Ils ne se limitent plus à remplacer le transport de numéraire d'un endroit à un autre. La lettre de change sert principalement comme instrument de crédit entre commerçants éloignés."[57] That is not to say that the use of bills and notes as a mechanism of credit financing is new; the use of bills of exchange in England as a means of credit was recognized by the 1560s.[58]

However, "[d]evant la prolifération de nouveaux instruments de paiement plus perfectionnés simplifiant d'avantage l'extinction des obligations pécuniaires, l'utilisation de l'effet de commerce a graduellement été restreinte surtout aux opérations de crédit."[59] Indeed, although bankers' acceptances have been used to facilitate international trade for hundreds of years, it was not until the 1962 that BAs appeared in Canada. From the outset, BAs have served a different purpose in Canada. Whereas in the United States bankers' acceptances had been used to finance international transactions, Canadian

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[56] J. ZIEGEL, B. GEVA and R.C.C. CUMING, *op. cit.*, note 6, p. 3.
[57] Nicole L'HEUREUX, Edith FORTIN and Marc LACOURSIÈRE, *Droit bancaire*, 4th ed., Cowansville, Yvon Blais, 2004, p. 411-412. For a discussion of how the bill evolved into an instrument of credit, see Janice D. McGINNIS, "Statute Law and the Owl of Minerva: The Bills of Exchange Act, 1882", (1986) 24 *Alta. L.R.* 275, 285 *ff.*
[58] Daniel R. COQUILLETTE, "Legal Ideology and Incorporation IV: The Nature of Civilian Influence on Modern Anglo-American Commercial Law", (1987) 67 *B.U.L. Rev.* p. 887, 888.
[59] Octavian CAPATINA, "L'Évolution des fonctions de la lettre de change dans les rapports de commerce extérieur", (1978) 22 *Revue Roumaine des Sciences Sociales* p. 309, 311.

authorities were enthusiastically encouraging the use of BAs as an instrument for financing corporate debt.[60] The Canadian government's decision to allow foreign banks to engage in certain banking activities in Canada was a factor which most certainly influenced this trend. The result was an increase in the number of players in Canada's money market who could accept BAs. Bankers' acceptances are reported to be the largest single short-term paper negotiated in Canada's money market.[61] While their development was gradual and deliberate, BAs have become a significant component of the Canadian financial market.

To aid in the promotion of a more dynamic money market, on June 11, 1962, bankers' acceptances were introduced in Canada. Investment dealers, the Bank of Canada, and chartered banks were all actively involved in outlining the initial shape of the Canadian acceptance market. Several essential requirements were put into place that had to be respected by chartered banks before they could grant a customer's request for acceptance financing. Firstly, only Canadian customers of Canadian banks could draw bankers' acceptances, and they could be drawn only in Canadian funds. Furthermore, maturity had to be between 30 and 90 days from acceptance. The minimum face value was predetermined at two hundred thousand dollars ($200,000).[62] Acceptances were only to be issued to finance the production or marketing of goods, wares and merchandise as defined in the *Bank of Canada Act.* This included "products of agriculture, products of the forest, products of the quarry and mine, and products of the seas, lakes and rivers" as

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[60] D. MERRETT, *loc. cit.*, note 9, p.3. See also, L. BOULTON, *loc. cit.*, note 11, 32.
[61] The amount of outstanding Canadian dollar BAs was 150 million dollars in 1965, 395 million in 1970, 1,047 million in 1975, 5,365 million in 1980, and jumped to 42.5 billion by October 1988, including 2.8 billion in foreign currencies. See S. SARPKAYA, *op. cit.*, note 18, p. 63.
[62] D. MERRETT, *loc. cit.*, note 9, p. 5.

stated in section 18 (1)(*f*) or 18 (1)(*g*) of the Act.[63] All these limitations placed on the Bank of Canada impacted on the scope of acceptance activity engaged in by charted banks. These constraints were "...designed to satisfy the legal restrictions on the Bank of Canada as to the type of assets it could acquire, and it also reflected the desire of the chartered banks to limit the creation of acceptances to 'self liquidating transactions.'"[64] It was not until the extensive amendments of 1980 that we saw a significant change in the acceptance practices of banks in Canada.[65]

In the later part of 1962, the acceptance market noticeably increased its activities. The outstanding amount remained relatively stable, due to the apprehension of the chartered banks in issuing acceptances to less-than-acceptable credit risks, and the fact that smaller firms were necessarily excluded by the substantial minimum face value of $200,000.[66] By December 1962, the aggregate of current acceptances issued stood at nine million dollars. This was so despite the fact that not many BAs had been drawn after the first few months of that year. During the following two and a half years, acceptances reached a peak of 15.6 million dollars, never falling below 6.4 million dollars.[67] It should be noted that these extremes occurred just several weeks apart, indicating the relative smallness of the size of the market at that time. The issuance and maturity of acceptances had a considerable impact on the market.

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[63] *Bank of Canada Act*, R.S.C. 1970, c. B-2.
[64] D. MERRETT, *loc. cit.*, note 8, p. 5-6.
[65] See Lazar SARNA, "Bankers' Acceptances" in Lazar SARNA (ed.), *Corporate Structure, Finance and Operations: Essays on the Law and Business Practice*, Vol. 8, Scarborough, Carswell, 1995, p. 39 at page 64.
[66] *Id.*, p. 7.
[67] *Id.*

A decrease in the stamping fee in 1965 allowed for rapid growth of the acceptance market. In fact, the increase in growth was tenfold, going from 11.6 million on every Wednesday in June to 149.4 million on the same day of the week in December. It may be assumed that fluctuations were due to the reduction in the charges for stamping fees, but the corresponding reduction of commercial paper reflected in an increased number of acceptances cannot be attributed to the change in stamping fees alone. Merrett attributes this growth in BAs to the failure of a major finance company in that year, which shook consumer confidence in financial companies and commercial paper.[68] For three years, from 1966 through 1969 the acceptance market was stagnant, with no expansion whatsoever.

At first, banker's acceptances were deemed to be a valid form of collateral for day-to-day loans of chartered banks and for purchase and resale agreements (PRA) with the Bank of Canada, as long as the loan was not sought from the same bank that had stamped the acceptance.[69] The Bank of Canada often purchased bankers' acceptances issued to finance suitable activities and to help promote the emerging market. However, it would be the investment dealers that would play a key role in this expansion of the bankers' acceptance market, by actively engaging in the purchase and sale of acceptances on a regular basis.

Nevertheless, throughout most of the 1960s, acceptances were looked upon as private placements (with investors) and experienced limited trading because they were assumed to be intended for investment purposes. As a result, secondary trading of

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[68] *Id.* Unlike BAs, commercial paper does not have the obligation of a second party to pay the debt. The primary and secondary obligations on the BA are discussed, *infra*, p. (cite page which begins section 3.2.3. Acceptance)
[69] *Id.*, p. 6.

acceptances was not widespread. In fact, dealers sought to avoid competition by not revealing the names of those for whom they held acceptances. The rationale behind this was that fierce competition by chartered banks for secondary reserves caused loans to become relatively inexpensive. These loans were used to finance other acceptances, making them very lucrative to investment dealers who preferred holding them.[70]

Two key changes had occurred by 1968. The first involved limiting the issuance of BAs and the second enlarging the power of chartered banks to accept BAs. The Bank of Canada restricted the total designated dealers' use as collateral for PRAs and day-loan credit. Secondly, consent was granted to chartered banks to consider acceptances carrying their own stamp as eligible loan collateral. Until this time, only acceptances of other banks could be used in such a manner. As a result, banks began to use acceptances (both their own and those issued by other banks) as a means of collateral against other loans provided to dealers.[71]

Acceptances were being retained by banks for their own accounts, as they were by numerous other investors, from the dealers' now waning reserves. The money markets flourished with the use of acceptances as a liquid asset that offered, as a practical alternative, the ability to expedite the management of short-term cash transactions. Although these changes were essential in creating a considerable increase to the sum total of bankers' acceptances outstanding, there were several other elements, presumably more significant, in effecting this increase. Bankers encouraged an increasing number of their clientele to use BAs because the cost to the customer compared to loans was lower than it had been in the past. Furthermore, it was an appealing option in light of the fact that strict

[70] *Id.*, p. 7.
[71] *Id.*, p. 8-9.

credit requirements were limiting business growth in the 1970s. Thus, acceptance usage became more widespread in Canada. The chartered banks wanted the acceptances they held to be included as part of their secondary reserve, although this never happened even with revisions to the Bank Act in 1967 and 1980.

> Early in the 1970s, BAs enjoyed a noticeable economic advantage over loans as a financial instrument, but this was not reflected in the BA market, as the aggregate of acceptances remained relatively unchanged. In 1974 however, BAs had a sudden growth in the market, which ended in 1975. In order to increase the potential market for bankers' acceptances, several banks considered expanding the list of authorized activities that could be financed with acceptances, as well as stretching the maturity date beyond the 90-day limit. Chartered banks were reluctant to incorporate these changes, however, since this type of modification meant creating a situation in which certain acceptances would meet the eligibility requirements for purchase by the Bank of Canada, while others would not.[72]

In 1978, one bank publicized its willingness to stamp acceptances for periods of 10 to 180 days, without regard to the activity for which the acceptance was being drawn to finance.[73] This bank also opened unique lines of credit against which acceptances or loans could be drawn at any time, as well as devising several pricing options that were to make acceptances more competitive with commercial paper, and hence a more lucrative alternative to other methods of financing. Even as these changes were implemented, the market saw little growth until several other banks followed suit and increased

[72] *Id.*, p. 10-11. The situation of eligible and ineligible acceptances arose in the United States in 1913 with the introduction of the Federal Reserve Act. Acceptances meeting reserve requirements were deemed eligible for discount. Conversely those that did not were ineligible and subject to having to match the amount with funds secured in reserve, whereas eligible acceptances could be leveraged. See generally, R. K. LAROCHE, *loc. cit.*, note 22.

[73] D. MERRETT, *loc. cit.*, note 9, p. 11.

competition. With this competition came a renewed expansion in the previously dormant acceptance market, marking an unprecedented growth that started late in 1978.

During the 1980s, the BA had become the preferred instrument of corporate debt.[74] During that decade, there were several major changes to the BA market. One such change was the advent of U.S.-denominated acceptances issued in Canada. Another change was due in large part to the total outstanding value of bankers' acceptances (which by the end of the 1980s well above the 7 billion dollar mark). With this came the realization that measures once needed to sustain the market were no longer necessary. On December 1, 1980, the Bank of Canada reversed its earlier legislation regarding the eligibility of acceptances as collateral for day-loans or PRA credit. Practically, this meant that only Government of Canada securities could be used as collateral, as was the case prior to 1962.[75]

Additionally, section 18(*g*) of the *Bank of Canada Act* stated that the bank could "buy and sell bills of exchange or promissory notes endorsed, accepted, or issued by a chartered bank and having a maturity not exceeding 180 days, excluding days of grace, from the date of acquisition by the Bank." [76] It is not likely, however, that this alteration of the *Bank of Canada Act* significantly impacted the bankers' acceptance market. The availability of other assets, such as government treasury bills, limited the effect of this legislative change. Significant variations in the amount of bankers' acceptances outstanding occurred in 1980 and 1981. In May and June of 1980, as well as from December 1980 through January 1981, there were decreases in acceptance activity in rising markets.

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[74] E. RAZIN, *loc. cit.*, note 10, p. 219.
[75] D. MERRETT, *loc. cit.*, note 9, p. 11.
[76] Supra, note 52.

The Canadian trend during this period is noteworthy in that there was a marked decline in what had been an upward movement of the market. Borrowers now returned to loans in order to finance their business ventures as their acceptances reached maturity. Up to that point, acceptances had been the preferred method of financing for over four years. But borrowers became more sophisticated, shifting to ordinary bank loans when relative costs favoured them over BAs. There is no indication that this type of shifting is likely to stop. In fact, it is probable that there will be a perpetual shift between the two, highlighting the new discriminatory nature of the borrower towards interest rates. Undoubtedly this will be facilitated by the various other financing options offered by chartered banks.[77]

The creation of more chartered banks may in fact mean that the *Bank of Canada Act* will aid in fostering greater competition. Already familiar with the fixed-term, fixed rate financial mechanisms and bankers' acceptances internationally, many of these banks have substantial expertise in Canadian commercial banking. Since December 1980, U.S. denominated acceptances have been issued in Canada. These are appealing to those requiring U.S. currency, as well as Canadian and American investors who previously had held U.S. dollar accounts in Canadian banks, as interest rates were lowered slightly.[78]

To bring the BA to the public market, in 1988, the Montreal Exchange introduced the futures contract on 3-month Canadian bankers' acceptances (BAX). Bankers' acceptance futures contracts are an innovation designed to hedge or reduce short-term interest rate risk.[79] After a relatively modest start, trading in this contract has grown

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[77] D. MERRETT, *loc. cit.*, note 9, p. 12.
[78] *Id.*
[79] See Lorne N. SWITZER and Samar OBAID, "The Performance and Efficiency of the Canadian Bankers' Acceptance Futures Market" in Lazar SARNA, (ed.), *Corporate Structure, Finance and Operations:*

rapidly. In practice, the yield on the BA represents the difference between the discounted price and the face value of the BA. However, in the futures market, the yield will depend on the value for which the BA is being traded on the stock market. As one author explains it, "[t]he contract is traded on an index basis. Thus, its price is calculated by subtracting the annualized implied yield on the bankers' acceptance from 100. For instance, if September contracts are offered at 95.20 on the floor of the Exchange, this would imply a 4.80 per cent (or 100.00 - 95.20) annual yield for BAs issued in September."[80]

Bankers' acceptances have become relatively less favoured as a money market instrument in recent years, although the market for futures in bankers' acceptances has grown exponentially. In 1990, bankers' acceptances accounted for 21.1% of money market instruments. This percentage fell to 18.3% by 1998. By contrast, bankers'

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*Essays on the Law and Business Practice*, vol. 9, Scarborough, Carswell, 1996, p. 375 at page 375. The authors suggest that although there is evidence of the inefficiency of the BAX market, there are signs it is becoming more efficient over time.

[80] Nancy HARVEY, "The Market for Futures Contracts on Canadian Bankers' Acceptances", (1996) *Bank of Canada Review* 19, 20. The author describes the technical aspects of the BAX in the following way: "The BAX contract is traded on the floor of the Montreal Exchange between 8 a.m. and 3 p.m. (Eastern Time) and is based on an investment of $1,000,000 in 3-month bankers' acceptances. Contracts mature two business days prior to the third Wednesday of the month in March, June, September and December over a two-year period. These delivery dates correspond to the delivery dates of Eurodollar futures contracts traded on the Chicago Mercantile Exchange, which helps create arbitrage opportunities between the BAX and the Eurodollar futures markets....The integrity of the BAX market is based on the role of the clearing house, in this case the Canadian Derivatives Clearing Corporation or CDCC, which guarantees the financial performance of participants' transactions on the Montreal, Toronto, and Vancouver exchanges. Subsequent to the conclusion of a transaction by two parties, the clearing house takes an offsetting position to each leg of the transaction. A margin deposit of $1,000 or $1,900 per BAX contract traded is required depending on the status of the participant. The deposit requirement is typically met by depositing financial assets in a special account prior to the transaction. This deposit, or margin, serves as collateral and is a sign of the participants' willingness to meet their obligations. It also enables the clearing house to cover its losses should one of the parties default. It should be noted that margin requirements vary since they are frequently reviewed by the CDCC. BAX contracts are marked-to-market daily, which brings about periodic adjustments. Resulting profits or losses are credited or charged to the margin account. If these daily adjustments result in the margin account falling below a pre-specified level, the investor must make an incremental deposit to bring it back to the desired level, or the futures position will be liquidated. When the contract expires, outstanding positions are liquidated. Although most investors are not interested in acquiring the underlying instrument of the contract, they must abide by certain rules. For instance, when they wish to liquidate their position prior to the delivery date of the futures contract, they must buy an offsetting position on the floor of the exchange."

acceptance futures rose threefold in value in the 1995-98 period.[81] Noting the variance in the purpose of BAs, Nancy Harvey explains:

> Classified according to purpose, BAX transactions fall into three broad categories: hedging, speculation and arbitrage or yield investment. Data published by the Montreal Exchange suggests that BAX transactions undertaken for hedging purposes are the most significant, accounting for more than 50 percent of total transactions. Speculation represents about 25 per cent of all the transactions, while less than 25 per cent are attributable to arbitrage and yield-investment strategies. This distribution seems relatively stable but can vary according to market volatility. When markets are volatile, the volume of transactions increases along with the share that reflects hedging activity, while speculative trading is more prevalent in periods of low market volatility.[82]

Since 1994, the BAX market has grown considerably due in large part to the effort to use BAX contracts as hedging instruments by banks and the encouragement of non-residents to participate in the Canadian market.[83] As well, the prices of BAX contracts are more responsive than traditional instruments. These multi-purpose instruments facilitate the smooth operation of the money market by complementing other instruments such as treasury bills. According to one analyst, more than 9,000 BAX contracts were traded daily in 1995 and amounted to around $90 billion dollars in May 1996.[84]

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[81] See SERGE BOISVERT and Nancy HARVEY, "The Declining Supply of Treasury Bills and the Canadian Money Market", (1998) *Bank of Canada Review* 53.
[82] N. HARVEY, *loc. cit.*, note 80, p. 25-26. For more on how Canadian financial firms manage short-term interest rate risk through the use of BAX futures contracts, see David G. WATT, "Canadian Short-Term Interest Rates and the BAX Futures Market: An Analysis of the Impact of Volatility on Hedging Activity and the Correlation of Returns between Markets", (1997) *Bank of Canada Working Paper* 97-18.
[83] N. HARVEY, *loc. cit.*, note 80, p. 20.
[84] *Id.*, p. 31.

# CHAPTER 2. The Nature and Legal Character of the Bankers' Acceptance

Chapter 1 examined the evolution of bankers' acceptances in Canada. BAs have greatly evolved since they were first introduced and so it will not come as a surprise if there is more innovation in the market in the years to come. Despite the emergence of a futures market, bankers' acceptances continue to be used to finance trade. To better understand the legal issues surrounding the BA transaction, in this section the juridical nature of bankers' acceptances will be examined. There has been very little attention given to the theoretical nature of negotiable instruments in general and bankers' acceptances in particular.[85] In order to truly comprehend the BA and resolve issues that may arise concerning its operation, it is important to begin by uncovering the nature of the BA and its unique qualities as a negotiable instrument. We will analyze the bankers' acceptances' contractual and proprietary features, in an effort to compare and contrast it with the various types and modalities of obligations, such as loans, suretyship, mandate, sale, novation, delegation, assignment of claim and stipulation for another. Through this analysis we will establish that a BA, as a form of bill of exchange, is a unique instrument that resembles various obligations but still remains independent of them.

[85] Barak laments the depth of analysis of negotiable instruments in Aharon BARAK, "The Nature of the Negotiable Instrument", (1983) 18 *Isr. L. R.* p. 49, 50. Sarna notes that BAs are "little studied in the legal community." See L. SARNA, *op. cit.*, note 65, p. 82.

## 2.1 The Contractual and Proprietary Aspects of BAs

BA AGREEMENT

US $ 20 000

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Montreal, April 20, 2005

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(Canadian Bank)

---------- PAY TO ----------

(ABC Exports Canada)

THE ORDER OF ----------

Twenty thousand US $----------

THE SUM OF ----------

Walley Green

TO ----------

123 Plamondon

---

Montreal, Quebec

---

---

ABC Exports Canada

A BA is an offspring of the bills of exchange family. The qualities of a BA are engraved within the very context of a bill. In the words of Justice Brossard, "...there are no provisions of the Act [*Bills of Exchange Act*] which state an instrument having all the characteristics of a bill of exchange ceases to be such because it is drawn on a bank; indeed article 165 which speaks of a bill of exchange drawn on a bank confirms that a bill of exchange may be drawn on a bank; it is only when such a bill of exchange is payable on demand that it is to be considered a cheque."[86] This notion is widely supported by doctrinal writers.[87]

From this explanation from the Honourable Justice Brossard, we can see clearly that the *Bills of Exchange Act* applies to bankers' acceptances, *mutatis mutandis*, and consequently, BAs must conform to the conditions of form set out in the Act. "However, because their use in Canada is as recent as 1962, there is no body of case law on banker's acceptances which discusses it as a negotiable instrument; when legal problems arise, resort should be had to the standard negotiable instruments texts."[88] Still, BAs are slightly different from other negotiable instruments, such as promissory notes and cheques, because in order to engage the liability of the banks on the BA there must be an "acceptance." This is not to say that without the bank's acceptance the bill will not be a negotiable instrument. In other words, the bank's acceptance does not "complete" the bill; it simply engages the liability of the bank, in addition to the drawer. The draft remains a negotiable instrument with or without the acceptance of the bank and the drawer remains liable with respect to it.

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[86] *Lavoie* v. *Abbott,* [1963] C.S. pp. 600, 602.
[87] Bradley CRAWFORD, *Crawford and Falconbridge Banking and Bills of Exchange*, 8th ed., vol. 1, Toronto, Canada Law Books, 1986, p. 878; see also, N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 319.
[88] M.H. OGILVIE, *op. cit.*, note 3, p. 429.

Keep in mind that the BA document as a negotiable instrument entails an obligation that is distinct from the interaction of the parties involved. For example, the BA may be created to effect payment between two parties involved in a commercial transaction such as a sale. The obligation engaged on the BA is distinct from the obligation to make payment for the sale. In the words of one author: "L'obligation cambiaire est également dite abstraite ou autonome en ce sens que la circulation du titre fait naître, en faveur du détenteur, des droits indépendamment du sort de l'obligation principale."[89] This notion of an "abstract" obligation, being autonomous from the underlying transaction, is known in continental countries where it corresponds more or less to the concept of "negotiability."[90]

The BA as a negotiable instrument is distinguishable from any ordinary property and obligations. To comprehend these unique traits of the BA, we will compare the BA instrument to forms of property and contracts (obligations) and determine its juridical character. In our view, the BA does not fit perfectly into any of those categories. It can only be defined as a negotiable instrument, governed by the *Bills of Exchange Act*. However, the implications of this exercise will take on a new relevance when we examine which law ought to apply to the BA when the *Bills of Exchange Act* is silent or ambiguous.

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[89] N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 419; *Infra*, p. 46.
[90] Uwe JAHN, *Bills of Exchange: A Guide to Legislation in European Countries, Asia & Oceania*, 3d ed., Paris, ICC Publishing, 1999, p.3.

## 2.2 The BA as Property

Like any moveable product that may be sold or purchased, a negotiable instrument is a tangible object susceptible to ownership and the rules of property. Chalmers stated this quite clearly when he explained that a bill is a chattel that can be transferred as such.[91] Baxter explains that when a bill of exchange is issued, property is put into circulation.[92] Likewise, according to Britton, the negotiable instrument is not only written evidence of the contract obligation of the parties, but is also a form of property.[93] Civil law authors are essentially silent on the issue of bills of exchange when seen as property. This reserve may be an indication that a negotiable instrument has its roots in the classical French doctrine that focuses on the contractual aspects of the instrument.

Thus like every other material thing in this world, a negotiable instrument can be sold, gifted, transferred, destroyed, or altered as the owner sees fit. It is also property for the purposes of criminal law[94] and conflicts of law.[95] The proprietary aspect of negotiable

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[91] David A.L. SMOUT, (ed.), *Chalmers on bills of exchange: A Digest of the Law of Bills of Exchange*, 13th ed., London, Stevens, 1964, xli.

[92] Ian F.G. BAXTER, *The Law of Banking*, 4th ed., Scarborough, Carswell, 1992, p.13.

[93] William Everett BRITTON, *Handbook of the law of bills and notes*, 2nd ed., St. Paul, West Publishing, 1961, p. 119, cited in A. BARAK, *loc. cit.*, note 85, p. 54.

[94] Negotiable instruments could certainly fall within the broad language of the s. 2 definition of property in the *Criminal Code*, R.S.C. (1985), c. C-46, modified by R.S.C. (1985), c. 2 (1st supp.). Under section 2 "property" includes

(*a*) real and personal property of every description and deeds and instruments relating to or evidencing the title or right to property, or giving a right to recover or receive money or goods,

(*b*) property originally in the possession or under the control of any person, and any property into or for which it has been converted or exchanged and anything acquired at any time by the conversion or exchange, and

instruments, specifically bills and notes, can be found in *the Bills of Exchange Act* itself. Take for example section 48(1), which provides:

> 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 to give a discharge therefore 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.

The distinction between the right to "retain the bill" and the right to "give a discharge" indicates that there is a proprietary element to bills of exchange. The right to retain relates to this aspect of the bill, while the right to give discharge relates to the obligational aspect of the bill.[96]

This proprietary nature of bills and notes was the underlying thought of Justice Rinfret, of the Supreme Court of Canada, in the case of *Pesant v. Pesant.*[97] He found that the promissory note in question was "moveable property." This moveable property, which may become the subject of a manual gift, comprises, of course, of corporeal moveables, but also *titres de créance*, the delivery of which is capable of effectually operating the transfer of ownership therein.[98] In such a case, the negotiable document and

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(*c*) any postal card, postage stamp or other stamp issued or prepared for issue under the authority of Parliament or the legislature of a province for the payment to the Crown or a corporate body of any fee, rate or duty, whether or not it is in the possession of the Crown or of any person;

[95] That is, insofar as we can determine the status of a bill or note for the purposes of private international law.

[96] This point is made by A. BARAK, *loc. cit.*, note 85, p. 53, in relation to section 23(a) of Israel's Bills of Exchange Ordinance, as it stood, which is the functional equivalent to s. 48 in the current Canadian Bills of Exchange Act.

[97] [1934] R.C.S. 249, 264-265.

[98] See *O'Meara* v. *Bennett*, [1932] 1 A.C. 80, which was discussed and applied.

the *créance* which it represents are identified with one another to such an extent that the *créance* itself is transferred by the sole delivery of the document from hand to hand, which is the characteristic of the manual gift ("*don manuel*").

This case establishes that a negotiable instrument is property. The reification of the obligation embodied in the instrument so as to make it transferable by physical delivery (without any necessary endorsement) makes it possible to view the BA as property. Interestingly, it is easier to conceive of the negotiable instrument as property, when it is overdue, because in that case although it is negotiated to subsequent holders, they can only take as good a title as the transferor. The perfection of title that is an effect of negotiability ceases to operate, but there is still a transfer to the subsequent party. The idea that negotiability is something different than title (i.e., property) is thus put into stark relief.[99]

On the other hand, it is clear that negotiable instruments, such as BAs, are not like other forms of property. Although there is a proprietary aspect of a negotiable instrument, its importance is limited for the most part to its evidentiary function (that is, possession of the physical document can act as proof that the obligation therein has been discharged). Generally speaking, it has little if any intrinsic value. Its primary usefulness lies in the obligation it represents.[100] Nevertheless, it is no less "property" because an individual will likely use it to collect an obligation than retain the instrument for use.

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[99] See *Ashurst* v. *Official Manager of the Royal Bank of Australia*, (1856) 27 L.T. 168.
[100] See *Wookey* v. *Pole*, (1820) 106 E.R. 845.

## 2.3 The BA as an Obligation

Previously we stated that negotiable instruments must be distinguished from any underlying credit arrangement or contract between a customer (drawer) and seller (payee) or between a customer and its bank (drawee). They are not the same. As we know, "...la jurisprudence admet le caractère autonome de l'obligation cambiaire."[101] In other words, we must be careful not to confuse the negotiable instrument as a contract with the underlying exchange or agreement (i.e., contract) for which the negotiable instrument was issued. The latter is a bilateral contract, the former is unilateral. Barak explains it this way:

> Frequently, a negotiable instrument is made within the framework of a bilateral contract. For example, A undertakes to sell goods to B and in consideration B gives A a bill. That is a bilateral contract; but the bill has an existence of its own. Once it has been made, an additional contract arises – that on the bill itself. If B fails to pay the bill, A will generally have two contractual remedies – one based on the bilateral contract, the other on the bill. There is, of course, a close connection between the two contracts: payment of the bill discharges the bilateral contract; failure on the part of A to perform his undertaking under the bilateral contract may provide B with a defence to an action brought on the bill.[102]

[101] N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 420
[102] A. BARAK, *loc. cit.*, note 85, p. 61-62.

The court in *Barbour v. Paradis*[103] treated a promissory note as being a contract. Likewise, Justice O'Leary of Ontario's High Court of Justice found that "...the word 'contract' in s. 4 of the *Interest Act* includes a promissory note. Not only is such conclusion arrived at by giving the words used in the section their ordinary meaning, but also by paying heed to the opinions of judges and other jurists."[104]

Negotiable instruments as contractual obligations are not terminated because the contract proving its existence is destroyed or lost. On this level, it is subject to the same defences as are other contracts; namely, fraud, duress, and *non est factum*. They may also be assigned like ordinary contracts.[105] Moreover, the *Bills of Exchange Act* (which governs BAs) provides that the capacity to contract and the issue of consideration are the same as for ordinary contracts.[106]The question then becomes, if negotiable instruments are understood to be contractual obligations, what type of contractual obligation is the BA? We will begin with loan.

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[103] (1929), 68 Que. S.C. 31 (S.C.).

[104] *Elcano Acceptance Ltd.* v. *Richmond, Richmond, Stambler & Mills*, (1989) 68 O.R. (2d) 165, 174. Conf. (1991) 79 D.L.R. (4th) 154 (Ont. C.A.).

[105] A non-negotiable bill (payable to order of A only) cannot be negotiated by endorsement, but it may be assigned according to the rules of assignment of a chose in action (See *Dealers Finance Corp.* v. *Sedgwick* [1932] 1 D.L.R. 71 (Sask. C.A.). See also, I. F.G. BAXTER, *op. cit.*, note 92, p. 13-14. Baxter notes however that the assignment is not negotiation, and that it will give transferee the title of an assignee and not the title of a transferee by negotiation. The difference will be discussed *infra*, p. 22

[106] 46. (1) Capacity to incur liability as a party to a bill is coextensive with capacity to contract.
52. (1) Valuable consideration for a bill may be constituted by
(*a*) any consideration sufficient to support a simple contract; or

### 2.3.1 Loan

Can a BA be understood as a loan? *Prima facie*, it appears the answer is yes. The Civil Code of Quebec defines a simple loan as follows:

> 2314. A simple loan is a contract by which the lender hands over a certain quantity of money or other property that is consumed by the use made of it, to the borrower, who binds himself to return a like quantity of the same kind and quality to the lender after a certain time.[107]

The relationship between the accepting bank and its customer is somewhat similar to that of a lender and borrower. Consider the following: the bank will agree to pay a certain sum of money to the payee, which, in many cases will be the customer as the practice with BAs is for the customer to name him or herself payee. This sum is to be reimbursed by the customer at a future date, along with the payment of additional fees (similar to premiums) and interests. Thus, this arrangement appears seems to be a loan. But, this is not the case. Although a BA involves a credit transaction, it is not a loan. The acceptor never lends money to the customer, although he may facilitate the transfer of funds to the customer by discounting the accepted bill or draft.[108]

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[107] S.Q., 1991, c. 64, art. 2314.

[108] Lazar SARNA, *Letters of Credit: The Law and Current Practice*, 3rd ed., (Publisher's Note 2002 – Rel. 2), Toronto, Carswell, 1989, p. 10-37. See B. CRAWFORD, *op. cit.*, note 87, p. 879; See also the decision of Gould, J. in *Air Canada* v. *Minister of Finance of British Columbia*, [1979] 4 W.W.R. 643, 648 (B.C.S.C.) (reversed on other grounds).

The court in *Inland Revenue Commissioners v. Rowntree & Co.*[109] had to determine whether capital arising from an acceptance was considered "borrowed money" for taxation purposes. In discussing the issue, Justice Tucker stated the following:

> As to that, if the word "lender" is to be given its strict legal meaning, I am unable to see how the discount houses lent any money to anybody. They did not. They purchased these bills, and I think it is a fallacy to regard a transaction of this kind as one of borrower and lender. "But," said the Solicitor-General, "even if Erlangers are not strictly lenders in law, none the less, if you look at this transaction as a whole, if you regard it as a tripartite arrangement, its object was to raise money in the money market, the money was in fact raised, it was made available for the use of the company by the discount house, and therefore, the discount house is to be regarded as the lender in a commercial sense, and for the purposes of this taxing Act there is a borrowing of money wherever A makes available for B money for B's use on the terms that B will pay an equivalent sum to A at some future date." I think the speeches in the Port of London case in the House of Lords indicate that the proper approach to this case is to construe the words "borrowed money" as words which require the existence of a borrower and lender, and that there must be a real borrowing in the legal sense of the word. I find it difficult, if not impossible, to appreciate how there can be borrowed money unless the legal relationship of lender and borrower exists between A and B. After all, the words "borrow" and "lend" are not words of narrow legal meaning. They represent a transaction well known to business people.[110]

From an analytical perspective, we must be careful to distinguish the underlying agreement (the credit arrangement, in this case) from the BA itself (a negotiable

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[109] [1948] 1 All E.R. 482 (C.A.).

[110] *Id.*, With respect to taxation, Professor Ogilvie has remarked, "Until 1984, it was uncertain as to whether acceptance stamping and other fees were deductible for tax purposes as were fees and costs associated with bank loans. However, changes in the *Income Tax Act* clarified the position so that although bankers' acceptances are not, legally speaking, loans, certain costs associated with them are deductible for tax purposes." M.H. OGILVIE, *op. cit.*, note 3, p. 428.

instrument), as mentioned earlier. To repeat, a loan is a bilateral contract, whereas the BA is a unilateral, independent obligation for the bank. Though the customer is secondarily liable to the holder in due course, should the bank default, the customer does not entertain a direct obligation to reimburse the bank (apart from that arising from the credit arrangement, which is a separate contract).

There are a number of theories put forward by German, Italian, French, British and American authors, concerning the unilateral nature of this obligation. Analyzing these theories would be beyond the scope of this paper. Nevertheless, for clarification purposes, the following is a brief overview.

German scholars first posited that negotiable instruments operate on the basis of the unilateral engagement of the drawer.[111] The German conception is based on a formalism whereby drawing the bill invests the legal rights in the instrument, independent of the underlying transaction.[112]

The leading Italian theories were fairly similar to the main German ones. However, as Jeantin and Le Cannu point out, German theory was not easily reconcilable with French law, which has not pushed the notion of the abstract nature of the bill of exchange to its limits.[113] Indeed, classic French doctrine was never receptive to unilateral engagements but has come to accept the notion with respect to negotiable instruments.[114] This has lead Jeantin and Le Cannu to propose that bills of exchange are only partially

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[111] The intellectual origins of the unilateral engagement theory have been attributed to Johannes Kuntze. See Johannes Emil KUNTZE, *Die Lehre von den Inhaberpapieren, oder, Obligationen au porteur, rechtsgeschichtlich, dogmatisch und mit Berücksichtigung der deutschen Partikularrechte*, Leipzig, J.G. Hinrichs, 1857, referred to in Frédéric NIZARD, *Les titres négociables*, Paris, Revue banque édition : Economica, 2003, p. 80.

[112] L. M. MITCHELL, *loc. cit.*, note 46, 240.

[113] Michel JEANTIN and Paul LE CANNU, *Droit commercial: Instruments de paiement et de credit; Entreprise en difficulté*, 6th ed., Paris, Dalloz, 2003, p. 172.

[114] Frédéric NIZARD, *Les titres négociables*, Paris, Revue banque édition : Economica, 2003, p. 76, note 1.

abstract in nature, operating out of the interaction of the will of the parties and the legislative requirements; the legislative formalism reinforcing the unilateral engagement of the drawer.[115]

On the other hand, according to American and British doctrine, the source of the obligation lies not in unilateral engagements, but rather in unilateral *agreements*. It is the acceptance that binds; "[b]efore acceptance...no legal obligation exists."[116]

Notwithstanding the nuanced doctrinal debate, the unanimous view is that negotiable instruments are by nature unilateral in their obligations. Therefore, the BA cannot be a loan. What the bank has done in practice is that it has shifted its creditworthiness to the customer, so that the latter can finance a particular transaction. Unlike a loan between the bank and its customer, in the BA nothing is transferred and no deposits are kept as reserves. Reserves are however maintained by the Bank of Canada for lending activities.[117]

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[115] Michel JEANTIN and Paul LE CANNU, *Droit commercial: Instruments de paiement et de credit; Entreprise en difficulté*, 6th ed., Paris, Dalloz, 2003, p. 172. This is similar to the view expressed by Roblot, who rejected other French and German theories on the source of the obligation. See René ROBLOT, *Les effets de commerce : lettre de change, billets à ordre et au porteur, warrants, facture protestable*, Paris, Sirey, 1975.

[116] Geoffrey Chevalier CHESHIRE, *Cheshire, Fifoot and Furmston's Law of Contract*, 12th ed., London, Butterworths, 1991, p. 57. See Frédéric NIZARD, *Les titres négociables*, Paris, Revue banque édition : Economica, 2003, p. 76, note 1.

[117] See M.H. OGILVIE, *op. cit.*, note 3, p. 429.

### 2.3.2 Guarantee

Should a BA be viewed as a contract of guarantee (suretyship)? As with a guarantee, the bank in a BA transaction is responsible for the liability of the customer, since it effectively guarantees payment to the holder in due course. The Act provides the means of a guarantee type of arrangement. An accommodation bill is one accepted or endorsed without value so that a party to the bill is accommodated. The BA is an instrument where the acceptor plays the role of a surety for a principal debtor who may or may not be a party to the bill.[118] The Quebec Civil Code states:

> 2333. Suretyship is a contract by which a person, the surety, binds himself towards the creditor, gratuitously or for remuneration, to perform the obligation of the debtor if he fails to fulfil it.[119]

Recall that "[b]ecause the obligations on a negotiable instrument are contractual the guarantor prevents nothing known to the general law of contract. Ordinary rules applicable to the relations between guarantor and the person he provides a guarantee apply in matters of negotiable instruments."[120] However, this is not to say that the bank is a guarantor in a BA transaction, but simply that another party may choose to act as a guarantor for either the bank or customer, and add their liability to that of the bank and the customer. This would be a separate agreement however, independent of the BA.

Insofar as the BA is concerned, it cannot be classified as a contract of suretyship or guarantee, because the accepting bank is *primarily* liable to the creditor (e.g., holder in

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[118] I. F.G. BAXTER, *op. cit.*, note 92, p. 40.
[119] S.Q. 1991, c. 64, art. 2333 (hereinafter C.C.Q.)
[120] A. BARAK, *loc. cit.*, note 85, p. 63.

due course), not secondarily liable as guarantors typically are. The obligation of the bank is independent of any obligation its customer may have towards any other party (such as the bank or a holder in due course). Moreover, while a surety can raise defences of the principal debtor, such as set-off and incomplete performance, these defences are not available for the accepting bank in a BA transaction, which must pay the holder in due course without invoking any of the customer's actions or failures.

Nevertheless, it does not help us any more if we invert their roles and consider the bank as the debtor, and the customer as the surety, because the BA transaction could not then be characterized as a suretyship. Thus, the customer's liability to the beneficiary/ holder of the BA, in the event that the bank refuses or is unable to fulfil its obligations, is a separate obligation. The customer, in paying the holder at maturity, does not "perform the obligation of the debtor" as set out in the Civil Code, but rather performs his own obligation, which stems from his signature on the BA. Furthermore, a contract of suretyship requires the surety (in this case, the customer) to "bind" himself to the creditor (e.g., a holder in due course). However, in a BA transaction, the surety would be binding himself to the debtor (bank), not the creditor. The contractual relationship formed exists only between the bank and customer and not third parties. The benefit to third parties derives from the nature of the contract, not from the contractual relationship itself. The BA is thus a guarantee *type* of arrangement, but is not a guarantee as understood under basic private law principles.

### 2.3.3 Mandate

Does the BA relationship between the bank and its customer resemble a mandate? Article 2130 Civil Code of Quebec states:

> 2130. Mandate is a contract by which a person, the mandator, empowers another person, the mandatary, to represent him in the performance of a juridical act with a third person, and the mandatary, by his acceptance, binds himself to exercise the power. The power and, where applicable, the writing evidencing it are called the power of attorney.[121]

This law can be said to describe the bankers' acceptance (negotiable instrument) contract. The customer is said to be the mandator (principal) while the accepting bank can act as its customer's mandatary (agent). The performance of the juridical act with regard to a third person would be the obligation to pay the holder in due course (or beneficiary) a sum certain of money at a specified date.

However, the mandate would not work to characterize a BA, since unlike ordinary mandates, the mandatary in this case (the bank) never intends to act on behalf of, or represent, the mandatory. Instead, from the outset, the bank acts in its own name. As we have pointed out, the commercial desirability of a BA is the fact that the bank (usually an eminently creditworthy institution) is primarily liable on the instrument, independent of the customer. We must be careful to distinguish between the bank acting at the request of

[121] C.C.Q., art. 2130.

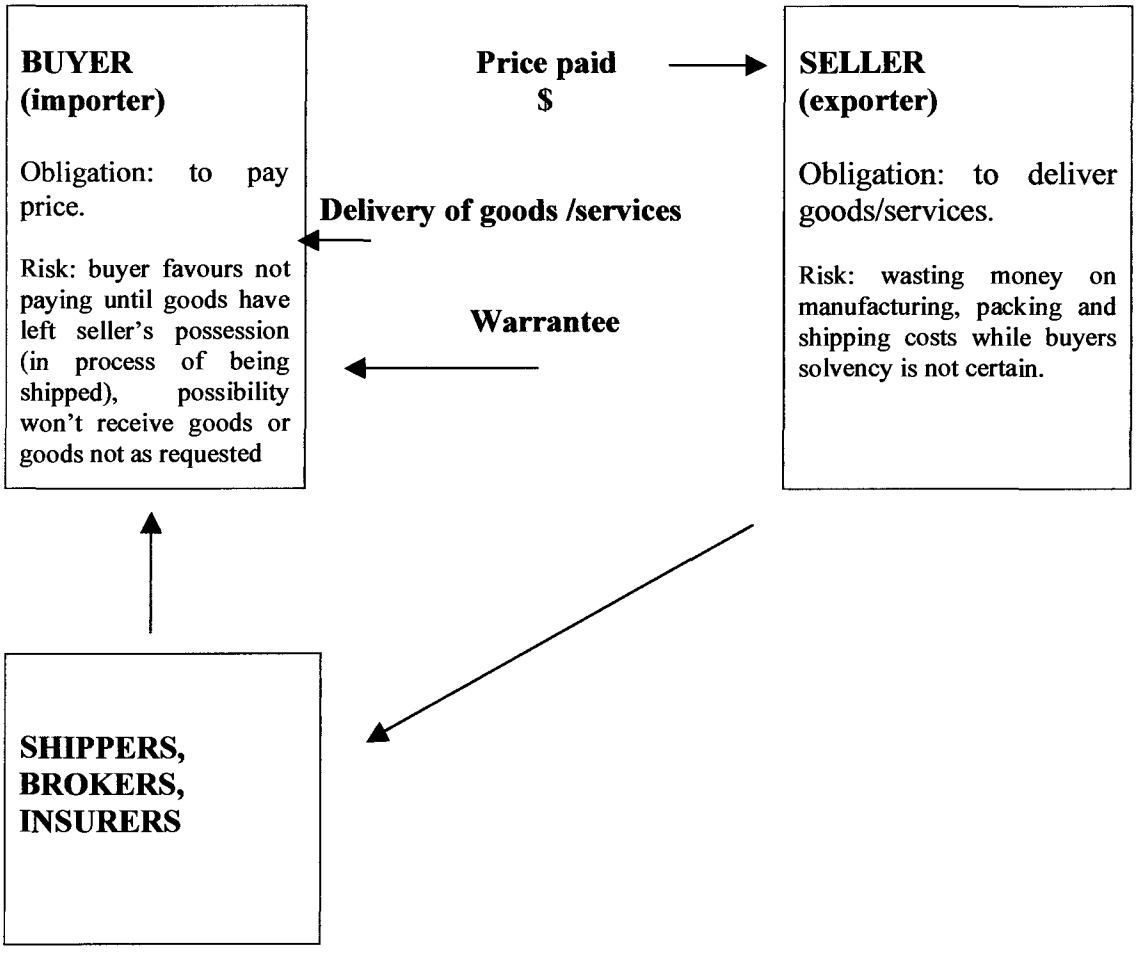
its customer and the bank representing its customer. In a BA transaction, the bank acts on the "unconditional order" of its customer; but it accepts the bill or note in its own name. It does not purport to exercise any "power" granted by the mandator. Moreover, although the bank binds itself to pay the holder in due course at maturity, it does not commit to represent the customer and act in its stead as mandatary/ agent. Whether the bank acts as the customer's mandatary will depend on some other arrangement.[122]

[122] See Harold LUNTZ, "Cheques as Mandates and as Bills", (1996-97) 12 *B.F.L.R.* 189, 190-191 for a discussion of a cheque (a negotiable instrument) as a bill or mandate. A cheque differs from a bankers' acceptance in that the former is payable on demand, while the latter is payable fixed or determinable future time.

### 2.3.4 Contract of Sale

Is the BA seen as a contract of sale? Indeed, in international transactions involving foreign parties, the contract of sale can stipulate that a BA will be used as the method of payment either in conjunction with a letter of credit or in lieu of one. When a BA is used in conjunction with an existing letter of credit, it will be used to hasten payment so that a beneficiary will not have to wait until the term of payment to cash in on his profits. If however, the BA is used as an alternative to the letter of credit, then although it will continue to have the characteristics of a bill; it will now have an added international character.

**THE CONTRACT OF SALE OF GOODS BETWEEN A BUYER & SELLER OF GOODS AND SERVICES**



Article 1708 CCQ defines sale:

> Sale is a contract by which a person, the seller, transfers ownership of property to another person, the buyer, for a price in money which the latter obligates himself to pay. A dismemberment of the right of ownership, or any other right held by the person, may also be transferred by sale.[123]

The BA may be sold, subject to the rules of the sale of movables. Notwithstanding this fact, the BA itself cannot be said to be a contract of sale, since a BA transaction involves no buyer or seller. Nor does the BA involve a transfer of ownership of property (although it may create "property"). As mentioned above, negotiable instruments are unilateral contracts, not bilateral contracts. Thus they could never be deemed a contract of sale, since they are not synallagmatic by definition,[124] and they do not involve the transfer of property.

As well, the BA cannot be classified as a specific nominate contract. The only alternative is to view the BA as a type of *sui generis* contract. The problem is if the BA instrument is a *sui generis* contract that creates a negotiable instrument, how then do we characterize the transaction that occurs between the customer and bank, whereby the order is made, and then accepted by the bank? Assuming that the bankers' acceptance is an obligation, the BA transaction resembles certain methods of transferring or modifying the obligation under the Civil Code.

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[123] C.C.Q., art. 1708
[124] *Id.*, art. 1380,

### 2.3.5 Novation

Can the BA be said to involve novation? We might think that like cash, the negotiable instrument is an instrument in circulation that destroys the title of the former owner and creates a title 'de novo' in the person receiving it.[125] The Quebec Civil Code provides:

> 1660. Novation is affected where the debtor contracts towards his creditor a new debt which is substituted for the existing debt, which is extinguished, or where a new debtor is substituted for the former debtor, who is discharged by the creditor; in such a case, novation may be affected without the consent of the former debtor.
>
> Novation is also affected where, by the effect of a new contract, a new creditor is substituted for the former creditor, towards whom the debtor is discharged.

Still, novation does not adequately capture what occurs in a BA transaction between the bank and its customer. The bankers' acceptance, as a negotiable instrument, constitutes a new and independent obligation; it does not arise in place of the existing debt, as mentioned previously. The bank's liability is not substituted for the customer's; it is simply added to it. The fact that the customer remains liable to the holder in due course

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[125] James Crossely VAINES, *Personal Property*, 5th ed., London, Butterworths, 1973, p. 161.

on the bankers' acceptance, along with the accepting bank means, practically speaking, that what occurs in a BA transaction is not novation.[126]

[126] See N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 420.

### 2.3.6 Delegation

Is it possible to envision the BA relationship as a form of delegation? Article 1667 of the CCQ defines delegation:

> 1667. Designation by a debtor of a person who is to pay in his place constitutes a delegation of payment only when the delegate obligates himself personally to the delegatee to make the payment; otherwise, it merely constitutes an indication of payment.

The customer in a regular BA transaction is the debtor and the beneficiary or holder is its creditor. The customer would be the *délégant*, the accepting bank would be the *délégué*, who receives instruction from its customer to make a payment, to the beneficiary (*délégataire*).

Delegation may be perfect or imperfect. Perfect delegation means that the creditor *(délégataire)* accepts the *délégué* as the new debtor (which in a sense entails novation). This would mean that the third party would have to accept the bank as a debtor. Imperfect delegation means the debtor does not consent to discharge the original debtor, and thus a new obligation is created. Thus, delegation can, to a certain extent, define the operation of a bill of exchange, and therefore the BA.[127] Still, the BA cannot truly be classified as a

[127] See Jean-Louis BAUDOUIN and Pierre-Gabriel JOBIN, *Les Obligations*, 5th ed., Cowansville, Yvon Blais, 1998, p. 760.

delegation, because it cannot account for the liability the acceptor undertakes to all successive beneficiaries' holders in due course.[128]

[128] See N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE, *op. cit.*, note 57, p. 420.

### 2.3.7 Assignment

Is the BA an assignment? Article 1637 CCQ states:

> A creditor may assign to a third person all or part of a claim or a right of action which he has against his debtor. He may not, however, make an assignment that is injurious to the rights of the debtor or that renders his obligation more onerous.

In a BA, a difference must be made in that although it can be assigned, it is not itself an assignment.[129] Section 126 of the *Bills of Exchange Act* provides:

> A bill, of itself, does not operate as an assignment of funds in the hands of the drawee available for the payment thereof, and the drawee of a bill who does not accept as required by this Act is not liable on the instrument.

Aside from the statutory pronouncement, the BA could not be an assignment of claim, because assignment presupposes a claim or right of action that can be transferred, while the contractual obligation forming the BA creates the claim in the first place. "The assignment does not create liability, it merely redirects it."[130] The customer cannot assign something it never had in his or her possession in the first place. Although the customer may well be a creditor of the bank (if, for example, the customer has an account in that particular bank), we must remember not to confuse pre-existing or underlying agreements

[129] For a complete discussion, see Ian F.G. BAXTER, "The Bill of Exchange as an Assignment of Funds: A Comparative Study", (1953) 31 *Can. Bar. Rev.* 1131.
[130] B. CRAWFORD, *op. cit.*, note 34, p. 1611.

with the BA. The customer is not purporting to transfer the debt owed to him by the bank to the third party, but rather is creating a new, independent obligation with a BA.

### 2.3.8 Stipulation for Another

Does a BA involve a stipulation for another (*stipulation pour autrui*)? [131] Article 1444 of the Civil Code of Québec provides:

> A person may make a stipulation in a contract for the benefit of a third person. The stipulation gives the third person beneficiary the right to exact performance of the promised obligation directly from the promisor.

Stipulation for another resembles in some way indication of payment, delegation, and assignment of claim. It appears that a BA is, in fact, a stipulation for a third party. Indeed, it meets the requirements of the Code. The customer would be the person making the stipulation, the bank would be the promisor, and the third person beneficiary would be the specified person or bearer. However, in a BA transaction, the third party retains his or her right against both the bank and customer. That is, there are two separate liabilities, unlike a stipulation for another, which maintains a single obligation. Moreover, the Code states that:

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[131] The *jus quaesitum terito* has a long tradition in civil law..The "stipulation pour autrui" is part of the civil law of both France and Quebec. In this book on letters of credit, Sarna concludes that "if the categorization of the letter of credit as a 'stipulation pour autrui' retains the possibility that the issuing bank may in certain limited circumstances refuse to honour the credit extended, this may very well reflect the current stage of development of the commercial use of letters of credit and accordingly provide harmony between the legal mechanism and the commercial practice." He seems to have in mind as "limited circumstances," special statutory and regulatory restrictions which can affect the lending practices of banks. I. F.G. BAXTER, *op. cit.*, note 92, p. 17.

> 1450. A promisor may set up against the third person beneficiary such defences as he could have set up against the stipulator.

Article 1450 provides an option that cannot be invoked in a BA transaction, or any negotiable instrument, where the stipulated party is the holder in due course because section 73(b) of the *Bills of Exchange Act* provides:

> The rights and powers of the holder of a bill are as follows...(*b*) where he is a holder in due course, he holds the bill free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill.

Because the holder holds the bill free from any defect in title as well as mere personal defences,[132] the BA cannot be a stipulation for another, because the bank (promisor) does not have the same defences against the third person beneficiary (the holder in due course) as he would have against the customer (as stipulator). The holder in due course doctrine is an exception to the *nemo dat quod non habet* rule, which is captured by Article 1450 of the Quebec Civil Code. There is thus an important difference between "immediate" and "remote" parties that is not captured in the stipulation for another.[133]

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[132] "Defect of title" and "mere personal defenses" are discussed in Benjamin GEVA, "Equities as to Liability on Bills and Notes: Rights of a Holder Not in Due Course", (1980-81) 5 *C.B.L.J.* 53, 61-72.
[133] For a discussion of some the holder in due course issues see Benjamin GEVA, "Reflections on the Need to Revise the Bills of Exchange Act", (1981-82) 6 *C.B.L.J.* p. 269, 271-302.

### 2.3.9 Letters of Credit

Can a BA function like a letter of credit? By the "look" of a BA, and given how often it is used instead of a letter of credit in international transactions, it would not be misplaced to question whether they are the same type of instrument.

A letter of credit is defined as a letter from of a party (the issuer, a bank) addressed to a party (the beneficiary) at the request of another party (the applicant, the bank's customer). The letter indicates an undertaking to pay the beneficiary upon demand by the latter. In most cases, this demand must be accompanied by other documents.[134] Generally speaking, letters of credit transactions involve a number of separate relationships: the issuer-beneficiary relationship, the beneficiary-applicant-relationship and the applicant-issuer relationship.[135]

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[134] John F. DOLAN, *The Law of Letters of Credit: Commercial and Standby Credit*, (rev. ed.), Arlington, VA, A.S. Pratt, 1999, §2.02[1].
[135] *Id.*, §2.01. See *United City Merchants.* v. *Royal Bank of Canada,* [1983] A.C. 168; (1982) All E.R. 720 (H.L.).

# LETTER OF CREDIT

Name of bank:
Address:

| | |
|---|---|
| **Type of credit document** | **Credit number** |
| **Beneficiary:**<br>Beneficiary's name<br>Beneficiary's address | **Applicant**:<br>Applicant name<br>Applicant address |
| **Advising Bank:**<br>Advising bank's name<br>Advising bank's address | **Amount:**<br>(specify currency) |
| **Credit available by:**<br>(specify mode of credit) | **Date & site of expiration** |

**List of accompanying documents**

**Purpose of Issuing Credit**

| | | |
|---|---|---|
| **Shipment form** | **Partial shipments** | **Transhipment** |

**Details:** re: shipment from x to y
**Restrictions:**

**Additional instructions:**

**Applicable law:** designate law to apply

In practice, the biggest worry of a seller is the risk of non-payment by a buyer in a foreign country. While the seller is anxious not to spend money wastefully in manufacturing, packaging and shipping goods without knowing for certain that the buyer will be solvent, the buyer will favour not paying until the goods have left the seller's possession on their way to him. This fact is usually attested to by documents produced by the seller. Consequently, at the demand of the seller, the buyer will call upon a bank to guarantee the execution of the obligation of payment by opening a letter of credit to the benefit of the seller.[136]

Authors have recognized that there has been some uncertainty about the precise legal nature of the letter of credit precisely because they resemble a number of other instruments.[137] However, authors have also noted that letters of credit are neither bills of exchange nor promissory notes.[138] This is true because most letters of credit are payable upon the production of certain documents, which is "fatal" to any argument they are bills of exchange, because they fail the requirement that the order be unconditional.[139] Even if letters of credit could be said to be negotiable instruments, they would be promissory notes[140] as the document contains a promise to pay, rather than an order. Although the

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[136] Audi GOZLAN, *International Letters of Credit: Resolving Conflicts of Law Disputes,* 2nd ed., London, Kluwer Law International Ltd., 1999, p.1.

[137] John F. DOLAN, *The Law of Letters of Credit: Commercial and Standby Credit*, (rev. ed.), Arlington, VA, A.S. Pratt, 1999, §2.01. See also Lazar SARNA, *Letters of Credit: The Law and Current Practice*, 3rd ed., (Publisher's Note 2002 – Rel. 2), Toronto, Carswell, 1989, p. 2–1.

[138] David A.L. SMOUT, (ed.), *Chalmers on bills of exchange: A Digest of the Law of Bills of Exchange*, 13th ed., London, Stevens, 1964, p. 179; Antonio PERRAULT, *Traité de droit commercial*, t. 1, Montreal, Albert Levesque, 1940, p. 1211, as cited in Lazar SARNA, *Letters of Credit: The Law and Current Practice*, 3rd ed., (Publisher's Note 2002 – Rel. 2), Toronto, Carswell, 1989, p. 2–20.

[139] BEA, s. 16.

[140] There are some letters of credit that are payable simply after the passage of time and do not require the presentation of documents. Notwithstanding, the difficulties associated with characterizing them as negotiable instruments, they may well be promissory notes. Nevertheless, "it serves little analytic purpose to characterize one limited species of letter of credit as a promissory note and to exclude the much greater realm of conditional letters of credit from that characterization. To say that some letters of credit are in law promissory notes is in effect simply to say that they are not letters of credit." Lazar SARNA, *Letters of*

BA functions in similar ways to a letter of credit, it remains markedly different, especially in its operation. The difference between a promise and an order is that in the former (letter of credit), although you have undertaken to do something, there is the option to fulfill the promise or not, if some other contingency has not been met. But, with an order (such as the BA), you are required by law to act in a certain way (i.e., to pay) in default of which you would be in breach of contract with all the consequences that entails. In the letter of credit, the payer may choose not to pay at a certain time by invoking the fact that the merchandise was defective, or that the seller defaulted in some way. But in a BA transaction, the payee bank must make payment at the agreed upon date of the document, irrespective of the seller's fulfillment of his obligations. This, for the seller and buyer, is the greatest advantage of the BA over the letter of credit.

Final consideration on this point should be given to anticipated acceptance theory, which states that in undertaking to open a credit on behalf of the applicant, the bank gives an anticipated acceptance, which obligates the bank to pay the beneficiary the face amount of the letter of credit.[141] Sarna attributes the source of this theory to jurisprudence that equated the promise in the letter of credit to an anticipatory acceptance of drafts, but he points out, however, that Canadian, French and British legislation require that the acceptance must be made on the bill itself for it to be valid.[142] And so the difference between a letter of credit and a BA in this respect is that while in the first an acceptance is a part of the document but not essential to its existence, in the BA, the acceptance is what makes the BA valid

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*Credit: The Law and Current Practice*, 3rd ed., (Publisher's Note 2002 – Rel. 2), Toronto, Carswell, 1989, p. 2–21.

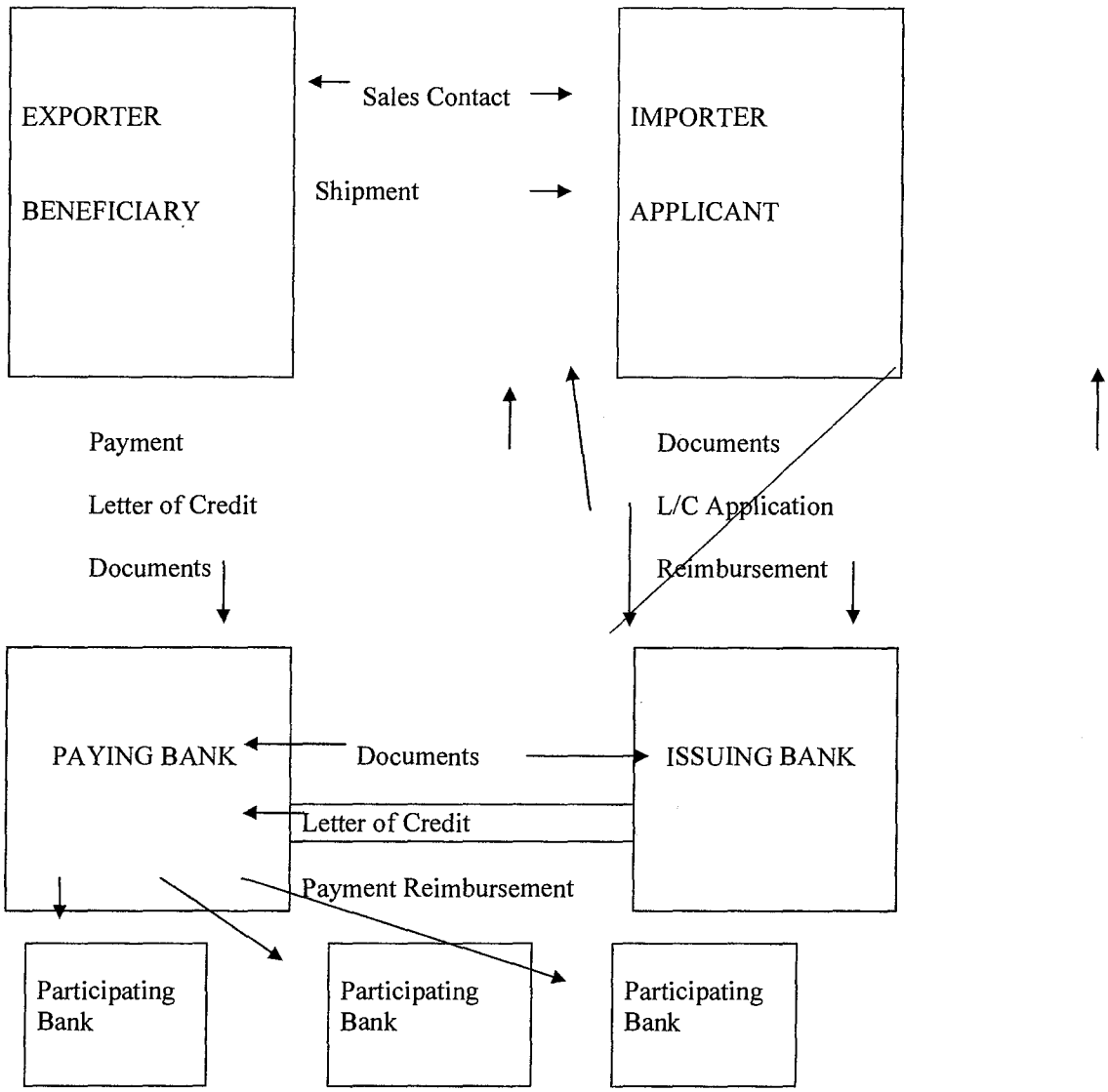
[141] Lazar SARNA, *Letters of Credit: The Law and Current Practice*, 3rd ed., (Publisher's Note 2002 – Rel. 2), Toronto, Carswell, 1989, p. 2–22. In France, this is known as "une acceptation cambiaire."

[142] Id., p. 2–22. In Canada, the relevant legislation is section 35 of the Bills of Exchange Act.

To summarize, the BA is an agreement that shares some similarities with certain forms and modalities of obligations, yet it remains distinct in that it is a negotiable instrument governed by the *Bills of Exchange Act*. The BA creates a new obligation for each of the signatories, which originates from the consent to be bound and statutory requirements. The obligation is both voluntary and legal.[143] Thus, we must concur with Justice Barclay who stated, "While negotiable instruments are contracts, they are contracts of a special nature, regulated by a special statute, and by that statute they are made part of the currency of the country."[144] This special statute is the *Bills of Exchange Act*, which governs the creation and operation, and unique characteristics of negotiable instruments.

[143] See N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 420
[144] *Bank of Montreal* v. *Amireault*, (1938) 65 B.R. 1, 19

## PROCEDURE FOR A LETTER OF CREDIT



## 2.4 The Complex Character of the Bankers' Acceptance

Rare is a legal document at once so simple and yet so complex. The BA is an obligation (contract) drafted and is considered property. Yet, it is also classified as a "negotiable instrument," which allows it to be transferred to any new holder in due course within its maturity date, while creating unique obligations upon the parties involved.[145] The identification of the right to possess a bill or note and the right to sue thereon corresponds to the double nature of a negotiable instrument as in a "chose in action" and a "chattel," otherwise known as an "intangible obligation" and "movable property" in civilian terminology. This earned the BA (and bills of exchange generally) the description of having a "duplex" nature. Concerning the "duplex nature" of the negotiable instrument, one author pointed out:

> It is a chattel, a tangible scrap of paper, sometimes valuable for its own sake if sufficiently ancient or bearing the autograph of some historic debtor.... Secondly, a bill or note is a bundle of contracts. Its ownership involves not only the right to possess a thing but the right to sue several persons - maker, drawer and acceptor endorsers. The right to hold the paper and the right to enforce the obligation are in the same person.[146]

However, others have asked us to consider the triple nature of the negotiable instrument, and rightfully so. BAs have more than a dual nature. As explained:

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[145] See A. BARAK, *loc. cit.*, note 85, p. 67

[146] Zechariah CHAFEE, "Remarks on Restrictive Endorsements", (1945) 58 *Harv. L.R.* 1182, 1190.

> [The answer to the previous question should be evident] ... recalling the triple nature of the negotiable instrument. An instrument is a chattel governed by general property law, as well as an obligation governed by general contract law. It is also a negotiable paper governed by the special law merchant or the law of negotiable instruments in the strict sense, as codified by the BEA in relation to bills and notes.[147]

This double, or rather triple nature of a negotiable instrument has long been recognized. This unique instrument is produced by the "reification" of the debt claim under the instrument or its "merger" into the paper embodying it.[148] That is, the physical bill itself, the very piece of paper, constituted, and did not merely evidence, the claim or debt that had created it.[149]

Professor Gilmore explains it this way:

> That was the idea, that the piece of paper in which the bill was written or printed should be treated as if it - the piece of paper - was itself the claim or debt which it evidenced. This idea came to be known as the doctrine of merger - the debt was merged in the instrument. Under merger theory the only way of transferring the debt represented by the bill was by physical delivery of the bill itself to the transferee.[150]

Is it truly important to exert so much intellectual effort in order to characterize the negotiable instrument? It would appear so. Barak reminds us that, "[t]heory is very often a matter of great practical importance," especially in a field which develops at such a

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[147] J. ZIEGEL, B. GEVA and R.C.C. CUMING, *op. cit.*, note 6, p. 58.
[148] *Id,* p. 57.
[149] K. EGGERT, *loc. cit.*, note 36, p. 383.
[150] Grant GILMORE, "Formalism and the Law of Negotiable Instruments", (1979) 13 *Creighton L. Rev.* p. 441, 449.

rapid pace. A return to underlying theory is necessary to deal with "new and unforeseeable" situations.[151] Indeed, it may be quite relevant in many instances, in particular where there are questions as to which law applies to the instrument. Barak further states:

> From the point of view of general theory it is important to emphasize that the negotiable instrument's existence does not depend solely on the special legislation on the subject; it also exists outside that framework. It would be a grave error to attempt to find the answers to all the questions on negotiable instruments in that special legislation alone. The nature of the negotiable instrument cannot be properly understood if it is not examined in the light of the legal system as a whole. Thus, for example, the legislation on negotiable instruments lays down rules as to negotiation. But negotiation is not the only way in which liability on a bill is transferred. As we have already seen, at least insofar as English law is concerned, the transfer can be in accordance with the rules governing the assignment of debts. In addition, the rights on a bill may also pass by way of succession or on bankruptcy. The latter are not regulated by a special legislation on negotiable instruments, but by general law, without which it is impossible to understand the theoretical nature or practical operation of the negotiable instrument.[152]

Therefore, as a bill or note "is both a chattel and a chose in action" and a "negotiable instrument," it is subject to two main sets of laws: one is the general law dealing with property and obligations; the other is the special law, derived from the law merchant dealing with the specific characteristics of a bill or note as a negotiable instrument. The former set of laws, relating to the property and obligatory elements of the instrument, is "the law of bills and notes in the wide sense." The latter set of laws, which

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[151] A. BARAK, *loc. cit.*, note 85, p. 50.
[152] *Id*, p. 72.

includes the form, issue, negotiation, and discharge of bills and notes, is "the law of bills and notes in the strict sense"[153] The question arises with section 9 of the *Bills of Exchange Act*, which provides:

> 9. The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques.

This part of our work has been the source of much doctrinal controversy. Some authors maintain that this section imports English common law to all matters coming within bills and notes.[154] Others, who represent the majority opinion, maintain that the scope of section 9 is limited to those matters coming within bills and notes in a "strict sense" only, not matters concerning bills and notes in a wide sense.[155] It should be noted that the distinction between the law of negotiable instruments in the strict sense and the law of negotiable instruments in the broad sense is not expressly referred to in section 9. Nevertheless, this interpretation of the section is premised on "the double nature of the bill or note as a 'negotiable instrument' governed by special law (whose historical roots are in the old law merchant), and as a chattel and obligation governed by the general law of property and contract."[156] According to some of the jurists who hold that English common law applies, reading the strict/ wide distinction into section 10 [now section 9] is

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[153] Benjamin GEVA, *Financing Consumer Sales and Product Defences in Canada and the United States*, Toronto, Carswell, 1984, p. 256.
[154] See e.g., Benjamin RUSSELL, *A Commentary on the Bills of Exchange Act*, 2nd ed., Montreal, Burroughs & Co., 1921, p. 22.
[155] *Infra*, p. (interpretive approach) *ff.* See Antonio PERRAULT, *Traité de droit commercial*, t. 3, Montreal, Albert Levesque, 1940, p.171 *ff.* and Maximilien CARON, *Précis de droit des effets de commerce*, 7th ed., A. BOHÉMIER and Michel DESCHAMPS, (eds.), Montreal, Beauchemin, 1986.
[156] Benjamin GEVA, "Negotiable Instruments and Banking: Review of Some Recent Canadian Case Law", (1994) 9 *B.F.L.R.* p. 197, 198. Although the leading Quebec authors agree with the strict/wide dichotomy, they do not discuss the notion of the "double nature" of bills, cheques and notes.

incompatible with the language of that section.[157] On the other hand, some jurists believe that this view reflects the true spirit of the law.[158] In any case, "...the distinction has proved a political and legal means of limiting the incident of sec. 10 [now section 9] and restricting its application to an absolute minimum."[159]

The issue of section 9 is important in Quebec, since private law in this province is based on the French civilian tradition, rather than the English common law. The matter is one related to the separation of powers between the federal and provincial governments in the constitution and federalism in general. Consequently, the difficulty with section 9 is not only a concern for Quebec, but in fact for all provinces.[160]

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[157] See A. BARAK, *loc. cit.*, note 85, p. 73.
[158] See M. CARON, *op. cit.*, note 155, p. 11-12. See also, Louis-Joseph de la DURANTAYE, *Traité des effets négociables*, Marc BRIÈRE, Louis-Philippe TASCHEREAU, and Guy LORD, (eds.), Montreal, Wilson & Lafleur, 1964, p. 42, who adopts Falconbridge's position.
[159] A. BARAK, *loc. cit.*, note 85, p. 73.
[160] *Id.*, p. 72 -73.

# CHAPTER 3. The Law and Operation of Bankers' Acceptances

In Chapter 2, we described the nature and juridical character of the BA. We have determined that the proper characterization of the BA will thus have a profound effect on the law that is applied. As mentioned, BAs are often part of wider transactions of business and financing operations, and so they will touch on both federal and provincial legislation. The scope of each field of legislation and the governing law is debatable. In the following sections, we will examine the various relationships formed in a BA transaction, and determine which law applies to them. To do this properly, we will begin by briefly exploring the legislation pertaining to the BA transaction and then turn to an examination of the actual operation. Understanding the law first is important because the BA transaction is a multifaceted operation with numerous obligations incurred by a variety of different parties, which may bring into play various federal and provincial laws, specifically the civil law in Quebec.

## 3.1 Canadian Legislation Affecting Bankers' Acceptances

Bills of exchange and negotiable instruments in Canada have been controlled by three primary pieces of legislation: The *Bills of Exchange Act*,[161] the *Bank Act*, [162]and the *Bank of Canada Act.*[163] Bills and notes may now be subject to a fourth enactment - the *Depository Bills and Notes Act.*[164] While the *Bills of Exchange Act* (and to some extent the *Depository Bills and Notes Act*) govern the creation of a BA and its conversion into a negotiable instrument, the *Bank Act* and the *Bank of Canada Act* relate to a BA on a broader level. We will examine each of these enactments in turn.

[161] R.S.C. (1985), c. B-4.
[162] 1991, c. 46.
[163] Supra, note 52.
[164] 1998, c.13.

### 3.1.1 The Bills of Exchange Act

The most important law applying to BAs is the *Bills of Exchange Act*, since it regulates the formal and transactional validity of negotiable instruments. The first Canadian *Bills of Exchange Act*[165] received Royal Assent on May 16, 1890 and came into force September 1, 1890.[166]

The Act states that any bill, draft, or promissory note will be treated as a negotiable instrument if it is expressed as a document in which one party obligates the other to pay a particular sum of money at a pre-determined or determinable date. BAs are governed by the *Bills of Exchange Act* because they are instruments drawn on a bank and payable at a future time. A bank, for the purposes of the *Bills of Exchange Act*, is defined as a bank or an authorized foreign bank within the meaning of section 2 of the *Bank Act*.[167] The details of the various requirements of the Act in respect to a BA will be analyzed in section 3.2 where its transactions will be discussed.

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[165] S.C. 1890, c. 33.
[166] See B. CRAWFORD, *op. cit.*, note 34, p. 1178.
[167] S.C. 1991, c. 46.

### 3.1.2 The Depository Bills and Notes Act

With the stated intention of the banking industry to evolve with technological developments, and to move towards electronic settlement and clearing, an understanding of the *Depository Bills and Notes Act* (DBNA), its effect on money market instruments, and its relationship with the *Bills of Exchange Act*, becomes crucial. [168]

*The Depository Bills and Notes Act* came into force June 11, 1998. This new legislation responds to recommendations by the banking and financial services industry. It is technical in nature and aims at improving the efficiency of Canada's money markets by creating "...a new class of investment securities designed to be traded and delivered by means of screen-based systems, replicating the protections of traditional negotiable instruments law by other means."[169] However, it was not intended to replace existing legislation such as the *Bills of Exchange Act*, but rather work with it and provide an additional means of drawing negotiable instruments.[170]

Nevertheless, the existing federal legislation in this area, the *Bills of Exchange Act*, discusses being in physical possession of negotiable instruments when describing the rights of parties involved in transactions. Today, it is increasingly common for banks and other stakeholders to hold instruments such as bills, treasury bonds, bankers' acceptances and other negotiable instruments through depositories. When such instruments are assigned, the transfer is facilitated by an entry in the records of the depository, not by

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[168] See Alison R. MANZER, "Depository Bills and Notes," (1998) 17 *Nat'l Banking L. Rev.* 69, 69-70.
[169] Bradley CRAWFORD, "The Depository Bills and Notes Act: Negotiable Instruments for the Electronic Age," (1998-1999) 14 *B.F.L.R.*, p. 205, 206.
[170] See A. R. MANZER, *loc. cit.*, note 168, p. 70.

way of the physical delivery of the instrument. Prior to the DBNA, the legislation governing financial institutions in this regard did not reflect the modern practice of financial institutions. *The Bills of Exchange Act* refers to the effect of possession of a negotiable instrument when determining the rights of parties to a transaction. When a negotiable instrument is in the hands of a depository and the transfer is effected through a record entry, the rights mentioned in the *Bills of Exchange Act* are impossible to interpret since the instrument itself remains with the depository. The DBNA corrects this problem by creating two new categories of financial instruments: the depository bill and the depository note. Now, a purchaser of a depository bill or note has the same legal rights as a purchaser of a bill or note under the *Bills of Exchange Act* without the instrument actually being delivered. In order to distinguish them from other similar securities, depository bills and notes will carry a notation on the reverse side indicating that they are depository bills and notes subject to the DBNA.[171]

The DBNA requires that the order be in writing, which according to some indicates that Canada is not yet entirely ready for e-commerce.[172] This is further evident from the concept of deemed physical delivery that will probably become fully obsolete within a few years. On the other hand, the law is unlikely to be of significant long-term influence or practical significance - not simply because of these deficiencies - but because it was deliberately designed from the outset as an interim measure.[173]

The terms "depository bill" and "depository note" in the DBNA are almost identical in substance to those of "bill" and "note" in the BEA. This was designed in

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[171] See B. CRAWFORD, *loc. cit.*, note 169, p. 219 and 220.
[172] A. R. MANZER, *loc. cit.*, note 168, p. 70.
[173] B. CRAWFORD, *loc. cit.*, note 169, p. 206. An additional reason offered for the writing requirement is it was thought to be necessary in order to locate the instruments in a particular jurisdiction for conflicts of law purposes.

order to ensure that it would be clearly recognizable whether it was subject to the BEA or DBNA.[174] For example, the DBNA requires that each instrument be marked with the words "This is a depository bill subject to the *Depository Bills and Notes Act*" or "Lettre de dépôt assujettie à la *Loi sur les lettres et billets de dépôt.*"[175]

Note that the legal relations of parties to a depository bill or note are appreciably different despite the fact that their practical effect and commercial value are substantially the same as instruments governed by the BEA.[176] For example, the Bills of Exchange Act distinguishes between primary, secondary and even tertiary liability of the parties involved. Moreover, the effect of section 16 is such that there is no defence of partial, or even total, failure of consideration under the Act, because a party is liable even if the bill does not constitute a binding contractual obligation.[177] Defences are limited to forged or unauthorized signatures and where the bill or note is counterfeit or materially altered with consent of the party liable to pay.[178] The requirements that the legend be prominently incorporated on the face of the depository bill, and somewhere within its text, are designed to ensure that persons signing the new form of bill understand that they are subjecting their liability on the instrument to the new legal regime. The requirements also serve to ensure that parties to instruments that were originally issued subject to the BEA are not at risk of having their liabilities materially altered by the addition of a legend at some later time.[179]

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[174] B. CRAWFORD, *loc. cit.*, note 169, p. 215.
[175] *Depository Bills and Notes Act*, 1998, c.13, s. 4(c) (hereinafter, D.B.N.A.).
[176] B. CRAWFORD, *loc. cit.*, note 169, p. 220.
[177] D.B.N.A., s. 16.
[178] *Id.*, c.13, s. 20(1).
[179] B. CRAWFORD, *loc. cit.*, note 169, p. 220.

The simplicity of the statute belies the fact that it is intended to be used by everybody. It contains few protections for parties contained in the *Bills of Exchange Act* (there is no section comparable to section V of the BEA), which are intended to insulate them against risk.[180] This legislation was designed for sophisticated and experienced issuers of money market instruments.

It is important to keep in mind that the "DBNA is a temporary measure narrowly focussed on avoiding, rather than solving, a number of difficult legal problems raised by the extension of electronic clearing and settlement systems to negotiable debt securities in the form of bankers' acceptances and commercial paper to which the market is accustomed." [181] Nevertheless, there may be resistance to abandoning the newly created legal regime under the DBNA, especially if actors in the money market have an encouraging experience with its liability regime. If this regime continues for any length of time, bankers will need to determine if BAs and other money market instruments will be settled through the Canadian Depository for Securities (CDS) system or not. If it is the case, they will need to ensure that the depository bill or note meets the requirements of the *Depository Bills and Notes Act.*[182]

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[180] *Id.*, p. 226.
[181] *Id.*, p. 242-243.
[182] A. R. MANZER, *loc. cit.*, note 168, p. 72.

### 3.1.3 The Bank Act

*The Bank Act*[183] confers the powers described in sections 409 and 410[184] to the banks falling within the Act's purview. These powers include, without limitation, certain

[183] Supra, note 137.

[184] The Business and Powers of banks was found in s. 173(1) of the Bank Act prior to 1991:

409. (1) Subject to this Act, a bank shall not engage in or carry on any business other than the business of banking and such business generally as appertains thereto.
(2) For greater certainty, the business of banking includes
(a) providing any financial service;
(b) acting as a financial agent;
(c) providing investment counseling services and portfolio management services; and
(d) issuing payment, credit or charge cards and, in cooperation with others including other financial institutions, operating a payment, credit or charge card plan.
410. (1) In addition to the powers that a bank may exercise pursuant to section 409, a bank may
(a) hold, manage and otherwise deal with real property;
(b) outside Canada, engage in the activities in which an information services corporation, within the meaning of subsection 464(1), may engage;
(c) in Canada, engage in such of the activities referred to in paragraph (b) that the bank was permitted to engage in by regulations made under the Bank Act, being chapter B-1 of the Revised Statutes of Canada, 1985;
(c.1) in Canada, engage in the activities in which an information services corporation, within the meaning of subsection 464(1), may engage, if before engaging in those activities the bank obtains the Minister's written approval for it to engage in those activities;
(c.2) engage in the activities in which a specialized financing corporation, as defined in subsection 464(1), may engage, if before engaging in those activities the bank obtains the Minister's written approval for it to engage in those activities;
(d) promote merchandise and services to the holders of any payment, credit or charge card issued by the bank;
(e) engage in the sale of
(i) tickets, including lottery tickets, on a non-profit public service basis in connection with special, temporary and infrequent non-commercial celebrations or projects that are of local, municipal, provincial or national interest,
(ii) urban transit tickets, and
(iii) tickets in respect of a lottery sponsored by the federal government or a provincial or municipal government or an agency of any such government or governments;
(f) ac t as a custodian of property; and
(g) act as receiver, liquidator or sequestrator.
(2) Except as authorized by or under this Act, a bank shall not deal in goods, wares or merchandise or engage in any trade or other business.
(3) The Governor in Council may make regulations
(a) respecting what a bank may or may not do with respect to the carrying on of the activities referred to in paragraphs (1)(b) to (c.2); and
(b) imposing terms and conditions in respect of
(i) the provision of financial services referred to in paragraph 409(2)(a) that are financial planning services,
(ii) the provision of services referred to in paragraph 409(2)(c), and

enabling provisions relating to specific aspects of banking and the permitted activities of banks, except as other provisions of the Act limit them. Subsection 409(1) provides that, subject to the provisions of the Act, a bank will not engage in or carry on any business other than the business of banking and such business that generally pertains thereto. For greater precision, section 409(2) identifies four areas which are included in the business of banking, namely (a) providing any financial service, (b) acting as a financial agent, (c) providing investment counselling services and portfolio management services, and (d) issuing payment, credit or charge cards in cooperation with others including other financial institutions; operating a payment, credit or charge card plan.[185] Additional powers and restrictions are listed in section 410 of the Act.

It should be noted that bankers' acceptances have been judicially recognized as part of the business of banking since at least the nineteenth century.[186] With respect to the power of a bank to deal in acceptances, Crawford has stated, "[t]o deal in bills of exchange is to traffic or trade in them; that is, to buy and sell them, or to lend on the security of them. This power has recently achieved renewed significance with the development of a domestic market in bankers' acceptances...and the renewed interest in international trade in forfeiting."[187]

Although the current *Bank Act* does not expressly empower the bank to deal in negotiable instruments as it once did,[188] this power can be inferred from the general

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(iii) the carrying on of the activities referred to in paragraphs (1)(b) to (c.2).

[185] Supra, note 137, s. 409(2).

[186] *Berton* v. *Central Bank* (1863), 10 N.B.R. 493 (C.A.).

[187] B. CRAWFORD, *op. cit.*, note 87, p. 341.

[188] R.S.C., (1985), c. B-1, s. 173(c)(g). Those provisions allowed the bank to:
(c) acquire, deal in, discount, and lend money and make advances on the security of, and take as security for any loan or advance made by the bank or any debt or liability to the bank, bills of exchange, promissory notes and other negotiable instruments, coin, gold and silver bullion and securities;

power to engage in the "business of banking"; that is, to be involved in such commercial transactions, such as making payments and providing credit. In order for these instruments to be effective, banks must have considerable freedom in engaging in these types of activities. The term, "business of banking" has been interpreted liberally as the banking power must reflect changing conditions.

In 1894 Lord Watson said, "Banking [is] an expression which is wide enough to embrace every transaction coming within the legitimate business of a banker."[189] The liberal interpretation of the phrase persists, despite the fact that the list of specific powers that followed may have resulted in a restrictive judicial construction.[190]

In *Canadian Pioneer Management Ltd. v. Labour Relations Board of Saskatchewan,* [191] the Supreme Court adopted the broad concept of banking as "what banks do" in its conclusion that banking "involved a set of interrelated financial activities." Similarly, in *Bank of Montreal v. Hall,* [192] the Court acknowledged the broad scope of banking in its recognition that the taking of security is a vital part of the banking enterprise.

Despite these decisions there is still ambiguity over the scope of the business of banking. In *Bank of Nova Scotia and Optima Communications Canada Inc. v. Superintendent of Financial Institutions et al.*,[193] the British Columbia Court of Appeal reversed a lower court decision, which had held that the telemarketing of creditor

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(g) subject to any terms and conditions prescribed by the regulations, guarantee the payment or repayment of fixed sums of money with or without interest thereon.

[189] *Tennant v. Union Bank of Canada* [1894] A.C. 31, 46 (P.C.).

[190] Wendy G. BELLACK-VINER, «The Business of Banking: C.D.I.C. v. C.C.B.», (1987-88) 2 *B.F.L.R.*, p. 236, 248.

[191] [1980], 1 S.C.R. 433.

[192] [1990] 1 S.C.R. 121, 147.

[193] (2003), 223 D.L.R. (4th) 126; [2003] 5 W.W.R. 217; (2003), 31 B.L.R. (3d) 1; (2003), 11 B.C.L.R. (4th) 206.

insurance by the bank was part of the business of insurance, not the business of banking and, therefore, was subject to provincial regulation.

The Alberta Court of Appeal more recently upheld a Queen's Bench decision, which had determined that the promotion of insurance by banks, even when connected with their lending activities, is not part of banking and that the licensing regime of the Alberta *Insurance Act* consequently applied to banks. In its decision, the Court of Appeal rejected the banks' argument that section 409(2) of the *Bank Act* defines the "business of banking" as the provision of "any financial service" by pointing out that the *Bank Act* itself distinguishes between banking and insurance: Section 416 treats the "business of insurance" as separate from the "business of banking."[194] It should be pointed out, however, the primary issue was whether the promotion of insurance was a "vital" part of banking for the purpose of resolving constitutional questions, such as interjurisdictional immunity. The fact that banking has been broadly interpreted by the courts was not truly at issue in that case.

It is now generally accepted that the power is unlimited by the specific examples provided in the Act. It should be noted that the *Bank Act* affects Schedule I or II Banks, and, except as otherwise provided, does not apply to any other institution that may be popularly considered a bank.[195] On June 28, 1999, amendments to Canada's *Bank Act* came into force, which permit foreign banks to establish Canadian Foreign Bank Branches (FBB) rather than operating through bank subsidiaries in Canada. "Foreign

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[194] *Canadian Western Bank v. Alberta* (2005), 249 D.L.R. (4th) 523; [2005] 6 W.W.R. 226; (2005), 39 Alta. L.R. (4th) 1.
[195] *Cf.*, Patrick N. MCDONALD, «The BNA Act and the Near Banks: A Case Study in Federalism», (1972) 10 *Alta. L. R.* 155.

banks have the option of choosing to establish either a 'full-service' FBB or a 'lending' FBB.... A lending FBB has more restrictive borrowing powers. It may not accept deposits or borrow in Canada or elsewhere, except from Canadian financial institutions and certain foreign banks, and they may not have access to Canadian commercial paper or bankers' acceptance markets."[196]

Since bankers' acceptances are deposit liabilities of the bank, in the case of insolvency they are combined with other liabilities and rank prior to the bank's subordinated indebtedness pursuant to section 369 of the *Bank Act.* [197]

There is a belief that the increasing use of these instruments will lead to greater regulation as in the United States, where banks are limited in the volume of BAs they may have outstanding as a share of their total capital. Participation arrangements have been one means by which U.S. banks have sought to elude this regulation, although

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[196] Theodore P. AUGUSTINOS, Walter Douglas STUBER, Adriana Gödel STUBER, Jeffrey P. GREENBAUM, Shourya MANDAL, Robert E. ELLIOT, Robert W. MCDOWELL, Kathleen S.M. HANLY and Pandora D. STASLER, «International Legal Developments in Review: 2000 International Banking and Finance», (2001) 35 *Int'l Law.* p. 287, 308.

[197] M.H. OGILVIE, *op. cit.*, note 3, p. 429. Section 369 reads:

> 369. (1) In the case of the insolvency of a bank,
> (*a*) the payment of any amount due to Her Majesty in right of Canada, in trust or otherwise, except indebtedness evidenced by subordinated indebtedness, shall be a first charge on the assets of the bank;
> (*b*) the payment of any amount due to Her Majesty in right of a province, in trust or otherwise, except indebtedness evidenced by subordinated indebtedness, shall be a second charge on the assets of the bank;
> (*c*) the payment of the deposit liabilities of the bank and all other liabilities of the bank, except the liabilities referred to in paragraphs (*d*) and (*e*), shall be a third charge on the assets of the bank;
> (*d*) subordinated indebtedness of the bank and all other liabilities that by their terms rank equally with or subordinate to such subordinated indebtedness shall be a fourth charge on the assets of the bank; and
> (*e*) the payment of any fines and penalties for which the bank is liable shall be a last charge on the assets of the bank.
> (2) Nothing in subsection (1) prejudices or affects the priority of any holder of any security interest in any property of a bank.
> (3) Priorities within each of paragraphs (1)(*a*) to (*e*) shall be determined in accordance with the laws governing priorities and, where applicable, by the terms of the indebtedness and liabilities referred to therein.

Canadian banks would have to consider section 415 of the *Bank Act*, which restricts banks in acting in the placement of securities. The question in Canada today remains of theoretical rather than practical importance.[198]

The term "business of banking" also enables banks to engage in BA participation facilities. The ruling in *Re: Canadian Deposit Insurance Corporation* (Re: C.D.I.C.) [199] presumably resolved many persisting questions as to the legitimacy and legality of participated credit arrangements. The Bank Act appears to insinuate its endorsement of facilitated participation arrangements. The premise upon which the court formed its judgement was contingent on its interpretation of the term "business of banking" as part of the Bank Act which allows a bank to engage in and carry on such business generally as appertains to the "business of banking."[200]The court mentioned part of the case of *Central Computer Services Ltd. v. Toronto-Dominion Bank,*[201] which was pleaded in the Manitoba Court of Appeal, in establishing the definition of the "business of banking." The ruling concluded that "the business of banking" could only be determined by analyzing and considering "current practices of reputable banks" and all other pertinent information. It was the court's opinion that any and all banking activity not unequivocally forbidden which conforms to standard procedure of risk-diffusion, low cost supply of funding and maintenance of a competitive market, may be encompassed in the words "business of banking." BA participation appears to have these criteria and adheres to the

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[198] M.H. OGILVIE, *op. cit.*, note 3, p. 429. Section 415 of the Bank Act provides: A bank shall not deal in Canada in securities to the extent prohibited or restricted by such regulations as the Governor in Council may make for the purposes of this section.

[199] 27 D.L.R.(4th) 229 (Alta. Q.B.); 46 D.L.R. (2d) 111 (Q.B.); 56 Alta. L.R. (2d) 244 (Q.B.) (Three different judgements in the same litigation).

[200] Bank Act, C.S.E., [1991, c.46] s. 409.

[201] (1980) 109 D.LR. (3d) 660.

guidelines of permitted banking practices. It was more precise from the court's judgement that BA participation was an acceptable procedure.

### 3.1.4 The Bank of Canada Act

Canadian banks have historically provided acceptances primarily for financial activities that would generate sufficient capital to satisfy the acceptance before it became due (*i.e.*, self-liquidating transactions) not unlike their American counterparts. Although Canadian chartered banks were not restricted by the regulations of the Bank of Canada, growth in acceptance financing was constrained in large part because of the definition of BAs eligible for Bank of Canada transactions.[202] The *Bank of Canada Act* stated that the Bank may:

> (f) buy and sell bills of exchange and promissory notes endorsed by a chartered bank drawn and issued in connection with the production or marketing of goods, wares, merchandise as defined in the Bank Act, excepting those mentioned in paragraph (g), and having a maturity not exceeding ninety days, excluding days of grace, from the date of the acquisition of the Bank;
>
> (g) buy and sell bills of exchange and promissory notes endorsed by a chartered bank drawn and issued in connection with the production or marketing of agriculture, products of the forest, products of the quarry and mine, or products of the sea, lakes and rivers, as defined in the Bank Act, and having a maturity not exceeding one hundred and eighty days excluding days of grace from the date of acquisition by the Bank....[203]

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[202] E. RAZIN, *loc. cit.*, note 10, p. 224.
[203] Supra, note 52, s. 18(1)*(f)* (*g*).

The Act states that the Bank of Canada could only deal in acceptances issued for certain transactions, with maturity dates limited to 90 days and 180 days, respectively, depending on the activity in question. We must keep in mind though, that although the Bank of Canada was restricted in the types of acceptances in could deal in, the *Bank of Canada Act* did not directly limit chartered banks in their acceptance activity. In any case, the Act has since been amended; broadening the category of eligible acceptances the Bank of Canada can deal with. The relevant sections now allow the Bank to:

> (*g*) buy and sell bills of exchange and promissory notes endorsed, accepted or issued by a bank or authorized foreign bank that is not subject to the restrictions and requirements referred to in subsection 524(2) of the *Bank Act* and having a maturity not exceeding one hundred and eighty days, excluding days of grace, from the date of acquisition by the Bank;
>
> (*g*.1) if the Governor is of the opinion that there is a severe and unusual stress on a financial market or financial system, buy and sell any other securities, treasury bills, obligations, bills of exchange or promissory notes, to the extent determined necessary by the Governor for the purpose of promoting the stability of the Canadian financial system;
>
> (*k*) for the purpose of its open-market operations, buy and sell in the open market from or to any person, either in or outside Canada, securities, bills of exchange and promissory notes of the kinds and maturities and subject to the limitations, if any, referred to in paragraphs (*c*) to (*e*) and (*g*) with or without the endorsement of a bank....[204]

The effects of these changes were considerable; notably, banks were no longer limited to dealing with BAs used to finance transactions of a certain nature. The potential

[204] R.S.C. (1985), c. B-2, s. 18(g)(g.1)(k).

for greater involvement of the Bank of Canada meant not only increased demand, but also established the security of the instrument.[205]

[205] E. RAZIN, *loc. cit.*, note 10, p. 226.

### 3.1.5 The Civil Code of Quebec

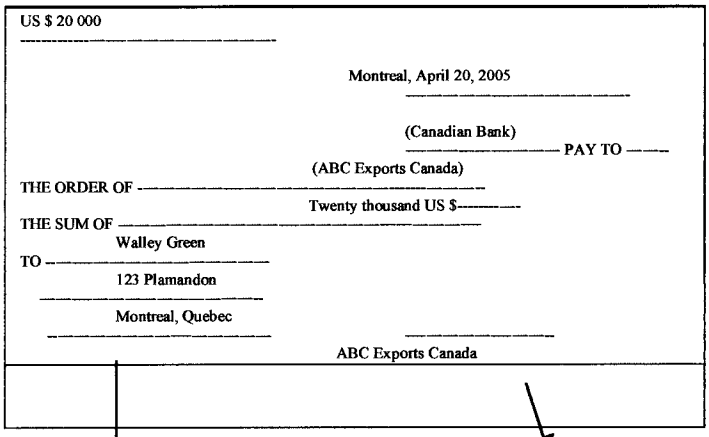
The Quebec Civil Code's relationship with federal legislation on bills and notes is not an easy one to characterize. In 1866, the codifiers of the Civil Code of Lower Canada generated 76 articles on *Bills of Exchange*, which they placed in Book Four of the code. They relied on the 1849 statute on bills and notes, reproducing much of it in the code. They were also inspired by both English and French law on bills of exchange and promissory notes. Their codifiers cited, among others, the works of Savary, Pothier, Nougier, Pardessus, Bayley, Story, Chitty and Hulme. Despite federal legislation in 1872 and 1877, these codal provisions remained largely in force until the enactment of the *Bills of Exchange Act* in 1890. This Act repealed articles 2279 to 2354 (with the exception of articles 2340 to 2342, 2346 and 2354) although there continues to be some doubt as how much more of the civil law applicable to bills of exchange (and promissory notes) was "repealed" by section 10 (now section 9) of the Act.[206] In other words, while there is no doubt that the codal provisions dealing expressly bills of exchange are no longer of any effect, there is some question as to the applicability of the other provisions of the code (e.g., those provisions dealing with contract and prescription for example) with respect to bills and notes, and thus BAs.

[206] See Rosalie JUKIER and Roderick Alexander MACDONALD, "The New Quebec Civil Code and Recent Federal Law Reform Proposals: Rehabilitating Commercial Law in Quebec," (1992) 20 *C.B.L.J.* p. 380, 396.

The courts and doctrinal authors have examined several aspects of the *Bill of Exchange* in light of the Quebec Civil Code (and civil law generally), namely (1) capacity to contract (e.g., incapacity by minors) (2) the liability of co-signers (joint and several) (3) the liability of endorsers (4) the means of defence available against a holder in due course (5) cause or consideration (6) proof (e.g., the admissibility of evidence given orally, or by a consort, onus of proof of good faith) (7) procedure, and (8) prescription.[207] However, there is no consistent line of jurisprudence as to when the civil law ought to be applied to issues of BAs arising in Quebec. We will examine these aspects in Chapter 4 in our discussion of the interaction of provincial and federal law with respect to bankers' acceptances.

[207] J. LECLAIR, *loc. cit.*, note 32, p. 695-696. See also, B. CRAWFORD, *op. cit.*, note 34, p. 1218-19.

# APPLICABLE LAWS TO THE BA


US $ 20 000

Montreal, April 20, 2005

(Canadian Bank)

PAY TO

(ABC Exports Canada)

THE ORDER OF

Twenty thousand US $

THE SUM OF

Walley Green

TO

123 Plamandon

Montreal, Quebec

ABC Exports Canada

Creation of the BA into a negotiable instrument
- Bills of Exchange Act
- The Depository Bills & Notes Act

Powers and restrictions
in the activities of the Bank
- The Bank Act
- The Bank of Canada Act

## 3.2 Agreements pertaining to a Bankers' Acceptance Transaction

The BA, like a contract, will have at least two parties involved who are bound in a legal relationship, governed by a law that sets out their respective rights and obligations to each other. The law of the parties will be essential in depicting the proper law of the BA. Still, the BA is unique since it is an instrument that is part of a wider transaction which includes other parties, and several obligations, spanning a considerable period of time. In this section, we will focus on the various stages in the creation and execution the BA transaction.

First, a draft document is drawn by the customer on its bank (the drawee). Generally speaking, a BA is referred to as a draft until it is accepted, and thereafter, as an acceptance.[208] Often, the named payee is the drawee bank or the customer, though it need not be. The bill bears the date upon which it is drawn as well as an indication of the number of days after sight upon which it matures. The draft is then sent to the bank, which then accepts the draft by stamping it, or affixing its notation across the fact of the draft which simply states "accepted" with the date of acceptance and the bank's signature (either its corporate seal, or the signature of a signatory authorized to sign on its behalf).[209] Note that the word "accepted" is not necessary; the bank's signature is sufficient for a valid acceptance.

[208] See B. CRAWFORD, *op. cit.*, note 34, p. 1189.
[209] L. SARNA, *op. cit.*, note 65, p. 43.

The bill may then be endorsed by the payee (either bank or customer) in blank and then negotiated to a third party through delivery. "In commercial terms the act of negotiation witnesses the sale of the bill in the acceptance market at a discount based on the period of time to maturity. The proceeds of the sale of the bill at a discount rate on the acceptance market are used to finance the commercial transaction of the customer."[210] Bear in mind the BA is a bill of exchange; what distinguishes a BA from other bills of exchange is that it is drawn on a bank. As such, BAs tend to be created pursuant to a credit agreement and according to established practices in the banking industry.

Effectively, this mechanism enables the drawer of the BA to "borrow" funds until it can generate sufficient capital from the proceeds of the transaction he or she is involved in.[211] The bank never actually forwards funds to its customer, but simply promises to pay. The BA captures the bank's promise to pay in a document, which has a market value. This document can then be sold (discounted) to generate funds, or in some cases be negotiated directly to the creditor seeking to be paid. The bank will assess the ability of its customer to generate sufficient income to reimburse the bank when it is called upon to pay as it promised. If the bank believes the transaction involved can generate these funds (or the customer can access these funds from another source) it will "accept" the document, thereby turning the draft into a bankers' acceptance.

In practice, acceptances are short-term in nature. "The short-term is a reflection of the brief turn-around expected in realizing a return in the underlying financed transaction. A longer term, with the resultant increased risks caused by the mere afflux of time and

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[210] *Id.*, p.44.
[211] B.J. TERRY, *op. cit.*, note 8, p. 702.

greater number of variables, calls for a different credit arrangement, chiefly, a secured long-term loan."[212] However, there is no reason, in principle, why the BA cannot be issued for any term the parties agree upon.[213] Acceptance financing can be part of an overall credit facility opened for the benefit of the customer, which serves both short and long term financing needs.

The bank is compensated by the stamping fee it charges its customer to accept the BA draft. This is paid when the BA is accepted, rather than as a commission later on, due to the minimal amount of remuneration involved and the risk the bank takes by accepting the instrument (which, as we pointed out, makes the bank primarily liable to pay the BA upon maturity). Moreover, as one author pointed out, "it would add insult to injury for the customer to default on the payment of remuneration as well as the amount of the acceptance made by the customer immediately prior to, and not after, maturity."[214]

The BA operation has been described in the following hypothetical example:

> Let us assume that the customer of Bank A wishes to finance its importation of certain raw materials for 120 days. The customer expects that 120 days would be the time it would take for the goods to be imported, resold, and paid for. Thus after 120 days, the customer expects to be able to pay off the credit.
>
> In this situation, once Bank A agrees to extend acceptance financing, it will usually require that the appropriate acceptance credit agreement be executed. Under such an agreement, the customer-importer will agree that in consideration for the bank's accepting one or more of the drafts drawn on it as well as taking on his or her credit risk, he or she will pay the bank the amount of each draft

[212] L. SARNA, *op. cit.*, note 65, p. 10-38-10-39.
[213] See B. CRAWFORD, *op. cit.*, note 87, p. 880.
[214] L. SARNA, *op. cit.*, note 108, p. 10-39.

the bank may accept on or before the last business day before its maturity (or at maturity in same day funds), together with the appropriate acceptance commission. Apart from making clear the terms of payment, the nature and amount of the commission, and other amounts payable by the customer, the acceptance credit agreement also includes other agreement representations and provisions aimed at protecting the credit position of the bank.

When the acceptance credit agreement has been executed, the customer-importer then draws a 120-day time draft on the bank, payable to the order of the customer-importer. It is also possible for the draft to be made payable to the order of the bank or to the bearer. The bank then accepts the draft by stamping "accepted" together with the date and the authorized signature on the face of the draft. Once accepted, the draft is a negotiable bankers' acceptance and can be transferred by the customer-importer to another person by endorsement and delivery.[215]

We have just seen how the BA is created and negotiated with the bank or investor to secure funds, and possibly further traded, until presented for payment at maturity. In the following section we will examine this process according to the typical chronology of events.

[215] E. M.A. KWAW, *loc. cit.*, note 5, p. 22.

### 3.2.1 Credit Agreement

When a bank agrees to finance a customer through a BA, the bankers' acceptance becomes the direct and primary obligation of the bank by virtue of the statutory engagement of s. 127 of the *Bills of Exchange Act*.[216] Because the bank has agreed to assume a primary obligation to honour the acceptance, it will always require some agreement with its customer, involving a prearranged line of credit.

Often, loans between banks and their larger commercial customers will involve a bankers' acceptance facility. In these situations, the customer provides its bank with a number of pre-signed bills where it names itself as drawer. The BA usually names the customer as payee, so it also pre-endorses the back of the BA in blank.[217] The credit agreement is used to ensure that the bank receives adequate funds from its customer to cover the face value of the acceptance. Through it, the bank can fulfil its obligation to pay the holder at maturity, without having to use its own funds.[218] We must not forget that the bank is also an accommodation party on the bill (pursuant to s. 54 of the Act). As such, it retains a common law right to indemnification from the party accommodated (in this case, the customer). However, banks rarely rely on this right alone, but prefer to make payment of money to cover the BA at maturity and pursuant to an explicit clause in the credit agreement.[219]

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[216] *Bills of Exchange Act*, R.S.C., (1985), c. B-4, s. 127 (hereinafter cited as B.E.A.)
[217] L. BOULTON, *loc. cit.*, note 11, p. 32.
[218] See M.H. OGILVIE, *op. cit.*, note 3, p. 427; L. BOULTON, *loc. cit.*, note 11, p. 32.
[219] See B. CRAWFORD, *op. cit.*, note 87, p. 878; E. RAZIN, *loc. cit.*, note 10, p. 221-222.

parties to meet the definition of a stipulation of adhesion, it would be interpreted restrictively, and against the bank.[226]

These agreements will also provide for additional collateral, where necessary, allowing the bank to assume an interest in insurance policies, warehouse receipts, documents of title to the goods financed and the proceeds arising from the sale of the goods. Security taken by banks on loans to these customers will be extended to cover any shortfall resulting from the failure of the customer to indemnify the bank upon which it drew the BA.[227]

Most agreements will also contain a number of provisions that contemplate certain possibilities. For example, the agreements may stipulate a term longer than the usual six months (180 days) or establish a maximum value for outstanding acceptances. It may also provide an option for the creation of a new acceptance following the maturity of an older one. Other agreements will contain an offer by the bank to provide its customer with a line of credit where the acceptance market is "reduced" or alternatively might call for the customer to furnish promissory notes in the event that he or she defaults on reimbursing the bank for paying the acceptance upon maturity.[228]

For those situations where the law restricts the nature of acceptances, the agreement will set out, firstly, that the customer warrants that the acceptances will meet the appropriate requirements and in some cases require that the customer supply the appropriate documents to support this representation (e.g., contracts, receipts, shipping

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[1988] R.R.A. 507 (C.A.); *Liberty Mutual Insurance Co. v. Transport Montkar Ltée*, J.E. 95-373 (C.S.).
See also, Pierre GABRIEL, *Les Obligations*, 6th ed., Cowansville, Éditions Yvon Blais, 2005, p. 951; Didier LLUELLES and Benoît MOORE, *Droit des obligations*, Montréal, Éditions Thémis, 2006, p. 1787.

[226] Pierre GABRIEL, *Les Obligations*, 6th ed., Cowansville, Éditions Yvon Blais, 2005, p. 955.

[227] B. CRAWFORD, *op. cit.*, note 87, p. 879.

[228] M.H. OGILVIE, *op. cit.*, note 3, p. 428.

documents and insurance documentation).[229] The agreement may impose the additional requirement of board of director's resolution that demonstrates it has authorized the acceptance.[230]

As stated above, although the bank becomes primarily liable through its acceptance, the acceptance credit agreement provides for the reimbursement of the funds by the customer. In the context of a credit facility, to generate those funds the customer will either obtain a prime rate advance or by creating and selling another BA. However, "[i]f the latter approach is taken, there will often be a deficit between the amount due to the bank for a maturing BA and the proceeds the borrower obtains on sale of a further BA. The credit agreement should provide that any such deficiency will, to the extent of availability under the credit facility, be funded as a prime rate advance and, failing that, be funded by the borrower from its own resources."[231]

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[229] L. SARNA, *op. cit.*, note 65, p. 47.
[230] M.H. OGILVIE, *op. cit.*, note 3, p. 428.
[231] L. BOULTON, *loc. cit.*, note 11, p. 33.

### 3.2.2 Bankers' Acceptance Draft

Following the credit agreement, the BA to be created must respect certain criteria. Upon receipt of instructions from the borrower that it wishes to draw a BA, the bank will begin by filling in the amount and term chosen by the borrower on a standard, pre-signed form.[232] The bank will then accept the BA by completing and signing the acceptance portion of the form. BAs are typically drawn in multiples of $100,000 and have a maturity of between thirty (30) and one hundred and eighty (180) days,[233] although, as mentioned above, the credit agreements may allow for a longer term. Additionally, the draft accepted by the bank will contain the basic elements, such as the order to pay the bill (usually, to the order of the drawer), the amount, the due date and the drawer's signature. The draft will also contain the bank's acceptance (signature or stamp), the date of acceptance as well as the accepting branch's address and signature of the person authorized to sign the draft on behalf of the bank.[234]

Since bankers' acceptances are a type of a bill of exchange they must conform to the requirements set out in the *Bills of Exchange Act*. If these requirements are not met the instrument will not be deemed a bill of exchange, although it may continue to have some legal effect. The effect of the instrument, and any possible cause of action, will

[232] These pre-printed and pre-signed forms, which are used almost exclusively, prevent many of the difficulties that arise from the requirement that the bill be unconditional. See B. CRAWFORD, *op. cit.*, note 34, p. 1228.
[233] M. H. OGILVIE, *op. cit.*, note 3, p. 426.
[234] *Id.*

depend on the particular circumstances.[235] Instruments that do not meet the requirements of the Act are not governed by the Act and derive their validity and effect, if any, from the law of the particular province; this has been confirmed by the Supreme Court decision of *MacLeod Savings & Credit Union Ltd. v. Perrett.*[236] We must remember, however, that a promissory note is based on the maker's promise, and thus a failed note may have effect as a contract. Not so with bankers' acceptances, where the obligation derives not from a promise made on the instrument, but from section 127 of the Act.[237] Likewise, the drawer makes no promise, but rather an order on the drawee.[238]

It should be noted that bankers' acceptances could refer to instruments subject to the *Depository Bills and Notes Act*. However, the requirements of form are quite similar to the *Bills of Exchange Act*, because the DBNA "is not intended to replace the *Bills of Exchange Act* or to provide for an alternate method of drawing negotiable instruments," and because the "DBNA is a temporary measure narrowly focussed on avoiding, rather than solving, a number of difficult legal problems..."[239] we will not, with some exceptions, explore the implications of the DBNA on bankers' acceptances. We will mention only that the Act requires the words: *This is a depository bill subject to the Depository Bills and Notes Act* to be "marked prominently and legibly on its face."[240] It cannot prohibit negotiation, transfer or assignment; it must be made payable originally or

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[235] See I. F.G. BAXTER, *op. cit.*, note 92, p. 6; B. CRAWFORD, *op. cit.*, note 34, p.1245-46.
[236] [1981] 1 R.C.S. 78, (1981) 118 D.L.R. (3d) 193 (S.C.C.). See B. CRAWFORD, *op. cit.*, note 34, p. 1246.
[237] B.E.A., s. 127.
[238] This point in made by B. CRAWFORD, *op. cit.*, note 87, p. 880.
[239] See A. R. MANZER, *loc. cit.*, note 168, p. 69.
[240] D.B.N.A., s. 4(c).

by endorsement to a clearing house, and be deposited at the clearing house to which it is made payable.[241]

Though there is no jurisprudence on the matter, certain authors suggest that the bill must be a single instrument, which may consist of more than one page.[242] They also suggest that two valid instruments may be joined, if it does not affect their unconditional status. Crawford remarked that "...a recent practice has developed for bankers' acceptances to be issued with other acceptances or notes for interest payments attached. They are unprecedented but not, we think, unjustifiable."[243]

The form of the draft, which becomes the BA, is regulated by section 16(1) which provides:

> 16. (1) A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay, on demand or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person or to bearer.

The formal requirements of acceptance are that: (a) it must be an unconditional order, (b) in writing (d) signed by the person giving it, (d) the order must be to pay on demand, or (e) at a fixed or determinable future time, (f) it must be for a sum certain in money, and (g) to a specified person or bearer. [244] We will now explore each element in turn.

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[241] *Id.*, s. 4(d)(e)(f).
[242] See B. CRAWFORD, *op. cit.*, note 34, p. 1246.
[243] B. CRAWFORD, *op. cit.*, note 34, p. 1228.
[244] See I. F.G. BAXTER, *op. cit.*, note 92, p. 39.

An "order" is an obligation to pay and not merely grant permission or authority to perhaps do so.[245] Vesting the drawee bank with discretion to pay is therefore insufficient authorization. The order to pay must be without condition, and must not be the subject of modalities or contingencies.[246] Note that at least one author cautions against using other terms in conjunction with the word "pay." In his view, the phrase "*Please* pay..." and similar expressions create doubt as to whether there is a true order or merely authorization.[247] This requirement is to ensure that the holder need not inquire if the condition has been fulfilled before circulating the bill.

The order of the drawer must be absolute.[248] Section 16(3):

> (3) An order to pay out of a particular fund is not unconditional within the meaning of this section, except that an unqualified order to pay, coupled with
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> (*a*) an indication of a particular fund out of which the drawee is to reimburse himself or a particular account to be debited with the amount, or
>
> (*b*) a statement of the transaction that gives rise to the bill is unconditional.

An order conditional is payment to be made from a particular fund or account, but it is not conditional if there is reference to a particular fund from which the drawee should take reimbursement.[249] A bill that orders any additional act other than the payment

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[245] N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 432 and M. CARON, *op. c it.*, note 155, p. 50.
See *Brookler* v. *Security National Insurance Co.*, (1915) 8 W.W.R. 861, 23 D.L.R. 595 (K.B.)
[246] *C.I.B.C.* v. *Morgan*, [1993] 7 W.W.R. 171 (Q.B. Alta.), see also, Nicholas ELLIOT, John ODGERS and Jonathan M. PHILLIPS (eds.) *Byles on Bills of Exchange and Cheques,* 27th ed., London, Sweet & Maxwell, 2002, p. 11.
[247] A. PERRAULT, *op. cit.*, note, 155, p.191.
[248] See N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 432
[249] *Wilson* v. *Pelletier*, (1927) 54 N.B.R. 60; [1928] 1 D.L.R. 716 (C.A.).

of money is not a bill.[250] Section 17(1) provides that "an instrument expressed to be payable on a contingency is not a bill and the happening of the event does not cure the defect."[251] However, statements such as "On my death, pay X $500" or similarly, "Ten days after my death, pay X $100" do not violate the requirement that the order be unconditional, because death does not constitute a condition, but rather a term.[252] Nevertheless, one is not likely to see this type of stipulation in a bankers' acceptance today, as the form and procedures are fairly standardized. A statement on an instrument that the consideration is executory does not make it conditional, unless payment is made conditional upon performance of the consideration.[253]

Section 16 requires that the BA be issued in writing, since a verbal order is not sufficient.[254] This may be inscribed by hand, printed or engraved on any material with any manner of apparatus.[255] Moreover, it can be written in any language[256] and need only be legible, though writingof a more permanent nature is preferred.

Certain Quebec authors maintain that electronic transactions that do not take the

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[250] B.E.A., s. 16(2).
[251] See *C.I.B.C.* v. *Curtis*, (1978) 15 Nfld. & P.E.I.R., 38 A.P.R. 92 (Nfld. C.A.); *Bank of Nova Scotia* v. *Kelly Motors Danforth Ltd.*, [1961] O.W.N. 34 (C.A.).
[252] M. CARON, *op. cit.,* note 155, p. 52.
[253] Anthony G. Guest, (ed.) *Chalmers and Guest on Bills of Exchange, Cheques and Promissory Notes*, 15th ed., London, Sweet & Maxwell, 1998, p. 24.
[254] A. PERRAULT, *op. cit.*, note 155, p.187.
[255] Where part of the bill is in writing, part in print, it would seem the part in print should prevail in the case of any inconsistency. See Anthony G. Guest, (ed.) *Chalmers and Guest on Bills of Exchange, Cheques and Promissory Notes*, 15th ed., London, Sweet & Maxwell, 1998, p. 17.
[256] See M. CARON, *op. cit.*, note 155, p. 50. See also, N. ELLIOT, J. ODGERS and J. M. PHILLIPS, *op. cit.*, note 246, p. 14. See also, *Re Marseilles Extension Ry. & Land Co.*, (1885) 30 Ch.D. 598, and more recently, Banco Atlantico S.A. v. British Bank of the Middle East, [1990] 2 Llyod's Rep. 504.

form of written documents are not deemed to be bills of exchange.[257] However, according to the *Interpretation Act* (which provides definitions for terms used in federal legislation), " a writing, or any term of like import, includes words printed, typewritten, painted, engraved, lithographed, photographed or represented or reproduced by any mode of representing or reproducing words in visible form."[258] Accordingly, it could be argued that the term "writing" in section 16 of the Act must be read as including the representation or reproduction of words in a bill in electronic form as long as they were capable of reproduction in a visible form. A reproduction on a computer screen or on a print out would satisfy the definition of writing in the *Interpretation Act.*

In Quebec, a BA would be considered 'private writing' under the Civil Code of Quebec.[259] As well, there seems to be unanimity on the fact that such instruments cannot be made by notarial act or patent.[260] It should be noted that BA's in Quebec, do not need to be written in French[261] regardless of what the *Official Languages Act of Quebec* requires of legal agreements drafted in the province.[262]

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[257] N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 434.
[258] R.S. 1985 c. I-21, s. 35(1). Crawford queries whether under Canadian law, a bill of exchange could be expressed in electronic or magnetic media, as long as it is visible (or can be made visible by computer) because they would met the requirement of the Interpretation Act that the words be "in visible form" whether or not the writing is tangible. See B. CRAWFORD, *op. cit.*, note 34, p. 1202. In Quebec, it has been suggested that a bill must be a private writing as defined in the Quebec civil code. An "écrit en brevet" before a notary would not qualify. See M. CARON, *op. cit.*, note 155, p. 50.
[259] C.C.Q., art. 2826. A private writing is defined as, "a writing setting forth a juridical act and bearing the signature of the parties; it is not subject to any other formality."
[260] M. CARON, *op. cit.*, note 155, p. 50, See also, A. PERRAULT, *op. cit.*, note 155, p.188-189; George V.V. NICHOLLS, "The Bills of Exchange Act and Prescription in the Province of Quebec", (1936-37) 15 *R. du D.* 396, 420; *Robert* v. *Charbonneau*, (1902) C.S. 466.
[261] *Abitbol* v. *Store & Office Equipment Co.*, [1984] C.A. 635.
[262] B. CRAWFORD, *op. cit.*, note 34, p. 1234; N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 434.

The term "person" is not defined in the Act. However, the *Interpretation Act*[263] includes a corporation in its definition. Thus, a "person" can include a legal or moral person. It is interesting to note the liberal definition given to "person" in the *Depository Bills and Notes Act*. The Act states that "person" means, "a natural person, a corporation, a trust, a partnership, a fund, an unincorporated association or organization, Her Majesty in right of Canada or of a province or the government of a foreign country or of any political subdivision of a foreign country."[264] It is doubtful whether, for example, a partnership would constitute a person for the purposes of the *Bills of Exchange Act.*[265] The courts may well construe the term 'person' to include a partnership, although there has been little support for this in the case law.[266] The one exception has been *Canadian Commercial Bank v. Carpentier.*[267] In his decision, Justice MacKinnon agreed that the Act should be amended, with respect to defining 'person' but he did not rule notes payable to a partnership to be invalid. On this point, he asserted that "[t]he commercial realities dictate that an instrument ought not to be invalid on this ground alone." [268]

The bill must be addressed from one person (the drawer) to another (the drawee), thus the BEA contemplates two persons. The Act requires that "[t]he drawee be named or otherwise indicated in a bill with reasonable certainty."[269] A document that is not drawn

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[263] R.S. 1985, c. I-2, s. 35(1).
[264] D.B.N.A., s. 2(1).
[265] See Bradley CRAWFORD, *Payment, Clearing and Settlement in Canada*, vol. 2, Aurora, Ont., Canada Law Book, 2002, p. 655, note 33. In Quebec, partnerships (*sociétés*) whether general, limited or undeclared, are not legal persons and do not have an independent juridical personality. They must be distinguished from *sociétés par actions* (corporations), which are legal persons.
[266] See Davey v. Shawcroft, [1948] 1 All E.R. 827 (K.B.); Re Warner and Manitoba Labour Board (1960) 25 D.L.R. (2d) 217 (Man. Q.B.); C.B.C. v. A.G. Ontario (1959) 16 D.L.R. (2d) 609 (S.C.C.).
[267] (1991) 58 B.C.L.R. (2d) 209 (S.C.).
[268] (1991) 58 B.C.L.R. (2d) 209 (S.C.) at 216.
[269] B.E.A., s. 19.

upon any person cannot be a bill of exchange (or BA).[270] Where the drawer and the drawee are the same person, where the drawee is a fictitious person, or the drawee lacks capacity to contract, the instrument may be treated as a promissory note or bill, at the discretion of the holder.[271] Crawford points out that where the drawee and drawer are the same person it is neither a bill nor a note, because it is not from one person to *another* as required by section 16. It can nevertheless be treated as one [272] because the customer must draw on a bank, a second party who perfects payment on the BA.

The requirement of it being addressed from *one* person to *another* is not to be understood in its literal sense. The Act provides that a bill may be payable to two or more payees jointly or payable in the alternative to one of two or more payees.[273]

The Bills of Exchange Act requires that the bill be "signed" by the person giving it.[274] This requirement ensures that the consent of the drawer is expressed clearly. Since a BA may be drafted in an electronic format, this presumes the possibility of an electronic signature. However, this requires some careful consideration. Although the *Interpretation Act* provides a definition of "writing" which seemingly allows for BAs in electronic form, the *Act* nevertheless offers no definition of the terms "signed" or "signature."Since the signature is treated as an element of form,' which is part of the law of bills and notes in a strict sense, we must look to the common law of England, pursuant to section 9 of the Bills of Exchange Act, in order to determine whether an electronic signature is valid.

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[270] *R.* v. *Jorgenson,* (1953) 17 C.R. 52, 9 W.W.R. 189, 106 C.C.C. 94 (B.C.C.A.).
[271] B.E.A., s. 25.
[272] See B. CRAWFORD, *op. cit.*, note 34, p. 1266-67. Crawford cites, Romer, L.J. in *Re British Trade Corp.*, [1932] 2 Ch. 1 (C.A.).
[273] B.E.A., s. 18(2).
[274] See generally, Ina ACKERMANN, "Signature and Liability in the Law of Bills and Notes", (1993) 8 *B.F.L.R.*, p. 295.

Can a BA validly be signed with a digital or electronic signature? The answer to this question is complicated since there is simply no authoritative definition of the term "signature" under common law.

In common law a signature is understood to be a mark that is attributable to a source and used to signify one's intention.[275] Accordingly, it seems acceptable to characterize asymmetric cryptography and a public key infrastructure (PKI) of digital signatures as "signatures," although there is a marked absence of jurisprudence on the topic. This silence is probably due in part to the fact that the law of electronic commerce and digital signatures has been developed through legislative enactments and directives. As Jane Winn pointed out, "....an obvious research problem was to find the existing law of signatures to determine if it would validate the use of this new technology. Such research efforts uncovered surprisingly little on the 'law of signatures'" [276]

We must keep in mind the principle that the legal significance of a "signature" does not "lie in the form of the signature but in the information it conveys."[277] In common law, a signature is any mark or symbol attached to a document and manifesting the signatory intent to be bound by it.[278] In light of this, it is certainly arguable that existing encryption techniques, namely digital signatures, are at the very least marks that authenticate the document and identify it as an act of signing by the party attaching the

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[275] See generally, Leif GAMERTSFELDER, "Electronic Bills of Exchange: Will the Current Law Recognise Them?", (1998) 21 (2) *University of New South Wales Law Journal*, 568. The civil law of Quebec is essentially of the same view. "Signature" is defined in the Quebec Civil Code as "...the affixing by a person, to a writing, of his name or the distinctive mark which he regularly uses to signify his intention," C.c.Q. 2827.

[276] Jane K. WINN, "The Emperor's New Clothes: The Shocking Truth About Digital Signatures and Internet Commerce", (2001) 37 *Idaho L. Rev.* 353, 367.

[277] Jane VAUGHN, Tanya SEWARDS and Ross KELSO, *Study of the Law of Internet Commercial Transactions*, Centre for International Research on Communication and Information Technologies, 1997, p. 34.

[278] See e.g.., *Just Pants v. Wagner*, 617 N.E.2d 246, 251 (Ill. App. Ct. 1993).

digital signature. This idea satisfies the signature requirement of the Bills of Exchange Act. Therefore, courts should adapt the legal definition of any mark or symbol made with the intention of authenticating a text to the online environment. [279] As Professor Alan Tyree maintains, digital signatures appear to satisfy "the legal criteria for valid signatures under the general law even without legislative recognition."[280]

According to the Act, any person who is authorized to do so by the person who must sign may affix the signature.[281] A corporate seal may constitute a signature, but a seal is not required for the bills or notes of corporations.[282] The form of the signature is interpreted liberally. As with all contracts, the signature must reflect the signatory's desire to be bound by it.[283]

To constitute a BA, the bill must be payable at some fixed or determinable time; a bill drawn on a bank, payable on demand, would be a cheque. Bills payable at some fixed or determinable time are referred to as term instruments. According to BEA , the bill is payable at a determinable future time, where it is expressed to be payable (*a*) at sight or at a fixed period after date or sight;[284] or (*b*) on or at a fixed period after the occurrence of a specified event that is certain to occur, though that moment is often uncertain.[285] A bill containing the order to "Pay, 20 days from this date..." would be a valid bill as it is

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[279] See generally, Jane Kaufman WINN, «Open Systems, Free Markets ,and Regulation of Internet Commerce », (1998) 72 *Tulane L. Rev.* 1177.
[280] Alan L TYREE, 'PINS and Signatures', *Journal of Banking and Finance Law and Practice.*
[281] B.E.A., s. 4.
[282] *Id.*, s. 5.
[283] See N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 434.
[284] Note that there is no logical distinction between bills payable on demand and bills payable at sight. Despite the distinction in Canadian legislation, English, French and American law considers them to be the same. See M. CARON, *op. cit.*, note 155, p. 133.
[285] BEA, s. 23. The fact that the time at which a specified event is to happen is not yet certain does not render the bill "conditional" as long as its occurrence is a certainty. In Quebec civil law terms, it is the difference between a condition and a term. See C.C.Q., art. 1497.

payable at a fixed time after a given date. Likewise, an order to "Pay, 10 days after sight" would be valid as a bill payable at a fixed period after sight.[286] The order to "pay upon the death of X" is considered certain, but to "pay upon the arrival of goods at point X" is not.[287]

There is a difference in the English and Canadian case law respecting the validity of a bill drawn payable, on or *before* a fixed date.[288] The English court of Appeal in *Claydon v. Bradley*[289] reaffirmed its earlier decision[290] that an order permitting payment before a fixed date did not constitute an unconditional order to pay at a fixed or determinable future time. On this issue, the Supreme Court of Canada maintained that such a statement constitutes a bill payable at a fixed future time (the date stated) with an option to pay earlier if so desired.[291] It is thus a valid bill in Canada, although not in England. Nevertheless, BAs generally are created in standard form, so this type of variation is not likely to arise in practice.

Bills payable at sight or a fixed time after the occurrence of a certain event, benefit from days of grace. Supposing that the last day of grace falls on a legal holiday or non-juridical day, then the final day of grace is deferred until the next following that is a non-legal holiday or juridical day. Thus, for example, if the last day of grace was Thursday, January 1, 2004, the bill would be payable on Friday, January 2, 2004.

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[286] See M. CARON, *op. cit.*, note 155, p. 134.
[287] Interestingly, English authorities have found that a note payable when a King's ship shall be paid off has been held to be good, as the paying off of the ship is a thing of a public nature. Nevertheless, there is some doubt as to whether similar decisions would be arrived at today. See N. ELLIOT, J. ODGERS and J. M. PHILLIPS, *op. cit.*, note 246, p. 23.
[288] See Emil HAYEK, "Recent Developments in Canadian Law: Bills of Exchange", (1989) 21 *Ott. L. Rev.*, p. 263, 272-273.
[289] (1986), [1987] 1 W.L.R. 521, [1987] 1 All E.R. 522 (C.A.).
[290] *Williamson* v. *Rider*, (1962), [1963] 1 Q.B. 89, [1962] 2 All E.R. 268 (C.A.).
[291] *John Burrows Ltd.* v. *Subsurface Surveys Ltd.*, [1968] R.C.S. 607, 68 D.L.R. (2d) 354. See also, N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 435.

However, according to Crawford, Canadian commercial practice does not respect days of grace in connection with instruments that are short or medium-term or with bankers' acceptances.[292]

The BEA requires that the amount ordered on the draft be a "sum certain in money."[293] The BEA provides some examples of what constitutes a sum certain, which in all likelihood are mentioned for illustrative purposes. They are not exhaustive.[294] Where the bill is required to be paid (a) with interest, (b) by stated instalments; (c) by stated instalments, with a provision that on default in payment of any instalment the whole shall become due; or (d) according to an indicated rate of exchange or a rate of exchange to be ascertained as directed by the bill, the sum in certain.[295]

Nevertheless, according to one author this requirement "creates difficulty where bills or notes are used in commercial transactions that demand flexible payment schedules, flexible rates of interest and similar arrangements."[296]

Likewise, there have been decisions that have found that a note specifying as its rate a particular bank's prime rate plus a certain percentage (a floating rate) is too vague to be a sum certain.[297] We must keep in mind though, that this does not mean that the exact amount must be expressed on the face of the bill. The amount must be precise,[298] but it is sufficient that the amount be easily calculable (e.g., interest, exchange rate). For example, an order to pay "$50 per square foot, for 20,000 feet contained on lot X" has

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[292] See B. CRAWFORD, *op. cit.*, note 34, p. 1276. But see *Re Fraga Enterprises Ltd. and Wright*, 208 A.P.R. 220 (Q.B.N.B.), 6 A.C.W.S. (3d) 38.
[293] B.E.A., s. 16(1).
[294] See I. F.G. BAXTER, *op. cit.*, note 92, p. 8.
[295] B.E.A., s. 27.
[296] E. HAYEK, *loc. cit.*, note 288, p. 266.
[297] *Bank of Montreal* v. *A & M Investments Ltd.*, (1982) 136 D.L.R. (3d) 181 (Sask. Q.B.); *Bank of Montreal* v. *Dezcam Industries Ltd.*, (1983) 147 D.L.R. (3d) 359, [1983] 5 W.W.R. 83 (B.C.C.A.)
[298] *MacMillan* v. *MacMillan*, (1977) 76 D.L.R. (3d) 760 (C.A. Sask.); *Matte* v. *Caisse populaire de Donnacona*, [1965] C.S., p. 535.

been held by one author to be a sum certain.[299] Although other decisions have found floating rates were in fact capable of constituting a valid sum certain,[300] the fact that the amount is ascertainable is not enough to make it a sum certain.[301] Any amount that requires some measure of research to be determined is not considered to be certain.[302] Thus, it has been held that where the prime interest rate is not easily ascertainable, a note was void for uncertainty.[303] Where the amount is written in letters as well as numbers, the sum is deemed to be the amount spelled out in words where there is a variance between the two.[304]

It is important to remember that issues of sum certainty are prevalent with promissory notes, whereas bankers' acceptances do not generally have these problems because they are issued with a face value of $100,000 or multiples thereof (and then sold at a discount). In other words, BAs always have a certain sum payable because they trade at a discount from their face value; it is this face amount which enables parties to determine the discount. "The discount reflects the market-required yield and the time value of money until maturity of the instrument."[305]

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[299] M. CARON, *op. cit.*, note 155, p. 67. This he acknowledges is contra to A. PERRAULT, *op. cit.*, note 155, n° 129.

[300] *Royal Bank of Canada* v. *Reed*, (1982) 21 B.L.R. 64, [1983] 2 W.W.R. 419 (B.C.S.C.); *Royal Bank of Canada* v. *Stonehocker*, (1985) 61 B.C.L.R. 265 (C.A.); *National Bank of Canada* v. *Pearl*, (1983) 33 C.P.C. 158 (Ont. Co. Ct.). For a discussion of floating rates, see Emil HAYEK, "Promissory Notes and Floating Interest Rates", (1989) 3 *B.F.L.R.* 210.

[301] In *Jones* v. *Simpson*, (1823) 2 B. & C. 318, 107 E.R. 402, the order was to pay the total proceeds from the sale of specific goods. This was found not to be a sum certain so as to make the bill negotiable.

[302] See *Alberta Treasury Branches* v. *D. & L. Insulation*, [1991] 83 Alta. L.R. (2d) 181 (C.A.).

[303] *Alberta Treasury Branches* v. *N. Braaten & Sons Enterprises*, (1987) [1988] 4 W.W.R. 79 (Alta. Q.B.)

[304] *Bank of Nova Scotia* v. *Guénette*, 68 A.R. 369 (Q.B. Alta.).

[305] B. CRAWFORD, *loc. cit.*, note 169, p. 221.

The requirement that the bill be payable in *money* raises some interesting and potentially complicated problems, none of which will be addressed here.[306] Suffice to say, the amount should be expressed in the currency of the location in which the bill is to be paid; however, the amount on a bill can be expressed in a foreign currency.[307] The Act provides that on a bill drawn outside the country, payable in Canada but not expressed in Canadian currency, "...the amount shall, in the absence of an express stipulation, be calculated according to the rate of exchange for sight drafts at the place of payment on the day the bill is payable."[308]

The term "person" as we have discussed above, includes a corporation. "Bearer" according to the BEA means "the person in possession of a bill or note that is payable to bearer."[309] The BEA states that a bill is payable to bearer where it is expressed to be so payable or where the last endorsement on the bill is in blank.[310] If not payable to bearer, the payee must be named with reasonable certainty.[311] He need not be mentioned by name, but he must be indicated for identification.[312] To be payable to order, it must be payable to a specified person, and contain no restrictions on transfer or otherwise

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[306] For a brief discussion of the issues, see B. CRAWFORD, *op. cit.*, note 34, p. 1238-41. Some authors suggest a bill or note can only be payable in specie or legal currency. See N. ELLIOT, J. ODGERS and J. M. PHILLIPS, *op. cit.,* note 246, p. 24.

[307] *Currency Act*, R.S.C. (1985), c. C-52, provides:

> 13(1) Every contract, sale, payment, bill, note, instrument and security for money and every transaction, dealing, matter and thing relating to money or involving the payment of or the liability to pay money shall be made, executed, entered into, done or carried out in the currency of Canada, unless it is made, executed, entered into, done or carried out in (*a*) the currency of a country other than Canada; or (*b*) a unit of account that is defined in terms of the currencies of two or more countries.

[308] B.E.A., s. 162.

[309] *Id.*, s. 2.

[310] *Id.*, s. 20(3).

[311] *Id.*, s. 20(4).

[312] *Lavoie* v. *Turbide*, [1943] B.R. 1 (C.A.).

indicating that it should not be transferable.[313] If payable to a person's order (and not to him and his order) it is payable to that person or his order.[314]

The distinction is that a bill payable to the order of a person must be endorsed. This gives rise to certain responsibilities in the event of non-payment, although a bill payable to the bearer may be transferred with simple delivery. The payee may be a fictitious person, in which case the bill is treated as payable to the bearer.[315] As discussed, certain elements of the bill are optional, since they are not essential for validity. Rather, like many rules that form part of contractual laws, they are useful in terms of management and circulation. These elements include the date of issuance, the place of issuance and the place of payment.

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[313] B.E.A., s. 21(1).
[314] *Id.*, s. 21(2).
[315] *Id.*, s. 20(5). See *Boma Manufacturing Ltd. v. CIBC*, [1996] 3 S.C.R. 727.

# CHARACTERISTICS OF THE BA

**Section 16 (1) of the Bills of Exchange Act**

**For a Banker's Acceptance to be considered as a negotiable instrument pursuant to the Bills of Exchange Act, it must be an:**

- unconditional order;
- in writing;
- made by one person to another requiring them to make payment;
- at a future date;
- for a sum certain;
- and to a specified person;

US $ 20 000
---

Montreal, April 20, 2005
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(Canadian Bank)
---------- PAY TO ----------
(ABC Exports Canada)
THE ORDER OF ----------
Twenty thousand US $----------
THE SUM OF ----------
Walley Green
TO ----------
123 Plamondon
---
Montreal, Quebec
---

---
ABC Exports Canada

### 3.2.2.1 Acceptance

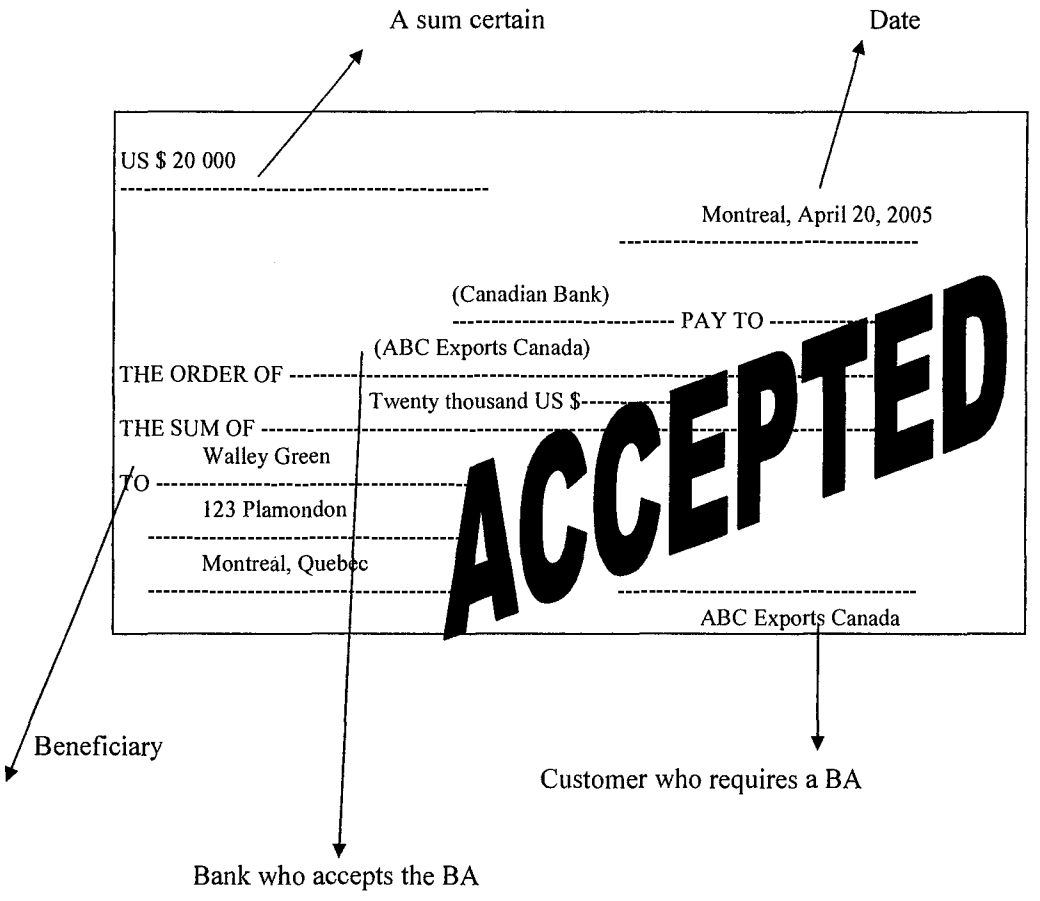
Once the draft has been formed, the bank must "accept" it, in order to activate it and make the draft a bankers' acceptance. An analogy can be made between the acceptance of BAs and the certification of cheques. Sarna states, "The most common analogue of the banker's acceptance is the certified cheque. A certification by a bank obliges the certifier to pay the face value of the cheque on demand." However, the two can be distinguished, "[s]ince the cheque is a demand instrument, and there is no time period during which the holder must wait prior to receiving payment."[316]

The draft is accepted, in practice, by writing "ACCEPTED" across the face of the bill.

> When the drawee accepts the bill, he or she is the acceptor and the draft an acceptance. If the drawee is a merchant or some other person, the draft is referred to as a trade acceptance. On the other hand, if the drawee is a bank, the acceptance is referred to as a bankers' acceptance. The drawer of the bill is then said to possess a two-name bill because the draft bears the name of the bank as well as his or her own name.[317]

[316] L. SARNA, *op. cit.*, note 65, p. 41.
[317] E. M.A. KWAW, *loc. cit.*, note 3, p. 21.

# ACCEPTED BA


A sum certain
Date
US $ 20 000
Montreal, April 20, 2005
(Canadian Bank)
PAY TO
(ABC Exports Canada)
THE ORDER OF
Twenty thousand US $
THE SUM OF
Walley Green
TO
123 Plamondon
Montreal, Quebec
ACCEPTED
ABC Exports Canada
Beneficiary
Customer who requires a BA
Bank who accepts the BA

According to the Act, "The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer."[318] The Act sets out conditions for a valid acceptance: (*a*) it must be written on the bill and be signed by the drawee; and (*b*) it must not express that the drawee will perform his promise by any other means than the payment of money.[319] The signature alone is sufficient for acceptance. No other words or formula need accompany it.[320] "The drawee may give his assent by accepting personally or by an agent, and if the latter, questions about authority might arise."[321]

Acceptances, unlike the order, may be qualified. They fall into two categories, general or qualified.[322] A general acceptance is without qualification.[323] A qualified acceptance "in express terms varies the effect of the bill as drawn."[324] This means that if an acceptor wishes to modify the obligations which acceptance ordinarily imposes, he must do so on the face of the bill in clear and unequivocal terms, and in such a manner that any person taking the bill could not reasonably fail to understand that it was accepted subject to an express qualification.[325]

The Act provides particular examples of qualified acceptances that are, (*a*) conditional, (makes payment by the acceptor dependent on the fulfilment of a condition therein stated); (*b*) partial, (an acceptance to pay part only of the amount for which the bill is drawn); (*c*) qualified as to time; or (*d*) the acceptance of one or more of the

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[318] B.E.A., c. B-4, s. 34.
[319] *Id.*, s. 35(1).
[320] *Id.*, s. 35(2).
[321] I. F.G. BAXTER, *op. cit.*, note 92, p. 39.
[322] B.E.A., s. 37(1).
[323] *Id.*, s. 37(2).
[324] *Id.*, s. 37(3).
[325] *Canadian Bank of Commerce* v. *B.C. Interior Sales Ltd.*, (1957) 23 W.W.R. 366, 9 D.L.R. (2d) 363 (B.C.S.C.). Affirmed (1957) 23 W.W.R. 682, 11 D.L.R. (2d) 609 (B.C.C.A.).

drawees, but not of all.[326] A holder may refuse to take a qualified acceptance.[327] A BA drawn in conformity with the *Depository Bills and Notes Act* must be accepted unconditionally.[328]

The bank charges a "stamping fee" for accepting the BA draft, which is a percentage of the face amount, expressed as a number of basis points.[329] The stamping fee, which has been known to fluctuate considerably, is a direct fee. However, because this fee is not consideration for the bill, but rather consideration for accepting the bill, the bank remains an accommodation party according to the Act.[330] The stamping fee, which varies, is based on a number of criteria, such as the creditworthiness of the customer, the amount of the acceptance, the period of time until maturity, and market forces such as "economic climate and competitive pressures."[331] Certain conditions associated with holding a line of credit, which vary from one bank to another, are the indirect costs of BAs. The total of the fees and discount is the cost to the customer for obtaining BA financing.[332]

As a matter of practice "... the acceptor has a keen interest, going beyond mere reference purposes, in knowing the reason for or application of the funds. Not only does

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[326] B.E.A., s. 37(3).
[327] See I. F.G. BAXTER, *op. cit.*, note 92, p. 39.
[328] D.B.N.A., s. 4(b).
[329] L. BOULTON, *loc. cit.*, note 11, p. 33.
[330] The relevant section is B.E.A., s. 54(1). For a discussion see P. G. BEVANS, *loc. cit.*, note 7, p. 526-529. In Oriental *Financial Corp.* v. *Overend*, (1871) L.R. 7 Ch. 142, it was held not be an accommodation bill because the acceptor had received a fee. However, it is generally conceded that the fee is not directly related to the instrument, and the bills are therefore accommodation bills. See Eliahu Peter ELLINGER, Eva LOMNICKA, and Richard HOOLEY (eds.) *Modern Banking Law*, 3rd ed., Oxford University Press, New York, 2002, p. 717.
[331] L. SARNA, *op. cit.*, note 65, p. 52.
[332] See L. BOULTON, *loc. cit.*, note 11, p. 33.

the underlying transaction give some clue as to the risk involved, it also emphasizes the desire of the acceptor that that transaction be self-liquidating."[333]

If a bill is accepted, the primary liability falls on the acceptor, who engages that he will pay it according to the tenor of his acceptance.[334] The drawer and endorsers have secondary liability. Tenor refers to the qualification of the acceptance, if any, permitted by the Act. The bank thus assumes the primary obligation to pay the BA at maturity. The Act precludes the acceptor from denying to a holder in due course, "(*a*) the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the bill; (*b*) in the case of a bill payable to drawer's order, the then capacity of the drawer to endorse, but not the genuineness or validity of his endorsement; or (*c*) in the case of a bill payable to the order of a third person, the existence of the payee and his then capacity to endorse, but not the genuineness or validity of his endorsement."[335]

[333] L. SARNA, *op. cit.*, note 108, p. 10-38-10-39. However, the bank is not restricted to self-liquidating transactions. It can choose to accept a draft, regardless of the purpose for which it is being used.
[334] B.E.A., s. 127.
[335] *Id.*, s. 128.

### 3.2.2.2 Discount

The bank's acceptance of the BA simply commits it to pay the holder of the instrument at maturity. However, where the BA is used to finance an international trade, by retaining the BA, a seller has an assurance from the bank that payment for the goods it has sold will be made by the purchaser (the bank's customer).[336] The more common practice in a BA transaction is to deliver it to the drawer for endorsement, which is normally done in blank so that the acceptance is payable to the bearer (though it can be endorsed "specially" making it payable to a named broker).[337] As a negotiable instrument endorsed in blank, the BA is transferable by delivery.

The importance of delivery is often overlooked. According to the Act, acceptance is completed by delivery or notification.[338] Without delivery, every contract on the BA is incomplete and revocable. However, where an acceptance is written on a BA and the bank, "gives notice to, or according to the directions of, the person entitled to the bill that he has accepted it, the acceptance then becomes complete and irrevocable."[339] "Delivery" means transfer of possession, actual or constructive, from one person to another.[340] Once the BA is delivered to the customer, it is then sold in the money market, that is,

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[336] E. M.A. KWAW, *loc. cit.*, note 5, p. 22.
[337] See B. CRAWFORD, *op. cit.*, note 87, p. 878.
[338] B.E.A., s. 2.
[339] *Id.*, s. 38.
[340] *Id.*, s. 2.

"negotiated to a third party in much the same way as other commercial paper, at a discount so as to provide an appropriate yield at maturity."[341]

This means that a BA is sold for an amount different from the face value, the interest being the difference between the sale price and the face value, rather than interest being paid on the face value of the BA. In other words, the profit to the investor is the difference between the face value and the price at which it is purchased. Through discounting, the BA is negotiated, and the drawer receives the funds and may use them so as to generate profit to pay the bank (pursuant to the credit arrangement) by the maturity date. The amount of the discount is a function of a number of factors such as the creditworthiness of the accepting bank, term to maturity and the opportunity for similar returns with alternative investments with similar levels of risk. Because discounting takes into consideration the accepting bank's creditworthiness, not all banks are equal when it comes to discounting. Consequently, "BAs accepted by smaller, less active or less established banks will have higher discount rates applicable to them. The discount rates of BAs of varying terms of most Canadian chartered banks are determined each banking day, and the resulting yields are then published on the Reuters Screen CDOR page."[342]

There are a number of different ways the acceptance can be discounted. One possibility is that the bank (as acceptor) may purchase its own acceptance, providing the face value of the acceptance, at a discounted rate. This is what occurs when the customer wishes to obtain payment of the acceptance immediately. When the bank discounts the acceptance, it becomes a holder in due course and at maturity merely debits its customer's account. It is also possible for the acceptance to be discounted with a bank other than the

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[341] M.H. OGILVIE, *op. cit.*, note 3, p. 426-427.
[342] L. BOULTON, *loc. cit.*, note 11, p. 33.

accepting bank.[343] The bank may decide to hold the bill itself until maturity or decide to sell the BA on the acceptance market. By selling the acceptance, the bank is able to discount the instrument (at a rate lower than it charged its customer) and thereby recover the money it paid to the drawer immediately, rather than waiting for the customer to reimburse it.[344] If the bank chooses to sell the BA, it will then turn over BA to its own money market desk for sale.

Alternatively, the customer may also arrange for the discount of the acceptance with a money market dealer. The dealer in turn may hold the BA, or rediscount it to an investor. The customer will contact a money market dealer while in the process of arranging an acceptance line of credit with the bank, to establish the annual rate of discount at which the dealer is prepared to buy or sell the draft after it has been accepted by the bank.[345]

Discounting through a money market dealer is more common because most customers engaged in BA financing do not have any mechanism or department sufficiently large or sophisticated to successfully deal with the money market. Nevertheless, banks try to retain as much trading of the BAs as possible, so that they can be involved in the money market themselves.[346]

The provisions of the *Bills of Exchange Act* on negotiation will generally govern most discounting activity.[347] If the discounting transaction does not conform to the Act, it is then only a transfer or assignment - not a negotiation - and therefore not subject to the

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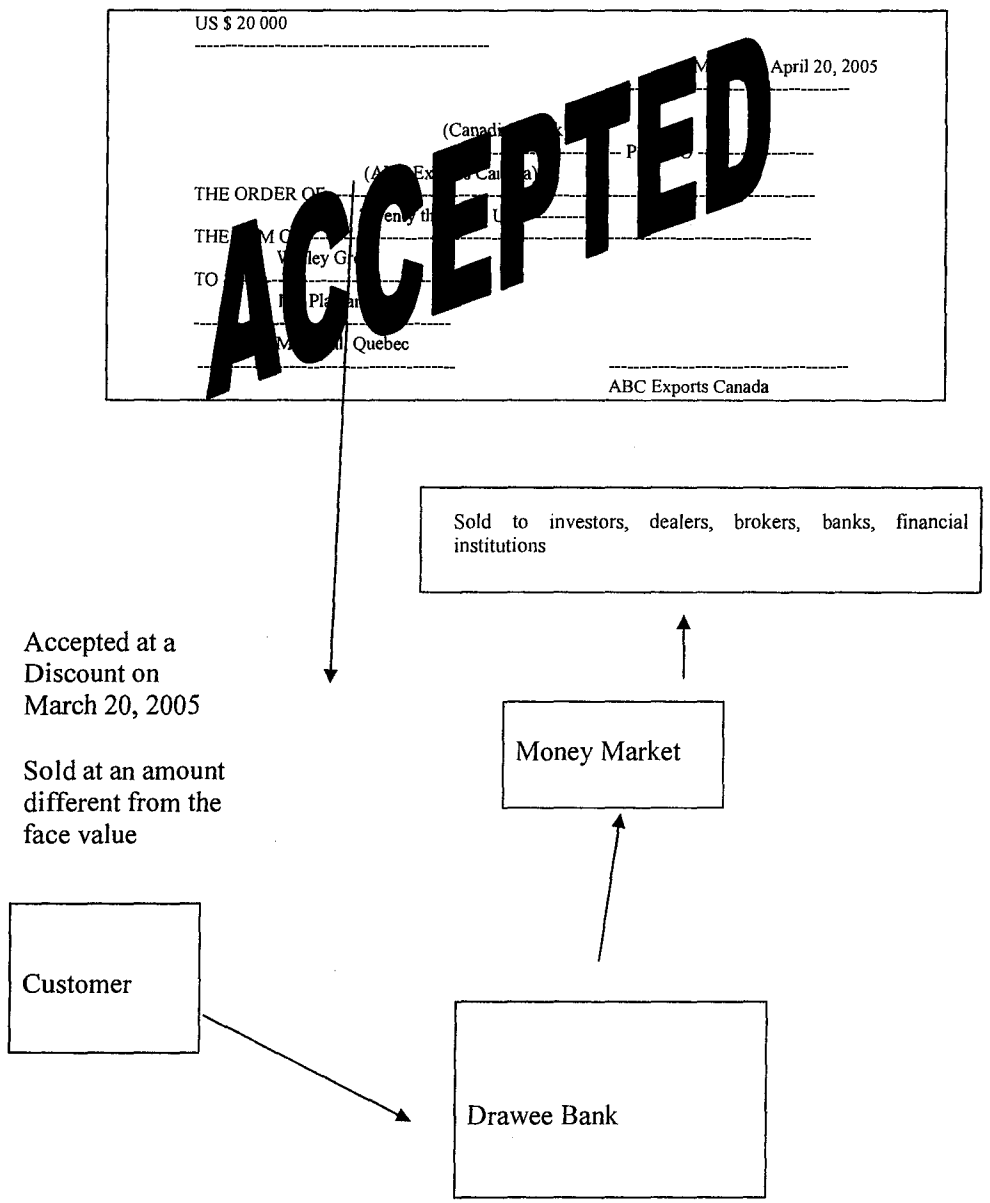
[343] E. M.A. KWAW, *loc. cit.*, note 5, p. 22.
[344] L. SARNA, *op. cit.*, note 65, p. 45. Speaking of English and American BA's, Brian Terry stated that the accepting bank will invariably be the discounting bank; however, it is quite likely to rediscount the bill rather than hold it to maturity. See B.J. Terry, *op. cit.*, note 8, p. 702.
[345] See S. SARPKAYA, *op. cit.*, note 18, p. 61.
[346] L. BOULTON, *loc. cit.*, note 11, p. 33.
[347] B.E.A. of Exchange Act, R.S., 1985, c. B-4, ss. 59-72.

special protections of the Act. The bank, or other parties to whom a bill has been discounted, will become the holder in due course if they meet the eight requirements of the Act; namely, (1) that they are a holder, that is, the payee or endorsee of a bill or note who is in possession of it, or the bearer thereof[348]; (2) that the bill was complete and regular on the face of it; (3) that he became the holder of it before it was overdue; (4) without notice that it had been previously dishonoured; (5) that he took the bill in good faith; (6) for value; (7) the bill was negotiated; and (8) without notice of any defect in the title of the person who negotiated it.[349]

[348] B.E.A. of Exchange Act, R.S., 1985, c. B-4, s. 2.
[349] B.E.A. of Exchange Act, R.S., 1985, c. B-4, s. 55(1). For a discussion of some the holder in due course issues, see B. GEVA, *loc. cit.*, note 133, p. 271-302.

# AN ACCEPTED BA THAT IS TRADED IN THE MONEY MARKET



### 3.2.2.3 Maturity

Before it finally matures, the BA may come into the possession of many other parties, including investment dealers, banks, financial and non-financial corporations. The ultimate holder of a BA waits until maturity, at which point the customer has presumably placed the accepting bank in funds to make payment on the acceptance. [350] At that time, the BA is presented for payment at the designated branch of the accepting bank, which must make payment of the sum stipulated.[351] Effectively, the ultimate holder of an acceptance is the one financing the customer's transaction.

The Act lays out several rules regarding presentment for payment. For example, a BA is duly presented for payment on the day it falls due.[352] Abel views the requirement of reasonable diligence as a guiding principle in dealing with issues of presentment.[353] Delays in presentment are excused where it is beyond the control of the holder, but presentment must be made with "reasonable diligence" when it becomes possible.[354] Maclaren offered several examples of excusable delays, including the outbreak of hostilities, delays in the mail or death of the holder.[355] Falconbridge pointed out that Russell[356] concurred with this view, although he was partial to the more cautious

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[350] See S. SARPKAYA, *op. cit.*, note 18, p. 63.
[351] See M.H. OGILVIE, *op. cit.*, note 3, p. 426-427.
[352] B.E.A., s. 85(1)(a).
[353] See Albert S. ABEL, "Presentment, Notice, Protest" (1974) 24 U.T.L.J., p. 191.
[354] *Id.*, s. 90(1(2). On the other hand, it would appear from s. 6(4) that the holder of a bankers' acceptance does not seem to have a cause of action, for example, where the branch at which it is payable is closed due to a labour disturbance. See B. CRAWFORD *op. cit.*, note 87, p. 691.
[355] John James MACLAREN, *MacLaren's bills, notes and cheques*, 6th ed., Frederick READ, ed., Toronto, Carswell, 1940, p. 250.
[356] Benjamin RUSSELL, *A Commentary on the Bills of Exchange Act*, 2nd ed., Montreal, Burroughs & Co., 1921, p. 315-316.

approach of Chalmers,[357] who emphasized that an excusable delay would be the "sudden death of the holder just before the bill matures,"[358] not simply the death of the holder.

The failure to duly present the BA for payment will discharge the customer and endorsers from liability.[359] Presentment for payment is dispensed with in a case where it could not be done, despite reasonable diligence or where the bank is fictitious, etc.[360] However, presentment is not dispensed with solely because one entertains the belief that the BA will be dishonoured on presentment.[361]

Presentment for payment must be made by the holder, or someone authorized to receive the payment on the holder's behalf, to the person designated by the bill as payer (i.e., the bank), its representative, or someone authorized to pay or refuse payment on the bank's behalf.[362] If the person were an agent not authorized to act on behalf of the holder, the payment would not discharge the BA.[363] The BA must be presented at the proper place, namely, the place indicated in the draft or acceptance.[364] In such cases, the acceptor is not discharged by the failure to present the BA on the day it matures (subject to any express stipulation to the contrary).[365] Where no place is specified, it must be presented at the address noted in the bill or acceptance or, alternatively, at the place of business of the bank.[366] Presentment for payment is not necessary to render the bank

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[357] David A.L. SMOUT, (ed.), *Chalmers on bills of exchange: A Digest of the Law of Bills of Exchange*, 13th ed., London, Stevens, 1964, p. 150.
[358] See B. CRAWFORD, *op. cit.*, note 34, p. 1565.
[359] B.E.A., s. 84(2).
[360] *Id.*, s. 91(1)(a)(b), etc.
[361] *Id.*, s. 91(2).
[362] *Id.*, s. 86(1).
[363] See *Murphy* v. *Canning*, (1905) 2 W.L.R. 103 (N.W.T.S.C.T.D.). Emphasis is placed on the word *authorized*, though Crawford suggests it might be reconsidered in light of modern agency law. See B. CRAWFORD, *op. cit.*, note 34, p. 1559.
[364] B.E.A., s. 87(a).
[365] *Id.*, s. 92(2).
[366] *Id.*, s. 87.

liable.[367] Either the customer or the bank may stipulate the place of payment. Where no branch is specified of a particular bank, but it is dated in a particular city, it should be presented in that city, at the principal branch, not at the head office.[368]

Where a BA is duly presented for payment, and is refused or cannot be obtained, or presentment is excused and the bill is overdue and unpaid, the bill is dishonoured by non-payment.[369] Consequently, the holder gets an immediate right of recourse against the customer, bank and endorsers.[370]

A BA is discharged where there is payment in due course, that means, "payment made at or after the maturity of the bill to the holder thereof in good faith and without notice that his title to the bill is defective."[371] Because the BA is an accommodation bill, if the customer pays in place of the bank, it is paid in due course, and thus discharged.[372] The BA is also discharged if, after maturity, the bank becomes the holder of it[373] or the holder "absolutely and unconditionally renounces his rights against the acceptor."[374]

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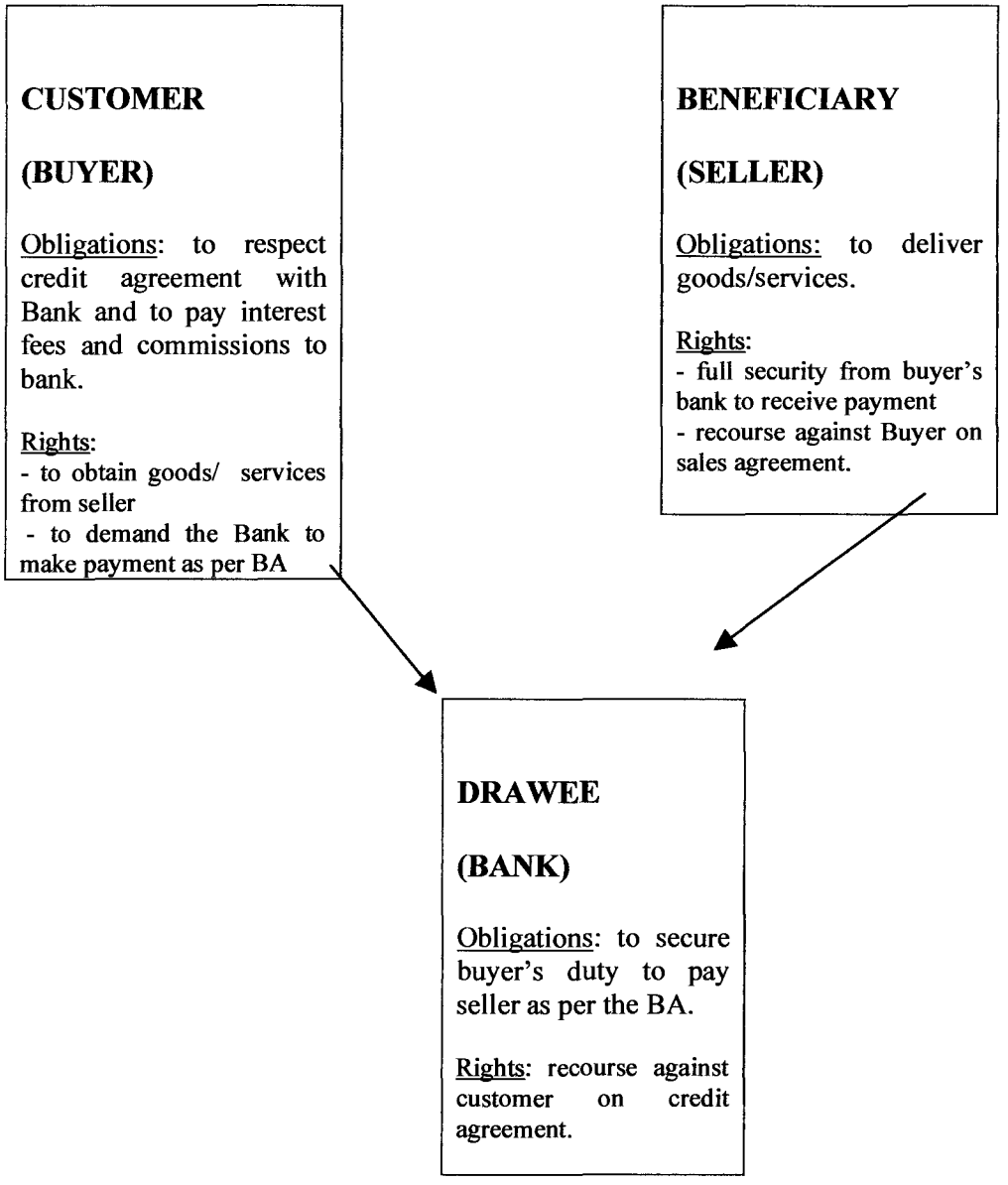
[367] *Id.*, s. 92(1).
[368] *Royal Bank of Canada* v. *Boyce; Royal Bank of Canada* v. *Wildman*, (1966) 57 D.L.R. (2d) 683 (Ont. Co. Ct.); *Commercial Bank of Canada* v. *Bissett*, (1891) 7 Man. R. 586 (Q.B., Appeal Side); See B. CRAWFORD, *op. cit.*, note 34, p. 1562.
[369] B.E.A., s. 94(1).
[370] *Id.*, s. 94(2).
[371] *Id.*, s. 138(1)(2).
[372] *Id.*, s. 138(3).
[373] *Id.*, s. 140.
[374] *Id.*, s. 141(1).

# RIGHTS AND OBLIGATIONS OF IMMEDIATE PARTIES TO A BA



### 3.2.2.4 Roly-poly

The roly-poly has an amazing benefit for the customer. It is a method by which a customer can take advantage of the BA financing but with a much longer repayment schedule.[375] This minimizes the exposure of the customer to shifting interest rates as BAs mature.[376]

The roly-poly arrangement was designed to provide for an ongoing financing which exceeds the term of individual acceptance. The roly-poly agreement is established at a predetermined discount or rate of interest; the terms of roly-poly are between six months and a year although the commitment extends over several years. Under this type of arrangement, a financial institution (such as a pension fund or insurance company) agrees to purchase the BA at a long-term rate, to an agreed maximum, while the customer engages in BA financing to the maximum short-term maturity limit allowed by its bank.[377] This period is usually between three to five years but may be as long as seven years.[378] "Generally, in order to set up the roly-poly, it is necessary to have an established acceptance credit with a chartered bank for a fixed term, as set out above."[379]

In practice, banks have been said not to be very sympathetic to this type of arrangement, as they would prefer to remain the primary purveyor of long and medium term loans. Increasingly, they are inserting clauses in their credit agreements that would

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[375] L. SARNA, *op. cit.*, note 65, p. 50.
[376] See P. G. BEVANS, *loc. cit.*, note 7, p. 543.
[377] L. SARNA, *op. cit.*, note 65, p. 50.
[378] P. G. BEVANS, *loc. cit.*, note 7, 543.
[379] *Id*, p. 544.

prevent the customer from entering agreements with other parties for the purchase of accepted drafts. Naturally, customers try to avoid such clauses.[380]

There is the question as to whether this clause is abusive, and therefore, if the customer may seek to have it struck down, pursuant to article 1437 of the Civil Code of Quebec. Being as this clause forms part of the banker-customer agreement generally, distinct from any relationship arising from the BA instrument itself, the contract ought to be governed by provincial contractual law. To avail oneself of the remedy in article 1437 C.C.Q., one must establish (1) that the clause in question forms part of a consumer contract or contract of adhesion, and (2) that the clause is excessively and unreasonably detrimental to the consumer or the adhering party and is therefore not in good faith.

Authors have suggested that that the notions of consumer contract and contract of adhesion should not be interpreted restrictively, and that courts have adopted a global approach to determining whether a contract is one of adhesion or mutual agreement.[381] This seems to be a preferable approach given that, as another author put it, "...il apparaît que le concept de contrat d'adhésion est, pour ainsi dire, indéfinisable."[382] In any case, these criteria leave a large scope for evaluation by the judge. Clauses may be considered to be abusive in three ways; (i) the clause may be intrinsically abusive, (ii) the clause may be abusive in its combined effect with other clauses in the agreement, or (iii) the clause may be abusive in light of other contracts to which it is closely connected.[383]

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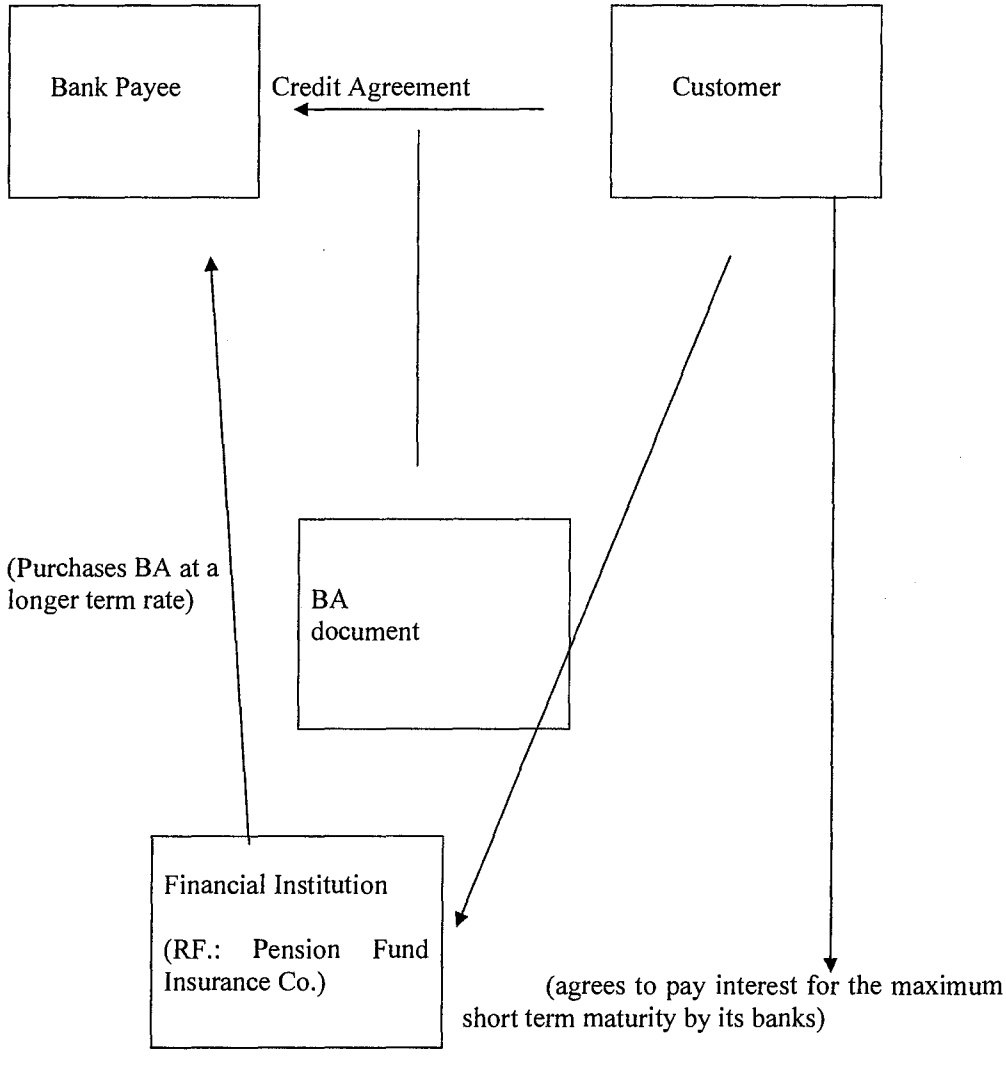
[380] *Id.*
[381] J.-L. BAUDOUIN and P.-G. JOBIN, *op. cit.*, note 127, p. 121.
[382] Benoît MOORE, "À la recherche d'une règle générale régissant les clauses abusives en droit québécois", (1994) 28 R.J.T. 177, p. 205.
[383] J.-L. BAUDOUIN and P.-G. JOBIN, *op. cit.*, note 127, p. 122-23.

Although theoretically possible, it is highly unlikely that the underlying agreement with respect to financing will be considered a consumer contract, as BA financing is likely to be used to finance international trade or generate capital, not for "personal, family or domestic purposes."[384] It could of course be considered a contract of adhesion, pursuant to article 1379 of the C.C.Q. The issue will turn on the extent to which negotiation of the contract was possible. This is a question of fact, and will depend on the relationship of the bank and customer, and their relative bargaining strength. With respect to the abusiveness of the clause, this too will depend on the particular fact situation. Preventing the customer from selling accepted drafts to any other party may or may not be "excessively and unreasonably detrimental to the consumer or the adhering party" as required by article 1437 C.C.Q. Among other things the courts will have to determine are: what other means of financing are open to the customer, the cost this restriction imposes on the customer, and the creditworthiness of the customer and the risk the bank is exposed to when its customer engages in roly-polys.

[384] Art. 1384 C.c.Q.

ROLY POLY

**For Longer Repayment Schedule**



### 3.2.3 Participation Agreement

We have seen the complexity of the BA and its operation. Because the nature and structure of BA financing has changed, multi-bank participation arrangements have become more common than they once were.[385] Despite the credit agreement between the bank and its customer discussed in section 3.1, it is necessarily more complex when there are a number of financial institutions and/ or banks are involved. However, "Despite their widespread usage, the legal position of all credit participations has been dealt with at law only recently; even following that legal study, the position of participated BA financings is subject to question."[386]

There are a number of policy objectives that are achieved with participation agreements. The court in *Re: C.D.I.C.*[387] describes these objectives as "facilitating loans while diversifying the incumbent risks associated with loans" as well as fostering "the lending of funds at the lowest cost to borrowers while enhancing the return to savers and investors" and "enabling smaller banks the ability to participate in loan agreements which would normally be beyond their limited asset base."[388]

BA participation arrangements involve the bank, known alternatively as the "lead," "selling," or "senior" bank, and other institutions (not necessarily banks) known as "participants," or "sub-participants." These participating institutions are not required to

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[385] E. RAZIN, *loc. cit.*, note 10, p. 218.
[386] *Id.*
[387] *Supra*, note 167, p. 233.
[388] *Id.*, 233.

be able to accept bills as required by the BEA.[389] There are various methods to orchestrating these participation arrangements, namely BA risk participations and BA generic participations.[390] "Risk participations" create an arrangement that "allows the transfer of all of the economic benefits and risks without the transfer of legal obligations or rights."[391] The legal obligation concerning the issuance and payment of the BA exists only between the customer and lead bank; there is no contractual relationship between the customer and the participants. Risk participations have no effect on the agreement between the customer and lead bank; they are separate contracts between the lead and participating banks.[392] The bank does not act as agent for the participants when it sells them portions of the loan,[393] nor does it act as agent for the borrower though there remain general duties owed by a bank to its customer (for example with regard to representations).[394] The lead bank allots a percentage interest in the present and future obligations of the customer. In return, the participating institutions enter into a binding agreement with the assigning bank to indemnify it for the funds it may pay upon the maturity of the acceptance. The bank remains primarily liable pursuant to the Act[395] but retains a separate claim against each of the participants. The participants maintain only an indirect claim on the customer, while directly responsible to the lead bank.

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[389] *Id.*, 237. Section 46(2) of the Act (R.S., 1985, c. B-4) provides that a corporation can only make itself liable on a bill if permitted under its governing law.
[390] There is also discussion of funded participations at BA rates, but these are not true acceptance arrangement, but rather a participated loan at lower BA rates. See E. RAZIN, *loc. cit.*, note 10, 241-242.
[391] *Id.*, p. 243.
[392] For the distinction between syndications and participations, see E. P. ELLINGER, E. LOMNICKA, and R. HOOLEY, *op. cit.*, note 330, p. 669.
[393] N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 234-235.
[394] Banks can be held liable for negligent misstatements made to their customers. See *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.).
[395] B.E.A., s. 127.

"Generic participations," on the other hand, differ in that the participants accept a portion of the drafts rather than indemnifying the lead bank. This is arranged in one of two ways. In one type of generic acceptance, the customer signs a blank draft and authorizes the lead bank to complete the BA by including the accepting institution. Alternatively, the participants may provide a bank with their own completed drafts, which are then given to the customer to sign.[396] The lead bank often finds the orchestration of a generic participation most appealing because, in part, it ensures its own exemption from liability by redistributing it among the participating institutions in proportion to their acceptance of the drafts. Generic BA participations are a form of BA syndication or an assignment, because there are separate acceptances by the participating banks governed by a single agreement.[397] In a syndication arrangement, each bank acquires a direct contractual relationship with the borrower (or in this case, the drawer). In an assignment, the parties are in the same situation, except that the direct contractual relationship arises from the sale of the lead bank's rights and obligations to another bank or banks. Each bank will normally be able to independently verify the customer's creditworthiness and conduct its own risk analysis.[398]

The characterization of participations between the parties has been unclear. In the United States, where participation agreements are now drafted as the purchase and sale of an undivided interest in the loan, courts interpreted the grant of a veto power over changes to the security corresponding to the underlying loan as establishing the

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[396] This is permitted by the Act. See B.E.A., s. 36(1)(a).
[397] For the distinction between syndications and participations, see E. P. ELLINGER, E. LOMNICKA, and R. HOOLEY, *op. cit*, note 330, p. 662.
[398] Peter J. LEWARNE and Kenneth E. THORLAKSON, "Syndications, Assignments and Participations by Canadian Banks," (1991) 6 *B.F.L.R.* p. 1, 2-3.

participant as a creditor of the lead bank.[399] The court viewed the participation as a commitment by the participant to extend credit or loans to the lead bank in the future, if necessary.[400] Such reasoning was rejected in a subsequent case[401] in which the court found that the language of assignment in the participation agreement produced a sale by the lead bank of an interest in future income. They also imposed a constructive trust on the lead bank in favour of the participants, which is what a Canadian court did in the only similar case to arise here.[402] The court implicitly found that what had occurred was the sale of a future stream of income, rather than a loan and commentators noted that under Canadian law. This sale excludes the notion that the participating banks are creditors of the lead or senior bank.[403] This may be true of risk participations, but with respect to generic participations, the situation is different. The lead bank doesn't "sell" anything to the participating bank, but rather allots a percentage of the acceptances to the banks, which they accept, creating a direct relationship to the customer. In this sense, the lead bank is the agent of the participating bank in creating the BA.

In either case, these arrangements enable banks to unite with other banks in their acceptance activity where the amount of debt sought by the customer is particularly great or too burdensome for a single bank. It also allows the bank to reduce its own risk in losing a large amount of money to cover the BA. As mentioned above, under the credit agreement, the customer has the duty to put the bank in funds to pay the BA at maturity. However, there is the risk that the customer will be insolvent and that the bank will be

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[399] *Taylor* v. *Arkansas Democrat Co.*, 54 S.W.2d 59 (Ark. 1932); *Stratford Financial Corp.* v. *Finex Corp.*, 367 F.2d 569 (2nd Cir. 1966).
[400] See also P. J. LEWARNE and K. E. THORLAKSON, *loc. cit.*, note 398 p. 1, 4.
[401] *Federal Deposit Insurance Corp.* v. *Madamemoiselle of Cal.*, 379 F. 2d 660 (9th Cir. 1967).
[402] *Canada Deposit Insurance Corp.* v. *Canadian Commercial Bank* (1986) 27 D.L.R. (4th) 229, 59 C.B.R. (N.S.) 1. Additional reasons at, (1986) 62 C.B.R. (N.S.) 205 and (1987) 64 C.B.R. (N.S.) 9 (Alta. Q.B.).
[403] See W. G. BELLACK-VINER, *loc. cit.*, note 1190, p. 236 and P. J. LEWARNE and K. E. THORLAKSON, *loc. cit.*, note 398, p. 1, 5.

left to shoulder the burden by itself. One way of reducing this risk is to set up a participation agreement between other banks. This can be done by the customer's bank, acting as the lead bank, inviting other banks into the financing transaction, thereby sharing in the risk (and the rewards) of the arrangement. Essentially, the lead bank assigns interests in the financing arrangement to other banks (known as participants or sub-participants). The participants agree to indemnify the lead bank proportionally to their interest in the financing. In practice, most participations are risk participations, whereby the lead bank will accept the draft and then rely in turn on its right of indemnification against the other participants, should the customer ultimately default at maturity.[404]

Though banks are not required under the *Bank Act*[405] to retain reserves against outstanding acceptances, practical concerns motivate them to retain a certain amount in reserve to repay the acceptance at maturity. Because the revenue generated from stamping fees is small and profits are modest, retaining such reserves is quite costly. Participation arrangements enable banks to put more of their capital to more productive uses, without jeopardizing their ability to pay the BA at maturity.

This arrangement not only reduces risk for the banks, but it facilitates and improves relationships between banks and other non-bank financial institutions.[406] The orchestration of a bankers' acceptance participation strengthens the affiliation of the institutions involved. Participation arrangements also allow smaller banks to engage in a sphere of banking activity they would otherwise be effectively excluded from. Also, their

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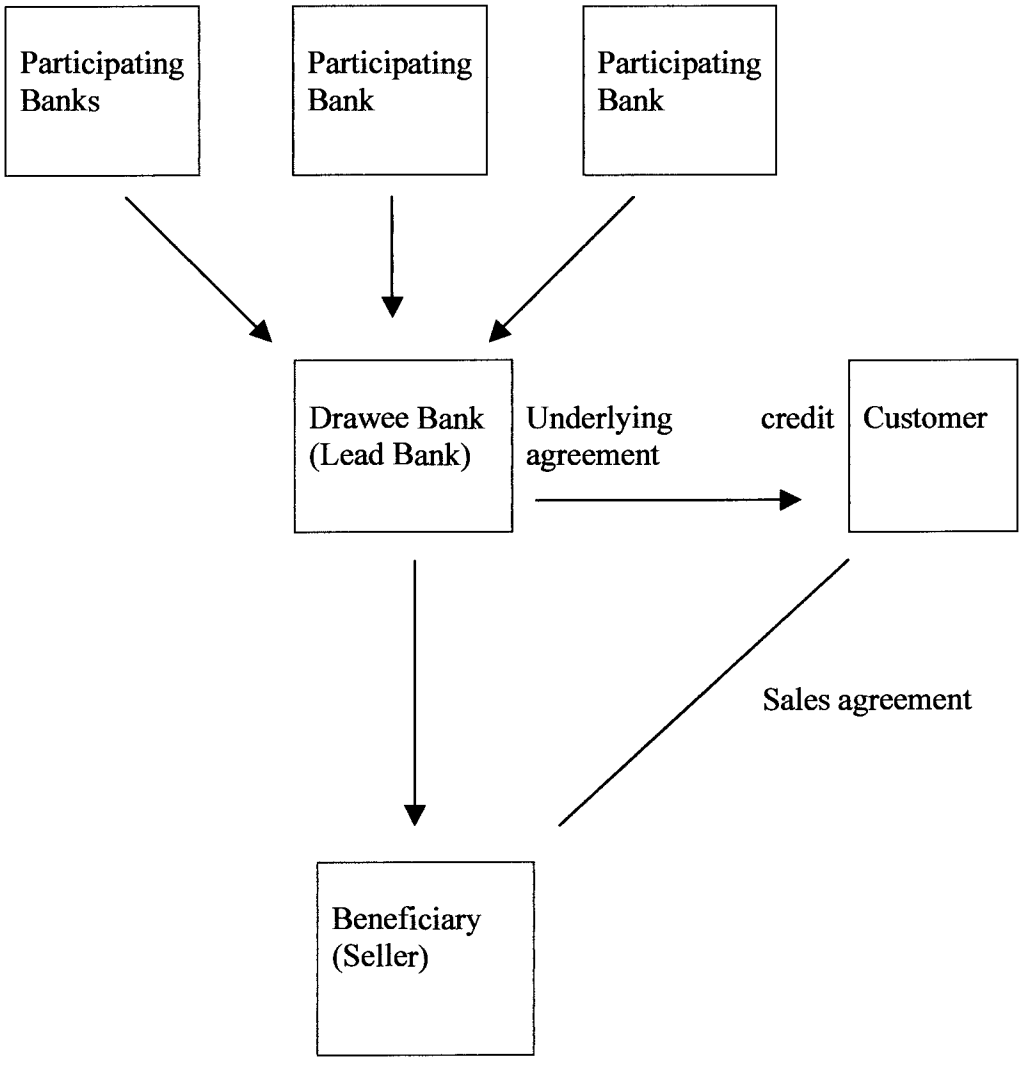
[404] L. SARNA, *op. cit.*, note 65, p. 50.
[405] 1991, c. 46.
[406] Frederick H. JENSEN and Patrick M. PARKINSON, "Recent Developments in the Bankers' Acceptance Market", (1986) 72 *Federal Reserve Bulletin* p. 1, 11.

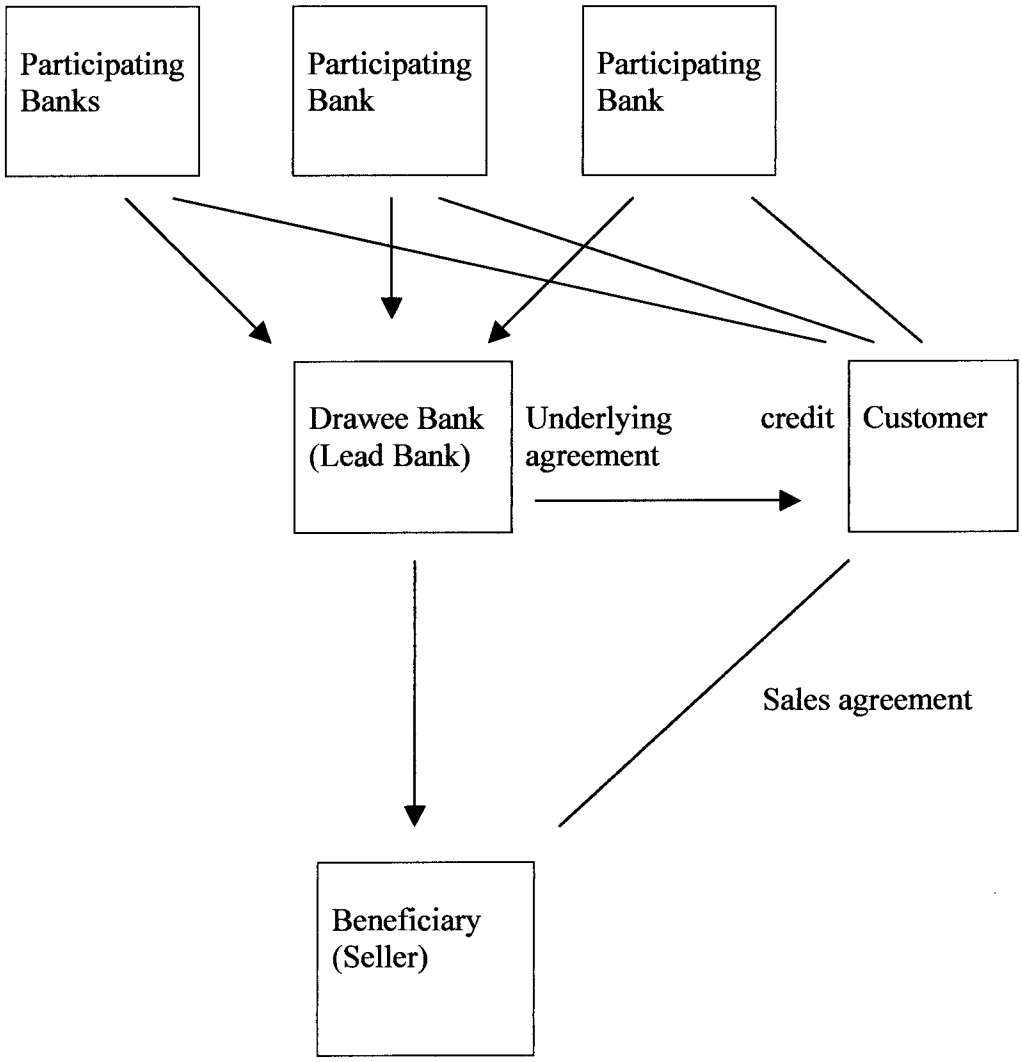
customers are not forced to seek out other financial institutions to handle their requests. This promotes the overall competitiveness of the banking industry. If it were not for participation in facilities, individuals seeking credit financing in the world's financial markets would be forced to employ other, more expensive methods (such as bank loans at the prime rate plus).

Numerous benefits and drawbacks exist in both risk participation and generic participation. Much of how beneficial or disadvantageous the different acceptances appear depends on the standpoint from which the situation is viewed. They must be carefully contemplated in each case to ensure the most fitting participation has been facilitated for the particular circumstances. To the customer, risk participations can access a greater measure of credit and ensure relatively stable pricing of funds, while generic participations offer the potential of financing at more economical rates because they can provide diversified price schedules. To a bank, generic participations are preferable because under such arrangements, the bank will take in fees regardless of the fact that any liability to pay, which it undertakes as an acceptor, will be covered by the funds remitted to it by its customer pursuant to the underlying credit agreement. In the eventuality that the customer defaults on the agreement, the bank has diversified the risk and has thus mitigated the negative effects.

# BA AGREEMENT AND "RISK PARTICIPATION" OF BANKS



# BA AGREEMENT AND "GENERIC PARTICIPATION" OF BANKS



Moreover, for the purposes of accounting, bankers' acceptances are treated as on-balance sheet items.[407] With risk participations, no portion of the bankers' acceptance may be removed from the balance sheet, according to the policy of the Office of the Superintendent of Financial Institutions (OSFI). This policy is unlike regular loans, where participations transfer the asset from the lead bank to the other bank's balance sheet. This can make risk participations unacceptable to the lead or senior bank.[408] Nevertheless, it is risk participations that are preferred, as they do not require the customer's approval of the participating institutions and because it broadens the number of institutions that may partake in the participation, and consequently indemnify the lead bank.

[407] P. J. LEWARNE and K. E. THORLAKSON, *loc. cit.*, note 398, p. 1, 16. The authors note that this treatment has been confirmed by the Office of the Superintendent of Financial Institutions (OSFI) of Canada, in a letter dated, April 18, 1989 to the Canadian Bankers' Association (CBA).
[408] P. J. LEWARNE and K. E. THORLAKSON, *loc. cit.*, note 398, p. 1, 16.

## POSSIBLE CLAIMS BETWEEN PARTIES TO THE BA TRANSACTIONS

Are the parties in the same jurisdiction?

If yes, which rules governing contract apply? (Section 9 of the Bills of Exchange Act)

(1) Who is claiming from whom?

(2) Is the dispute between the customer and the payee bank?

(3) Is the dispute between the customer and the beneficiary?

(4) Is the dispute between the payee bank and the sub-participating banks?

(5) Is the dispute between the payee bank and a financial institution in a Roly Poly?

(6) Is there a Letter of Credit in place?

What is the relationship between the applicant/customer and the issuing bank?

What is the relationship between the beneficiary and the paying bank?

What is the relationship between the payee bank and a financial institution concerning a maximum extension on the maturity date?

### 3.2.4 Letter of Credit Agreement and the Bankers' Acceptance Draft

To understand the relationship between the BA and letter of credit, a brief explanation of the letter of credit transaction is in order. International sales transactions differ from domestic sales in that, while the former involve the movement of products in the form of goods and services sold by a domestic-based enterprise to a foreign customer based in a different jurisdiction and vice versa, the domestic sale will be localized within the same jurisdiction. Furthermore, the economic and political risks involved make an international sale more complex.

The greatest concern of a seller is the risk of non-payment by a buyer in a foreign country.[409] The seller would rather not spend money wastefully in manufacturing, packaging and shipping goods without knowing for certain that the buyer will be solvent. The buyer however, will favour not paying the seller until he knows that the goods have left the seller's possession and are on their way to him. This scenario is usually proven by documents produced by the seller. In this context, banks have taken an active role in securing payment to the seller

Therefore, at the request of the seller, the buyer will call upon a bank to guarantee the execution of the obligation of payment. This payment technique is known as opening

[409] Louis PERRET, "Qu'est-ce que la gestion des risques dans les contrats internationaux?" (1990) 1 *Assurances* 45. Nicole LACASSE, "L'évaluation et la gestion du risque de défaut de paiement dans les contrats internationaux," (1989) 20 *R.G.D.* p. 451.

a letter of credit to the benefit of the seller.[410] In this transaction, the buyer in one jurisdiction contacts his bank to issue a letter of credit to the benefit of the seller. The issuing bank promises to pay the seller upon delivery of documents ensuring security of the goods being bought in the transaction. If this procedure is properly carried out, then risks are greatly diminished for both the buyer and the seller.[411]

As an accepted rule, all letters of credit will be governed by the ICC Uniform Customs and Practice for Documentary Credits, (UCP).[412] The body of the UCP consists of numerous general definitions, rules on the form and notification of credits, obligations and responsibilities of the parties involved, an analysis of the essential documents, various rules concerning expedition, presentation and terms, and rules regulating transfer of credits and the assignment of proceeds. Although the UCP is not, as such, a statute, once it is incorporated into the letter of credit, it becomes the law of the contracting parties.[390.1]

Letters of credit by their nature are separate and independent from the sales or other contracts on which they may be based.[413] In *Bank of Nova Scotia v. Angelica-*

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[410] Letters of credit may also be referred to as documentary credits, commercial letters of credit, or simply, credit. A letter of credit may also be used as a guaranteeing instrument issued at the request of the seller in favor of the buyer, usually as a performance bond. This type of letter of credit is known as a standby letter of credit, *ICC Uniform Customs and Practice for Documentary Credits,* (1993 Revision) Publication No 500, (hereinafter referred to as the UCP) see Article 2 for differences.

[411] Suzanne CÔTÉ and Francois BOURASSA, "Quelques aspects pratiques du crédit documentaire," Banque Nationale du Canada, 1991, p.2.

[412] Due to the new practices in international trade, introduced within the last ten years, the International Chamber of Commerce's Commission (I.C.C.) on Banking Technique and Practice, had set up a Working Group to revise the UCP 400. The authorization for changes took place at a meeting held in November 1989. The UCP new rules were approved by the Banking Commission on March 10, 1993, and became effective on January 1, 1994.

[393.1] It might be argued that underlying the reception of the UCP, is the implicit acceptance for the parties to choose a national law to their letter of credit.

[413] Article 3, UCP 500. The independence principle is also codified in the American UCC, sections 5-109 and 5-114(1).

*Whitewear, Ltd.*[414] Justice LeDain of the Supreme Court, in acknowledging the existence of the autonomy principle, stated the following:

> The fundamental principle governing documentary letters of credit and the characteristic which gives them their international commercial utility and efficacy is that the obligation of the issuing bank to honour a draft on a credit when it is accompanied by documents which appear on their face to be in accordance with the terms and conditions of the credit is independent of the performance of the underlying contract, for which the credit was issued. Disputes between the parties to the underlying contract concerning its performance cannot as a general rule justify a refusal by an issuing bank to honour a draft which is accompanied by apparently conforming documents.[415]

Consequently, a bank undertaking a letter of credit operation is in no way bound by such underlying contract, and there need be no mention whatsoever of such contract in the credit. Thus, any claims or disputes which may arise between the buyer and the seller or between the buyer and the issuing bank will not affect the credit.[416] The main concern in effecting a viable transaction is that the documents presented by the beneficiary at the time of payment comply strictly with the terms and conditions set forth in the letter of credit.[417]

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[414] (1987). 36 B.L.R-140; 36 D.L.R. (4th) 161 (S.C.C.):[1987] 1 S.C.R. 59. The *Angelica* case will be referred to in B.L.R.).
[415] *Id*, p. 148 (LEDAIN, J.).
[416] In *Malas (Hamzeh) and sons v. British Imex Industries,* [1958] 2 Q.B. 127, Mr. Justice Jenkins states that:
"[...It] seems to be [...] that a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which imposes on the banker an absolute obligation to pay, irrespective of any dispute which there may be between the parties on the question whether the goods are up to contract or not."
[417] Article 4 and Article 7, UCP 500.

The BA acceptance in relation to the letter of credit has been described in the case of *Guaranty Trust Co. of New York v. Hannay & Co.*[418] In this decision, the court referred to the role of the acceptance in relation to a letter of credit transaction as follows:

> The vendor, to help the finance of his business, desires to get his purchase price as soon as possible after he has dispatched the goods to his purchaser, with his object, he draws a bill of exchange for the price, attaches to the draft the document of carriage and insurance of the goods sold and sometimes an invoice for the price, and discounts the bill-i.e. sells the bill with documents attached to an exchange house. The vendor thus gets his money before the purchaser would, in ordinary course, pay; the exchange house duly presents the bill for acceptance, and has, until the bill is accepted, the security of a pledge of the documents attached and the goods they represent. The buyer on the other hand may not desire to pay the price until he has resold the goods. If the draft is drawn on him, the vendor or exchange house may not wish to part with the documents of title until the acceptance given by the purchaser is met at maturity. But if the purchaser can arrange that a bank of high standing shall accept the draft, the exchange house may be willing to part with the documents on receiving the acceptance of the bank. The exchange house will then have the promise of the bank to pay, which if in the form of a bill of exchange, is negotiable, and can be discounted at once. The bank will have the documents of title as security for its liability on the acceptance, and the purchaser can make arrangements to sell and deliver the goods. Before acceptance, the documents of title or the security, and an unaccepted bill without documents attached are not readily negotiable. After acceptance, the credit of the bank is the security, and an accepted bill with documents attached is unusual and not readily negotiable. If further appears from the evidence as to commercial use on which the above statements are based, that it is commercially convenient to have on the face of the bill an indication of the transaction in respect of which it is drawn.[419]

[418] [1918] 2 K.B. 623 (C.A.).
[419] [1918] 2 K.B. 623 at 659 (C.A.).

Although the court discusses the role of acceptance in association with a letter of credit in *Guaranty Trust Co.,* still the case does not demonstrate the actual practice in a letter of credit transaction. Today, the letter of credit itself is the payment security. As well, any documents connected to the transaction such as that of carriage and of title are stapled to the letter of credit and not the draft, and are delivered to the buyer at the moment when payment is rendered to the vendor or acceptance stays certain. Although two parties are sure of each other's intentions, reputations and solvency, what they do not have is security from a bank (third party) against default. In this respect, the BA guaranteed by a bank carries the most ideal form of a guarantee in the market place. Particularly, the BA will often be used in conjunction with the letter of credit to guarantee payment by a bank to its final beneficiary. The advantage for the beneficiary is that he will be paid, whether or not the applicant of the letter of credit is completely satisfied with the condition of the goods purchased and delivered.

Like letters of credit, the BA may also become the victim of fraud. For example, the BA may be issued and accepted by a bank that is nonexistent, or a bank that does not have the funds to make payment and is insolvent. The rules on fraud regarding letters of credit essentially stipulate that, even where documents presented appear to comply with the terms and conditions of the letter of credit, payment may be stopped. This is on condition that the fraud has been committed and the person demanding payment is not in a protected class.[420] The leading Canadian case on the fraud rule is *Bank of Nova Scotia*

[420] See Xiang GAO, *The Fraud Rule in the Law of Letters of Credit*, London, Kluwer Law International, 2002, p. 29.

*v. Angelica-Whitewear, Ltd.*[421], which relied on the foundational case of *Sztejn v. J. Henry Schroder Banking Corp.*[422]

The word fraud in Canadian law has been described as "impropriety, dishonesty or deceit."[423] This definition comes from *Cineplex Odeon Corp. v. 100 Bloor West General Partner Inc.*, where the court's comments on fraud were as follows:

> Fraud is not simply a legitimate dispute or disagreement over the interpretation of a contract, however one-sided that dispute may appear. While the notion of fraud may elude precise definition, it is a concept well-known to the law, and it must, in my view, import some aspect of impropriety, dishonesty or deceit.[424]

The court went on to conclude that there was a strong *prima facie* case of fraud:

> Where the demand on the letter of credit can be said to be "clearly untrue or false," or "utterly without justification," or where it is apparent there is "no right to payment," all fall within the foregoing principles and must be read in the context of those "fraud" principles.[425]

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[421] (1987). 36 B.L.R-140; 36 D.L.R. (4th) 161 (S.C.C.):[1987] 1 S.C.R. 59.
[422] (1941) 31 N.Y.S. 2d 631.
[423] See, e.g., *Royal Trust Corporation of Canada v. Royal Bank of Canada*, [1993] O.J. No. 718 (Gen. Div.); *930154 Ontario Inc. v. Onofri*, [1994] O.J. No. 2095 (Gen. Div.); *Royal Bank v. Gentra Canada Investments Inc.* (2000), 1 B.L.R. (3d) 170. See also *Royal Bank of Canada* v. *Darlington,* [1995] O.J. No. 1044 (Gen. Div.), where the court reviewed definitions of fraud provided to bank officers who testified at the trial, which definitions stressed that fraud required an absence of actual and honest belief in the truthfulness of a statement and an intention to deceive or the reckless disregard of the truth (at paragraphs 154 and 155).
[424] [1993] O.J. No. 112 (Gen. Div.), para. 31.
[425] [1993] O.J. No. 112 (Gen. Div.), para. 33, referring to *C.D.N. Research & Development Ltd. v. Bank of Nova Scotia* (1980), 18 C.P.C. 62 (Ont. H.C.), 65; *Henderson v. Canadian Imperial Bank of Commerce et al.*, (1982), 40 B.C.L.R. 318 (B.C.S.C.), 320; *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.*, [1978] 1 Q.B. 159, 169 (C.A.).

The decision in *Angelica-Whitewear* is to the same effect.[426]

*Angelica-Whitewear* also showed that the fraud exception should not be applied to a holder in due course of a draft on a letter of credit.[427] In Quebec, this question was considered in *Les industries Almac Ltée* v. *Al-Arishi,*[428] which maintained the defendant had not negotiated the draft; he did not have status as a regular holder in due course. The court also touched on this question in *Geestemünder Bank AG v. Barzelex Inc.,*[429] However, the Court of Appeal in this trial found that regardless of whether Geestemünder Bank was a holder in due course, Barzalex could in this case claim the causes of nullity under civil law. The court asserted the rights of the Bank of Nova Scotia, an immediate (or near) party in the circumstances.

The case is interesting because it deals with both letters of credit and acceptances (in that case, of a bank draft). In *Geestemünder*, the issue was whether the Bank of Nova Scotia had to honour the draft it had accepted in favour of Geestemünder Bank. The former maintained that Geestemünder Bank had committed fraud with respect to certain documents; namely, by inserting the wrong date into an invoice that had been left blank, and by having issued a second bill of lading when the original one was found to be incorrect. Given that the draft was accepted on the strength of these documents, it was argued that the draft should not have been paid.

The Court of Appeal found that, although Geestemünder had been acting as a mandatory of M.E.C.S. (the vendor, in this case), one could not impute knowledge of the

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[426] See *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59, 84-85.
[427] *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59, 84.
[428] [1991] R.J.Q. 830 (C.S.).
[429] [1995] R.J.Q. 88 (C.A.).

falsity of the bills of lading to the bank. In fact, as far as Geestemünder was concerned, the issuance of a second bill of lading was made in good faith and the first bill of lading had contained a mistake rather than a deliberate forgery. Accordingly, Barzelex could not request the resiliation of the letter of credit nor its effect in leading the Bank of Nova Scotia to accept the draft. The case teaches us that, for fraud to exist, the party must have actual knowledge of what is transpiring since imputed knowledge is insufficient.

Like the BA, a letter of credit may be transferable to a second beneficiary, provided that it is expressly designated as "transferable" by the issuing bank.[430] The BA, however, is always transferable since it is a negotiable instrument, subject to the rules of the *Bills of Exchange Act*. As well, the beneficiary of a BA (called the holder in due course) like a letter of credit beneficiary, may hold the draft until it is payable, or transfer it to another party for early payment, but at a cost as discussed above. The beneficiary of a letter of credit may also choose to assign any proceeds to which he may be entitled under such credit, even when the credit does not stipulate transferability.[431]

In practice, the letter of credit must state whether it is revocable or irrevocable. In the absence of such mention, the credit is deemed irrevocable.[432] A revocable letter of credit is one which can be revoked at any time, up to the moment when the seller presents the necessary documents. An irrevocable letter of credit is one that is final and annullable

[430] Article 48, UCP 500.
[431] Article 49, UCP. For further study on this point see Rolf EBERTH and E.P. ELLINGER, "Assignment and Presentation of Documents in Commercial Credit Transactions", (1982) 24 *Ariz. L. Rev.* 277; see also Jean-Pierre STOUFFLET, "Payment and Transfer in Documentary Letters of Credit: Interaction Between the French General Law of Obligations and the UCP", (1982) 24 *Ariz. L. Rev.* 267.
[432] Article 6(c), UCP 500.

only upon agreement of all the parties to the transaction, or upon evidence of a "strong *prima facie* case of fraud" in the documents presented by the seller to his bank.[433]

The court in *Angelica* in stating the exception to fraud when dealing with letters of credit noted that a bank must honour a draft, assuming that the tendered documents appear, on their face, to be regular and in conformity with the terms and conditions set out in the letter of credit. Justice LeDain made this point in the following terms:

> An exception to the general rule that an issuing bank is obliged to honour a draft under a documentary credit when the tendered documents appear on their face to be regular and in conformity with the terms and conditions of the credit has been recognized for the case of fraud by the beneficiary of the credit which has been sufficiently brought to the knowledge of the bank before payment of the draft or demonstrated to a Court called on by the customer of the bank to issue an interlocutory injunction to restrain the bank from honouring the draft.[434]

Irrevocable and confirmed letters of credit are the preferred choice of sellers, since they secure payment upon presentation of the documents, provided that they conform to the terms and conditions of the letter of credit.[435] The BA, however, becomes irrevocable once the bank has stamped its acceptance on the bill and payment will be due at its maturity. The BA is used together with the letter of credit, when payment is demanded before it becomes payable.

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[433] *Angelica, supra* no6 at 160. The court held that the requirement of a "strong *prima facie* case of fraud" was necessary for a customer who wished to stop the issuer from honoring the letter of credit by way of an interlocutory injunction. On the other hand, when a customer claims fraud in his defense to a suit initiated by the issuing bank for reimbursement, the test would be to determine whether or not the fraud has been adequately brought to the knowledge of the bank before payment or intended payment of the draft.

[434] *Supra* no. 6, at 150.

[435] Article 9, UCP 500. See Clive M. SCHMITTHOFF, *SCHMITTHOFF'S Export Trade*, 9th ed., London, Stevens and Sons, 1990, pp. 441-445.

Other important stipulations include a statement of the amount of the credit, the letter of credit's expiry date, and a list of the documents which must be presented by the seller.

Still, the courts have expressed a reluctance to interfere in such matters. In *R.D. Harbottle (Mercantile) v. National Westminster Bank*,[436] for example, one finds the following passage: "It is only in exceptional cases that the court will interfere with the machinery of the irrevocable obligations assumed by the banks. They are the life-blood of international commerce."

In the scheme of a letter of credit, there are usually at least four parties involved, namely the buyer-applicant, the bank issuing the letter of credit, the seller-beneficiary, and the correspondent bank, confirming and advising or negotiating the letter of credit.[437]

These parties may often be situated in different jurisdictions having different laws as regards both substance and procedure. Furthermore, when incorporated, letters of credit will be governed by the UCP.[438]

Because the UCP is a set of rules and practices generally recognized and adopted by merchants, traders and bankers, one might conclude that it is effectively the *lex mercatoria* (commercial law) regulating all issues involving letters of credit transactions.

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[436] [1977] 3 W.L.R. 752; [1978] 1 Q.B.P. 146; [1977] 2 All E.R. 862 and 870.

[437] While the second bank confirms the letter of credit, a third bank may be elected to advise and/or negotiate it. The purpose of the seller's engaging a confirming bank is to ensure that he will be paid on time at the place he chooses. Similarly to the issuing bank's role, the confirming bank must inspect the documents. It will then pay the seller the amount due under the credit, provided the documents are satisfactory: Article 9, UCP 500, and Lazar SARNA, *Letters of Credit: the Law and Current Practice*, 3rd ed., Toronto, Carswell, 1993, section 3 *et seq.* The role of the advising bank, on the other hand, consists in notifying the seller that a credit has been issued in his favor. Other than being responsible for transmitting accurate information the advising bank has no ability under the letter of credit in general (Article 7, UCP 500).

[438] Incorporation of the UCP into a letter of credit will not prevent a court from applying its national laws, especially when there is a conflict between the UCP and the former. See Charles D. BUSTO, "Documentary Credits – UCP 500 and 400 Compared", 1993, ICC Publication No 511. See comments on Article 1, UCP.

The BA is, however, governed by the *Bills of Exchange Act*. Any solution introduced to a problem involving a BA must respect the inherent nature of the BA as a negotiable instrument, governed by the federal laws of *Bills of Exchange Act* and the *Depository Bills and Notes Act*. Thus, in the case that a Canadian BA is used with a letter of credit and a problem arises between the parties, these federal laws will apply. While the UCP governs the rights and obligations of parties to a letter of credit, and prescribes the form and usage of letters of credit,[439] it does not offer solutions in the case that their may be several jurisdictional legal systems that can apply, and the parties fail to choose a law to govern a particular letter of credit.[440]

Issues pertaining to conflicts of laws are beyond the scope of this paper. Nonetheless, since both a BA and a letter of credit have issues that entail application of several systems of law, it is important to briefly explain how the law is treated in cases of letters of credit. Understanding the letter of credit and the jurisdictional problems it may face is helpful because it is often used together with a BA or they are used as options to one another.

Unlike the UCP, the *Bills of Exchange Act* contains section 9, a rule for choosing the appropriate law to govern the BA. Section 9, discussed in detail further in this work, provides that the *rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act; apply to bills, notes and cheques.*

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[439] The UCP 500 is divided into seven sections. Section A deals with general provisions and definitions, Section B with the form and notification of credits, Section C with liabilities and responsibilities of the parties, Section D with types of documents, Section E with miscellaneous provisions on the conformity of shipments, Section F with transferable credits, and Section G with the assignment of proceeds.

[440] Neither does the UCP deal with questions of fraud, common in disputes arising in letter of credit transactions, nor does it deal with procedures available in such situations. See David R. STACK, "Conflict of Laws in International Letters of Credit," (1983) 24 *V.J.I.L.* 176.

Since this provision explicitly stipulates the common law of England will apply, it has created confusion as to the usage of Quebec civil law to matters of bills of exchange. Later, we shall see from a review of the jurisprudence that the courts, for the most part, have been conciliatory to the application of provincial law in issues involving bills of exchange. The majority of judges express a hesitance to jeopardize the integrity of the provincial law as complimentary law in order to accommodate the idea that Parliament's desire was to enact an extensive and far-reaching law of bills and notes. This is also the position of most doctrinal writers. On the other hand, in letters of credit, the courts will turn to the conflict of laws rules and/or mandatory rules of their jurisdiction to decide which law will govern the document.

Consider, for instance, a court in Quebec, which must rule on a case of fraud in a letter of credit transaction. When there are elements in a transaction that are attached to few jurisdictions, and the parties have not chosen a law to govern that transaction, the court must decide whether to apply the rules or the mandatory laws of its forum, which would each lead to different conclusions.

In the former case, the court would apply in a letter of credit transaction, the law of the jurisdiction with which the Act is most closely connected. As a matter of public order, the court would apply its own law in order to protect Quebec's political, social and economic status. All foreign laws relevant to the issue would thus be dismissed in order to uphold Quebec's imperative rules.[441]

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[441] Article 3076 *C.C.Q.*; see also Article 7 of the European *Economic Community Convention,* June 19, 1980, on the law concerning contractual obligations 80-934 *E.E.C.,* where mandatory rules have been codified and accepted. This Convention came into force on April 1, 1991, and is usually referred to as the "*Rome Convention.*"

Specifically, the courts, in analyzing the connecting factors of a letter of credit, will choose the system of law most appropriate to the situation. Court decisions may vary since conflict of law rules often differ, particularly with respect to the weight given to factors closely connected to a particular situation. Often, the application of one system of law will be favoured over another if it is more beneficial to the interests of the parties in the dispute.

In principle, a court will consider such criteria as the law of the locality of contracting, the governing law intended by the parties, and finally the law having the closest and most real connection to the transaction.[442] In letters of credit, because the banks involved are not parties to the principal underlying contract or transaction, attention must be given to the places of business of the issuing bank and the other banks involved, the site of application for a letter of credit, the site of payment and the site of presentation of the documents.[443] The law of the BA, however, will not be dependent upon such criteria. Once it has been established that BA draft has the legal requirements to be considered a bill as discussed in section 3.2.2, the next step will be to understand the application of section 9 of the BEA, to be examined in Chapter 4.

The independence rule plays a central role in analyzing the letter of credit engagement itself, and not the underlying contract. When the origin of a dispute in a letter of credit transaction is determined, and the relationship between the parties has been examined, the factors relevant to establishing the law with the closest and most real connection to the transaction must be evaluated. For purposes of clarity, we must remember that the letter of credit engagement must be treated independently of any

[442] L. SARNA, *op. cit.65* No. 13, section 9-1.
[443] *Id.*

related contracts. Moreover, where more than one bank is involved in the transaction, the bank having the closest and most real connection to the letter of credit transaction must be determined by examining the obligations and functions of each bank.

The actual and potential connecting factors relevant in determining which jurisdictional laws should apply to an irrevocable letter of credit are: (1) the place of conclusion of the contract with the bank, of the *lex loci contractus*; (2) the place of tender and examination of the documents; (3) the place of payment; (4) the place of incorporation, domicile and place of business of the bank; and (5) the language and the currency used in the letters of credit.[444]

Depending on the interpretation we give, various sites may possibly apply to the letter of credit. The site would, in summary, be as follows: (1) between the applicant and the issuing bank: the site of the issuing bank; (2) between the beneficiary and the advising bank: the site of the advising bank or of the issuing bank; (3) between the beneficiary and the confirming bank: the site of the confirming bank; (4) between the beneficiary and the issuing bank: the site of the paying bank or ultimately the site of the issuing bank; (5) between the correspondent bank and the applicant (either the site of the issuing bank or the site of the correspondent bank); and (6) between the issuing bank and the correspondent bank: either the site of issue or the site of performance.

Supposing we were to analyze each of these relationships on an individual basis, as separate from the letter of credit transaction, it is our thesis that it would be possible to envision different laws as applicable to each. This would be by either stipulating an applicable law clause, or legally, in the absence of stipulation, by locating the site where the offer and acceptance were made, in virtue of provisions governing the formation of

[444] *Id.*

contracts in national laws.[445] Deciding the proper law in a BA is a question of interpreting section 9 of the BEA, as discussed further in chapter 4.

In a letter of credit transaction, although each of the six relationships mentioned above are autonomous, they are nonetheless united and interconnected by the letter of credit transaction. When conflict of laws occurs in a letter of credit transaction, the accepted rule, as we have seen, is to apply the law of the site of the bank. The bank, and not the applicant or beneficiary, is the party having the central obligation, unlike in a regular contract of sale. In fact, the courts should always apply the law of a bank when faced with a conflict in such circumstances. Consequently, the courts will have no choice of applying either the law of the issuing bank, or that of the correspondent bank, depending on which site has the closest connection to the transaction.

All the parties to the transaction are affected by the tender and examination, since it is a prerequisite to the payment of the letter of credit. The beneficiary makes the first tender to the correspondent bank, which will then make the second tender to the issuing bank, which will make the third tender to the applicant. At each tender, the party receiving the documents will examine them for conformity.[446] Assuming that the documents presented by the beneficiary appear to be on their face in compliance with the terms and conditions of the credit, the correspondent bank will then have the obligation to tender them.[447] If the documents presented have discrepancies, the bank may refuse to honour them.[448]

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[445] *Id,* p. 218; see also Article 1387 *C.C.Q.*, where a contract may be formed at the site where acceptance is received. Nonetheless, in matters of letter of credit transactions this Article should only be applicable when this site corresponds to the site of the bank.

[446] In this sense, the letter of credit may be looked upon as a conditional payment, since actual payment to the beneficiary is contingent upon the tender and examination of documents.

[447] Article 13, UCP 500.

[448] Article 14(b), UCP 500.

The beneficiary will have until the expiry date of the letter of credit to remedy the situation. If the beneficiary decides not to remedy the discrepancies, the applicant may choose to bring suit against him on the basis of their underlying contract. Nonetheless, the bank cannot exercise recourse against the beneficiary because of these discrepancies.[449]

Kurkela is of the view that the tender and examination should not be accorded too much weight, as it may happen that the site of tender will not be the same as the site of payment.[450] However, in practice, the bank counters where the documents are tendered and examined will usually be the site where the beneficiary will get paid.

While in the first tender, the beneficiary is not obliged to act with reasonable care (although if he does not it will be to his detriment), the correspondent bank *vis-à-vis* the issuing bank is obliged to act with reasonable care in verifying the authenticity of the documents.[451] The correspondent bank will then be reimbursed by the issuing bank, after it has confirmed the validity of the documents and paid the beneficiary.[452] The issuing bank will then make the third tender to the applicant, in order that he might be able to present the documents to the transporter, in exchange for the goods he has bought.[453]

While for the first and third tenders, the parties are usually located at the same site, for the second tender, between the correspondent bank and the issuing bank, the sites will differ.[454] Consequently, one should not give too much importance to the site of

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[449] Matti, KURKELA, *Letters of Credit Under International Trade Law: U.C.C. U.C.P and Law Merchant*, New York, Oceana Publications, 1985.
[450] *Id.* The delivery of documents by mail or by messenger can hardly be considered to constitute any characteristic or crucial performance under the letter of credit.
[451] Articles 7 and 13(a), UCP 500.
[452] Article 19, UCP 500.
[453] See beginning of Chapter one on the operation of the letter of credit.
[454] The second tender is normally made by the confirming bank, which mails the documents to the issuing bank. See M. KURKELA, *op. cit.* no. 53, note 420, p. 223.

tender, unless it coincides with the site of payment, such as in the case of an irrevocable and confirmed letter of credit.

Three payments will be made during the course of the letter of credit transaction: (1) the payment by the correspondent bank to the beneficiary; (2) the reimbursement of the correspondent bank by the issuing bank; and (3) the reimbursement of the issuing bank by the applicant.[455] The correspondent bank will usually pay the beneficiary at its counters upon presentation of the documents. The reimbursement of the correspondent bank will be made either at its place of business or at an account held by it in either the city of the issuing bank or elsewhere, in major world financial centers such as New York or London. The applicant will reimburse the issuing bank at the bank's counters.[456] Of the three sites of payment, the most important in terms of being closely connected with the letter of credit transaction, is that made by the correspondent bank to the beneficiary.

Often, the site of the bank doing business will not necessarily be the same as its head office or site of incorporation. Thus, its place of doing business will be a more important connecting factor in determining the appropriate choice of law. What is important is to locate the site where the letter of credit was issued, advised, confirmed and paid to the beneficiary.[457]

The language in which the letter of credit is drafted and the type of currency used may be helpful in certain situations as indications of a choice of law. For example, a letter

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[455] *Id.*, p. 225.

[456] *Id.* Payment may also be made at a branch of the issuing bank located in a different jurisdiction, and may be made either before or after tender of documents, depending upon the agreement of the parties.

[457] Questions of jurisdiction may arise, especially when it is the branch of the bank, which executes payment. In the commentaries made on the UCP 500 and 400 Compared, *supra* no. 18, under Article 2, we are reminded that branches are separate from their head offices. Therefore, a court, when faced with a situation in which a bank's branch is the party acting, it must be treated as separate from its head office. This will affect the law applicable, given the locations of the head office and the branch.

of credit is issued by an Indian bank in favour of an American beneficiary and payable by an American bank both located in the U.S... The letter of credit is in English and is payable in U.S. dollars. In such a case, the language and currency may lead a court to apply U.S. law rather than Indian law.

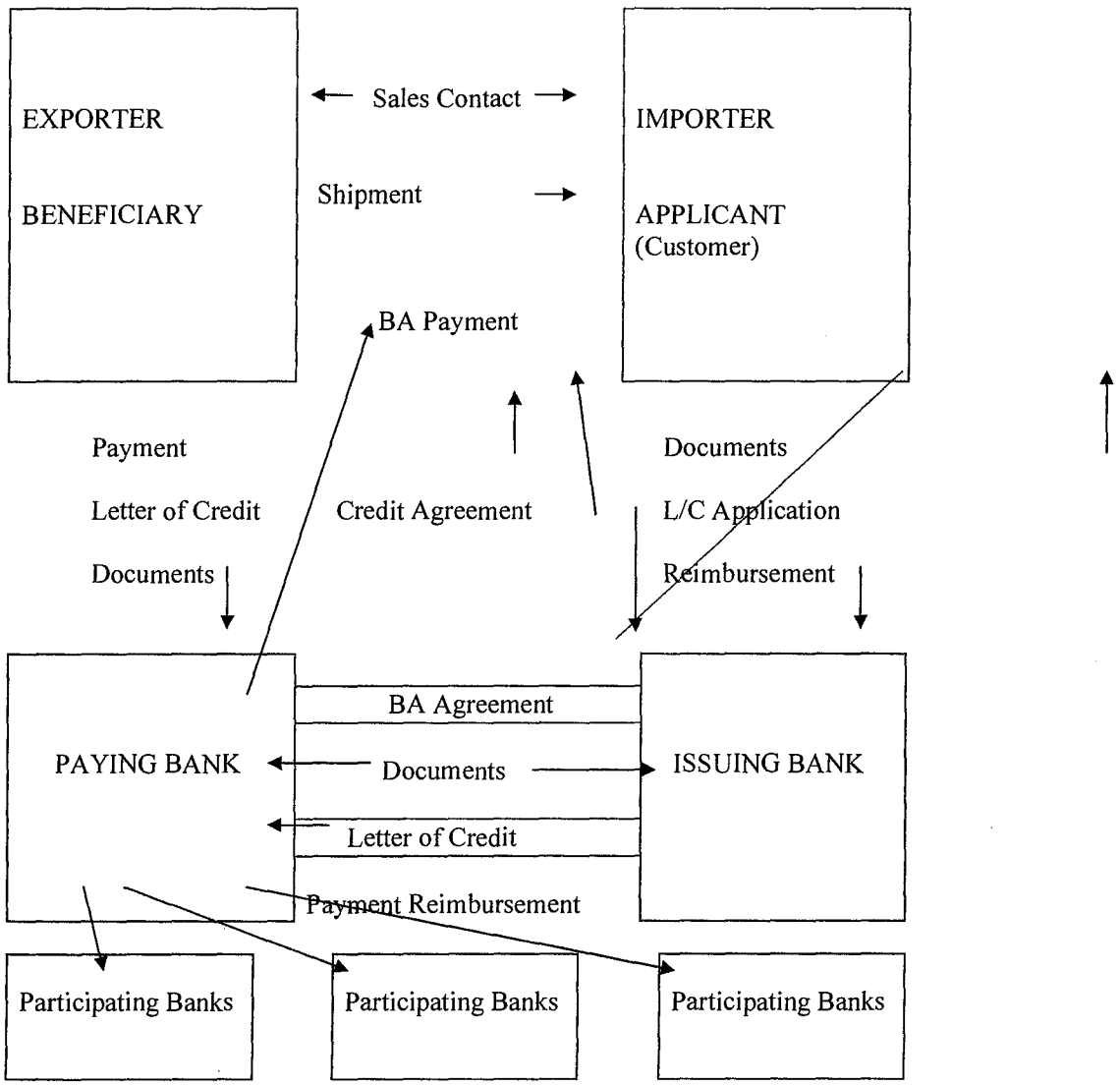
Since English is an internationally accepted language in business and U.S. dollars are commonly used in transactions, one must be careful not to accord these factors too much weight. However, if the parties to a transaction use a language and currency which are completely foreign to them, this choice may be of great import in determining the law applicable. To return to the example of the Indian bank and the American paying bank, the parties may prepare the letter in Chinese and stipulate payment in Chinese Yuan, and this would be taken as significant.

Looked at broadly, the letter of credit transaction creates a relationship between several parties, namely: the applicant, the issuing bank, a beneficiary, and the correspondent bank in some cases. Similar to the BA, it is therefore imperative to distinguish the letter of credit engagement from all other contracts developed between the parties, and isolate the letter of credit operation for consideration. The BA is a federal instrument, governed by federal laws, and in case of inconsistency, a choice must be made between applying common law or Quebec civil law, pursuant to section 9 BEA, explained in our Chapter. Since the letter of credit will only succeed if it is independent of these related contracts, this engagement must be analyzed as a single contract consisting of several parties. Like the BA, it is the bank(s) which normally assumes the principal roles, and therefore the governing law of the letter of credit is normally that of

the bank's location.[458] The BA is a separate issue and when used with the letter of credit, the *Bills of Exchange Act*, as well as the *Depository Bills and Notes Act*, will apply. When there are issues of inconsistency, how we interpret section 9 will be essential.

[458] Nonetheless, when analyzing each of the different relationships developed, other than the letter of credit engagement, application of several laws such as that of the site of the applicant or beneficiary may come into play. See H.C. GUTTERIDGE and Maurice MEGRAH, *The Law of Banker's Commercial Credits*, 1984, London, Europe Publications Ltd., p.243.

# PROCEDURE FOR A LETTER OF CREDIT & A BA TRANSACTION



### 3.2.5 Agreement between Bank and Holder of the Bankers' Acceptance at Maturity

By accepting the draft, the bank becomes the primary obligor towards any eventual holder of the BA, according to the tenor of its acceptance.[459] Particularly, the bank that has acquired an unconditional obligation for payment will be required to pay the holder at maturity of the BA.

In the case of a letter of credit however, the solution is not as obvious, since in one transaction, there may be several banks involved and each is situated in a different jurisdiction. Moreover, every bank will have its specific set of obligations to fulfill at a certain time and place, all of which are necessary for the letter of credit to become payable. Thus, the relationship between the advising bank and the beneficiary is limited to the latter's obligation to take reasonable care in checking the apparent authenticity of the credit which it is to advise. The advising bank has no formal commitment or obligations *vis-à-vis* the beneficiary. Rather, it has a duty towards the issuing bank to advise the letter of credit. If the advising bank is unable to establish the apparent authenticity, it must inform without delay the issuing bank of this liability. If it elects nonetheless to advise the unauthenticated letter of credit to the beneficiary, it has a duty to inform him of this inability.

The confirming bank does not guarantee the fulfilment of the obligations of the issuing bank. Rather, the confirming bank provides an independent undertaking to the

[459] B.E.A., s. 127.

beneficiary so that the beneficiary may have the right to look to both the issuing and the confirming bank. When a bank has confirmed the letter of credit, it has committed itself directly to the beneficiary, either to pay upon presentation of the documents or to confirm that the credit issued by the issuing bank or third bank will be honoured. Thus, the liability of the confirming bank due to its own undertaking is owed towards the beneficiary.

A relationship between the beneficiary and the issuing bank will be developed when in a three-party situation, the issuing bank is the only bank involved, or in four-party situation, where the correspondent bank merely advises the letter of credit without confirming. In both these cases, the issuing bank is committed to the beneficiary, since it is this bank which must pay at one point upon presentation of the required documents and drafts, which comply with the credit's terms and conditions.

Two opinions exist as to location of the most important performance.[460] The site of the advising bank was considered as the place of performance, since payment was made there. According to this view whether or not the advising bank has confirmed the letter of credit, its jurisdictional laws shall govern the relationship.

On the other hand, others stress that it is better to apply the law of the issuing bank when the correspondent bank is not confirming the letter of credit.[461] The justification is that the site of the issuing bank, the only bank personally and unilaterally obligated towards the beneficiary, is the site of conclusion of the undertaking.

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[460] A. GOZLAN, *op.cit*, note 136, p.45.
[461] A. GOZLAN, *op. cit.*, note 136, p.50.

Consequently, supposing the correspondent paying bank became bankrupt the beneficiary would most likely have a direct recourse against the issuing bank for payment, for the reasons stated previously.

Different from the letter of credit, although the BA draft orders payment, the bank acquires no obligation towards any party until it accepts the order by signing as acceptor.[462] Additionally, as an accommodation party to the BA, the bank "is liable on a bill to a holder for value, and it is immaterial whether, when that holder took the bill, he knew that party to be an accommodation party or not."[463] If he is not a holder in due course, the holder does not escape of all defences.

With respect to the holder, the bank as drawee is precluded from denying: "...(*a*) the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the bill (*b*) in the case of a bill payable to drawer's order, the then capacity of the drawer to endorse, but not the genuineness or validity of his endorsement; or (*c*) in the case of a bill payable to the order of a third person, the existence of the payee and his then capacity to endorse, but not the genuineness or validity of his endorsement."[464] It is interesting to note that the old case law had extended the protection of the preclusions even where the holder was found to be aware of the true facts.[465] With respect to (c) Crawford points out that no case since the enactment of the *Bills of Exchange Act* has distinguished between "validity" and "genuineness" of signature; however prior to the Act, "validity" referred to the fact that the bill had the legal effect it

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[462] See *Hopkinson* v. *Forster*, (1874) L.R. 19 Eq. 74.
[463] B.E.A., s. 54.
[464] *Id.*, s. 128.
[465] See Braithwaite v. Gardiner (1846) 8 Q.B. 473, 477; 115 E.R. 954; Perkins v. Beckett (1878) 29 U.C.C.P. 395. Cited in Crawford & Falconbridge, Vo. 2, p. 1613.

purported to have while genuineness referred to the fact that the signature was not forged.[466]

[466] Crawford and Falconbridge, Vol 2., p. 1614.

### 3.2.6 Agreement between the Customer, (Lead) Bank and Participating Institutions

Earlier, we explained how the participation of two or more financial institutions in issuing banker's acceptances is a complex matter. The involvement of an increasing amount of institutions in acceptance activity compounds the difficulty and it is further complicated by the fact that the *Bills of Exchange Act* makes no mention of participation arrangements.

As discussed previously, in matters of letters of credit it is very common to have several banks participate in a given transaction. The difference, however, is that while in a participating arrangement of a BA transaction, the banks are often sharing the risks and responsibilities in a letter of credit situation, each bank assumes its own risks and duties. What both a BA and a letter of credit have in common at this level is that any disputes arising between the banks must be dealt with separately.

Bank participation similar to that in a BA transaction is less commonly practiced in letters of credit. In fact, BAs that involve issuing extensive sums in acceptances transactions have increased bank participation.[467]

Risk participations and generic participations create different relationships among the parties involved. Risk participations, as mentioned above, create a legal obligation only between the customer and lead bank; there is no contractual relationship between the customer and the participants. All the documentation is drafted in the name of the lead

[467] See Daniel DESJARDINS, «Assignment and Sub-Participation Agreements – A Basic Overview», (1986) 65 *Can Bar Rev.* 224.

bank, so there is no connection through the BA itself. The lead bank has a separate contractual arrangement with the participants, which is governed by the rules of contract of the common law or Quebec Civil Code, as the case may be. The relationship between lead bank and participating bank has been described as analogous to that of a vendor and purchaser, because of the promise of the participating bank(s) to pay an amount of money for a specified good (a share of the loan, which is assigned to it by the lead bank). [468] Because the contract exists only with the lead bank, the customer cannot directly enforce the obligations of the participating banks, nor can the participating banks enforce the obligations of the customer.

Generic participations are different from risk participations, because the participants accept a portion of the drafts rather than indemnify the lead bank. Thus, generic participations do not appear to be true participations at all; they more closely resemble other arrangements such as club deals or syndications, because in true participations there is a lack of contractual privity between the customer and the participants,[469] whereas with their acceptance of the draft, the participants engage their liability through the BA. There can therefore be a legal relationship between the parties, as the participants are now deemed accommodation parties by acceptance.

In one type of generic acceptance arrangement, the customer signed the draft in blank, and thus he or she is unaware of the participating bank. The participants are nevertheless primarily liable as acceptors, though the customer deals with the lead bank

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[468] E. RAZIN, *loc. cit.*, note 10, p. 256.

[469] For an examination of the various structures and legal analysis of multi-lender financing see Paul H. HARRICKS, «Legal Aspects of Multi-Lender Financing» in Lazar. SARNA, (ed.), *Corporate Structure, Finance and Operations: Essays on the Law and Business Practice*, vol. 5, Scarborough, Carswell, 1992, p. 1. See also, Jacob ZIEGEL, «Characterization of Loan Participation Agreements» (1988) 14 *C.B.L.J.* 336. Roderick Alexander MACDONALD, «Legal Bilingualism», (1997) 42 *McGill L.J.* 119, 148.

(to which the customer provides the funds). The participants may not have an indemnification agreement with the lead bank; however, the lead bank acts as trustee, and is obligated to remit the funds it receives to the participants, so that they can pay the holder at maturity.[470] In the other type of generic participation, the customer is aware of the identity of the accepting banks, and in those cases, there may in fact be an indemnification agreement between the customer and participants, as in an ordinary BA transaction. Moreover, in either case, because the participating banks accept the drafts as accommodation parties for the lead bank,[471] the latter has a common law obligation to reimburse the participants, independent of any formal agreement or trust. This obligation would exist in Quebec as well.[472]

Whether acting as agent for the other banks, or simply facilitating the arrangements between the customer and the individual banks, the importance of the lead bank will vary. In the former situation, the role of the lead bank is quite far-reaching; in the latter it is quite limited. Nevertheless, because there is no existing contractual relationship between the customer and the participating institutions, in both types of generic participation arrangement, the customer must plainly consent to the proposed acceptance facility.[473] It would appear that difference between the two types of participation would arise in case of insolvency[474] or dishonour of the acceptance by the

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[470] E. RAZIN, *loc. cit.*, note 10, p. 246. See also, F.H. JENSEN and P.M. PARKINSON, *loc. cit.*, note 406, p. 7.
[471] See B.E.A., s. 54.
[472] As the liability of accommodation parties is considered part of the law of bill and notes in the "strict sense," the common law obligations of accommodation parties apply in Quebec by virtue of s. 9 of the Bills of Exchange Act. See B. CRAWFORD, *op. cit.*, note 87, p. 878; E. RAZIN, *loc. cit.*, note 10, p. 221-222 and "Resolving the Problem of the Law Applicable to Bas", *infra*.
[473] E. RAZIN, *loc. cit.10,* note, p. 246.
[474] See for example, W. STAHL, "Loan Participations: Lead Insolvency and Participants' Rights, Part I", (1977) 94 *Banking L. J.* 882; and W. STAHL, "Loan Participations: Lead Insolvency and Participants' Rights, Part II", (1978) 95 *Banking L. J.* 38; Eric G. BEHRENS, "Classification of Loan Participations

lead bank. For example, it would seem that where the lead bank dishonoured the BA by non-acceptance, participants under a generic participation would be liable to the holder (pursuant to s. 54(2) of the Act), whereas risk participants never engage any liability on the BA, and thus have obligations only towards the lead bank; they do not have any obligation to the holders at maturity.

Another issue which has arisen, specifically with respect to risk participations, is the extent to which the participants can directly intervene or consult with the customer if any difficulties arise. Naturally, such rights can be explicitly included in the agreement itself, which would be preferable. However, it has been suggested that participating banks might attempt to establish the existence of a fiduciary obligation (above and beyond what is expressly stated in the agreement) on the part of the lead bank, which it owes to the participants. The duty in the context of a participation would be for the bank to, "act in a commercially reasonable manner to meet traditional expectations of bankers...."[475] Although participation agreements will often contain exculpatory clauses, limiting liability to situations of gross negligence, trust law (upon which fiduciary obligations are based) would likely preserve the obligation of the lead bank to act in a reasonable and prudent manner.[476] Failure to act in this manner will allow the participants to seek redress before the courts. Nevertheless, there is no indication in standard participation agreements that lead banks owe any duty to participating banks, and given the relative equality and sophistication of the parties involved, courts will likely be reluctant to find

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Following the Insolvency of a Lead Bank", (1984) 62 *Tex. L. Rev.* 1115. Wendy Bellack-Viner suggests that the problem of characterization of the arrangements has tended to emerge upon the insolvency of the lead bank, See W. G. BELLACK-VINER, *loc. cit.*, note 190, p. 246.

[475] P. J. LEWARNE and K. E. THORLAKSON, *loc. cit.*, note 398, p. 1, 20.

[476] *Id*, p.22.

that such a fiduciary obligation exists unless the lead bank acted in the utmost bad faith.[477]

With generic participations, where the participants provide the lead bank with their own completed drafts, which are then given to the customer to sign, the situation is different. In that case, there is a mandate involved as defined in the Quebec Civil Code (or agency, in the common law world), because the lead bank is empowered to represent the participant in completing the BA.[478] There is no need to impute a fiduciary duty; obligations arise from the mandate itself. The lead bank is encumbered with duties of a mandatary as set out in the civil code. The lead bank must act with prudence and diligence and prevent placing itself in a position of conflict of interest.[479] As one Quebec author recently noted, except for limitations of liability for gross or intention fault[480](as mentioned above), the courts should enforce contractual restrictions of liability by the mandatary. He noted, "There is no reason why an agent cannot relieve itself of liability contractually, particularly when the lenders are sophisticated institutions represented by knowledgeable counsel. In addition, Quebec courts are not likely to 'second guess' an agent's actions taken within the confines of the credit agreement."[481]

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[477] *Id.*
[478] C.C.Q., art. 2130.
[479] C.C.Q., art. 2138.
[480] C.C.Q., art. 1474.
[481] Norman A. SAIBIL, « Relations Between Co-Lenders » in *Développements récents en droit bancaire,* Service de la formation permanente, Barreau du Quebec, 195, Cowansville, Yvon Blais, 2003, p. 1, 11.

## BA CHECKLIST
## (With L/C)

(1) Has the Bank signed a credit agreement with customer?

(2) Does the BA respect conditions of Section 16 (1) of the Bills of Exchange Act?

Does it consist of an:
(a) unconditional order;
(b) in writing;
(c) made by one person to another requiring them to make payment;
(d) at a future date;
(e) a sum certain;
(f) to a specific person;

(3) Is it payable at maturity?

(4) Is it discounted?

(5) Is there "Roly Poly"

(a) Has the BA been sold by the bank to a financial institution (ie. Pension Fund Insurance Co.) at a longer term;
(b) Has the customer agreed to the maximum short term maturity by its bank;

(6) Are there any Bank participants?

(a) Is there a lead bank;
(b) Are there sub-participating banks who have accepted to share in the financing and risks of the customer?

(7) Has a letter of credit been issued?

(a) Is the letter of credit in conformity with the underlying contract?
(b) Is the letter of credit subject to the current ICC Uniform Customs and Practice for Documentary Credits?
(c) Have the parties designated a law to govern the letter of credit?
(d) Is there more than one bank involved in the letter of credit operation?
(e) Is the letter of credit payable at the maturity of the BA?

# CHAPTER 4. The Interaction of the Federal and Provincial Systems: Reconciling Federal and Provincial Law Pertaining to Bankers' Acceptances

Previously, we discussed the BA operation on a step-by-step basis and explained the relationships created within every stage (including its involvement with letters of credit) leading to its maturity. We have seen that many obligations are formed in the transaction, which are primarily governed by federal legislation and at times subject to provincial law. How do we reconcile federal and provincial laws pertaining to BAs? When do we apply provincial law to an issue concerning the BA transaction?

We have purposely entitled this chapter "The Interaction of Federal and Provincial Systems" rather than "The Interaction of the *Bills of Exchange Act* and the Civil Code of Quebec" or "civil law." We have done so because several difficulties arising from the interaction of the *Bills of Exchange Act* and the private law of the province of Quebec (based on the civil law tradition as set out in the civil code) are not exclusive to Quebec. Below, we shall see that the *Bills of Exchange Act* (especially section 9) is a problem for all provinces that follow the common law tradition, because of the difficulty stemming from section 92 on the constitutional division of powers of the provinces.

In this chapter, we will look at the ways in which federal and provincial law interact, and then examine the specific question of section 9 and its impact on the

applicability of provincial law to the BA transaction. To this end, we will examine different interpretive approaches to section 9, notably, grammatical, interpretive/ contextual, historical and constitutional approaches. We will then propose a method to be used in evaluating problems arising from the BA transaction, to guide us in determining the applicable law.

The *Bills of Exchange Act* is perhaps the best example of exclusive federal jurisdiction, which clearly would have formed part of property and civil right had the division of powers in the Constitution Act, 1867 (specifically, article 19(18)) not made it a federal head of power. Whatever the reasons, parliament's legislative jurisdiction over bills and notes is beyond any doubt; however, there are a number of issues that are unclear and undecided. For example, what is the extent of the federal legislature's power to enact law over matters of bills and notes? Can the federal government regulate all the contractual and proprietary elements of bills of exchange? What do we do when federal legislation is silent? How do we interpret legislation, whose two linguistic versions conflict or express two different legal rules/ norms? Where should a lawyer look for the applicable law? Is the matter governed by the civil code or by special legislation?

We will look at types of interactions between provincial and federal law and determine the appropriate role for each sphere, in light of the *Bills of Exchange Act's* unique statutory provisions (e.g., section 9). Determining the proper scope of provincial law with respect to federal legislation is a daunting task. In fact, such efforts have been the subject of discussion and debate in both doctrine and in jurisprudence. Part of the problem lies in the fact that federal law does not constitute an autonomous legal system

(*système juridique*).[482] That which is "federal" corresponds to a level of government, not a territorial unit. Therefore, there was never any reception of law into federal jurisdiction; it exists only in the form of what was created by written enactments. Accordingly, it presupposes a body of law outside of it, to which one can have recourse to understand the law.

As a result, federal legislation is locked into a relationship of dependence with provincial law because it does not systematically and exhaustively regulate the general rules of private law. Private law generally falls within provincial legislative competence by virtue of section 92(13) of the *Constitution Act*, 1867.[483] Granted, Parliament may define basic terms for the purposes of its own legislation, but these definitions may operate only within the scope of federal legislative power. Federal private law does exist, but only "en quelque sorte du droit d'exception."[484]

Thus, by force of circumstance, federal legislation is incomplete and, consequently, it is joined in a relationship of dependence with the Civil Code of Quebec [485] and the common law of the other provinces and territories. The *jus commune* of the provinces serves as the "legislative dictionary in any jurisdiction, such as that when a concept – for example, lease – is used in an ordinary statute the meaning normally to be given to that concept is the meaning provided by the *jus commune*."[486] This role as

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[482] See André MOREL, "L'harmonisation de la legislation fédérale avec le Code civil du Québec - Pourquoi? Comment?" in *Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Collection of Studies*, Ottawa, Department of Justice, 1997, p. 1 at page 4.
[483] Jean-Maurice BRISSON, "L'impact du Code civil du Québec sur le droit federal: un problématique", (1992) 52 *R. du B.* 345, 349.
[484] François CHEVRETTE and Herbert MARX, *Droit constitutionnel*, Montreal, Les Presses de l'Université de Montreal, 1982, p. 639 cited in Jean-Maurice BRISSON, "Le code civil, droit commun?" in *Le nouveau Code civil: interpretation et application*, Montreal, Éditions Thémis, 1993, p. 298.
[485] J.-M. BRISSON, *loc. cit.*, note 483, p. 298.
[486] Roderick Alexander MACDONALD and Francis Reginald SCOTT, "Harmonizing the Concepts and Vocabulary of Federal and Provincial Law: The Unique Situation of Quebec Civil Law" in *Harmonization*

legislative default dictionary is usually not perceived, especially in unitary states such as England.[487] In Canada, which is a bilingual and bijuridical state, the role of *jus commune* as a legislative default dictionary is more nuanced and complex.

The civil law of Quebec constitutes the *jus commune* of Quebec. This is clear from the preliminary provision of the code, which provides:

> The Civil Code comprises a body of rules which, in all matters within the letter, spirit or object of its provisions, lays down the *jus commune*, expressly or by implication. In these matters, the Code is the foundation of all other laws, although other laws may complement the Code or make exceptions to it. [emphasis added].[488]

The Civil Code thus plays an analogous role to that of the unenacted common law. [489] In these situations, Quebec civil law takes on a suppletive role in applying a federal law in Quebec. Since federation, the principles, rules and concepts of the *Civil Code of Lower Canada* supplemented (and in some cases, was the base for) federal legislation and served to fill gaps or silence in the law. This continues to be the case, despite the fact that the Quebec Civil Code has replaced the *Civil Code of Lower Canada.*[490] The enactment of the new code did not alter the basic structure of interaction between federal and provincial law.[491] The code is thus the *jus commune* of Quebec, and the reservoir, upon which federal legislation draws. Some authors described it in the following way:

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*of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Collection of Studies* Ottawa: Department of Justice, 1997, p. 29 at page 44.

[487] R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 486, p. 47.

[488] *Civil Code of Quebec*, S.Q., 1991, c. 64.

[489] See A. MOREL, *loc. cit.*, note 482, p. 4.

[490] J.-M. BRISSON, *loc. cit.*, note 483, p. 296.

[491] See A. MOREL, *loc. cit.*, note 482, p. 4-5.

> The universe of possible legal concepts and relationships is exhausted *prima facie* by a civil code. In addition, the ideology of codal interpretation is such that, over time, unenacted customary practices and general principles of law get woven into the code's fabric. Thereafter, rather than the code being seen as ultimately resting on unenacted law, these practices and principles are seen as existing by virtue of the positive law set out in the code itself. Hence, a civil code serves (just like the unenacted common law in uncodified systems) as the principal repository of the *jus commune*.[492]

The federal legislation's dependence on provincial *jus commune* manifests itself in different ways. It can be explicitly expressed or it can be implicit. Parliament can explicitly determine the meaning it intends a particular word of term to have. For example, it may decide for whatever reason that the word "mammal" employed in its legislation excludes marine mammals such as dolphins. It may do this in a particular provision, in a definition section or by reference to other legislation, or the legislation of a foreign jurisdiction.[493] The federal legislature may enact rules that are irreconcilable with the private law of the provinces, or that derogate in part from provincial law. It could also conceivably enact a law with complete autonomy from provincial law by creating its own institutions, concepts and principles (in a given area, within federal legislative competency), in other words, a *sui generis* private law system.[494] When a legal

[492] R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 486, p. 44.
[493] See *Id.*, p. 49.
[494] See A. MOREL, *loc. cit.*, note 482, p. 7-8.

rule prohibits suppletive application of provincial legislation, the situation is referred to as dissociation.[495]

However, as mentioned above, this is possible but not pragmatic. In any case, it is worth noting that relying on the legal institutions and definitions of provinces already in place is far more common than explicit displacement; it is far more common to find implicit displacement.[496] Thus, one commentator noted:

> Federal legislation, by avoiding any reference to or reliance on rules, principles, terminology or concepts having their source in provincial law, may be independent of and unaffected by provincial law for its scope and meaning. For example, to the extent that federal legislation governing bills of exchange, patents and copyright were to establish complete, comprehensive and self-contained regimes for these s. 91 matters, no room would be left for the operation of provincial law. But these federal enactments are not sealed off entirely from provincial law. Promissory notes and bills of exchange depend on contract as an essential conceptual underpinning; and a patent is not only a form of property but a patent licence is based on contract.[497]

In most cases, the federal legislator is content to allow provincial law to play a complimentary role as the general rule.[498] Where, for example, the federal law makes reference to terms such as "property" or "partnership," it will take its meaning from the Quebec Civil Code (or the common law, in the rest of the provinces) unless otherwise

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[495] See Jean-Maurice BRISSON and André MOREL, «Droit federal et le droit civil: complémentarité, dissociation» in *Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Collection of Studies*, Ottawa, Department of Justice, 1997, p. 213 at page 215.
[496] R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 486, p. 49.
[497] Henry L. MOLOT, «Clause 8 of bill S-4: Amending the Interpretation Act» in *Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Collection of Studies*, Ottawa, Department of Justice, 2001, p. 1 at page 3.
[498] See A. MOREL, *loc. cit.*, note 482, p. 7-8.

defined in the Act itself or in the *Interpretation Act*.[499] This is by far the most widespread manner of dependence. It may well be that federal government did not make any explicit enactment that would interfere with the suppletive role of the Civil Code, for reasons of efficiency. It would be difficult and unnecessary to have to define basic terminology in every Act of Parliament.[500]

It is not surprising therefore to find at least one author who stated unequivocally that there in fact should be a constitutional presumption that federal legislation was enacted with the intent that provincial law play a suppletive role.[501] In other words, there is a presumption that when parliament refers to terms such as "property" or "contract" it intends that the common law meaning apply in its application in Ontario or Saskatchewan, and the civil law notion of contract to operate in Quebec.[502]

Nevertheless, this remains only a presumption. This presumption could be rebutted if it can be demonstrated that parliament explicitly derogated from the complimentary role of provincial law by legislating alternative definitions or creating alternative legal institutions. As mentioned above, the legislator is free to choose the body of law it wishes to take on a suppletive role, so as long as it remains within the confines of its sphere of legislative power. *The Bills of Exchange Act* is one example where federal law has expressly referred to another body of law (English common law) as suppletive.[503] Section 9 of the Act provides:

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[499] R.S. 1985 c. I-21.
[500] See J.-M. BRISSON, *loc. cit.*, note 483, p. 350.
[501] Roderick Alexander MACDONALD, «Provincial Law and Federal Commercial Law: Is "*Atomic Slipper*" a New Beginning?», (1992) 7 *B.F.L.R.* p. 437, 442.
[502] See R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 486, p. 47-48.
[503] The other example is the Federal Court Act, R.S. 1985, c. F-7. See J.-M. BRISSON, *loc. cit*, note 483, p. 354.

> 9. The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques.

What is the proper scope of section 9? We would be remiss if we did not note that the *Bills of Exchange Act* is hardly the only federal legislation that interacts with provincial law and that raises questions as to the proper scope of each. For example, section 91(24) of the Constitution assigns exclusive jurisdiction over "Indians, and Lands reserved for the Indians" to the Parliament of Canada. This raises, among other question, the issue of whether provincial legislative jurisdiction over "property and civil rights" extends to lands held by aboriginal title.[504]

Recently, another author has examined the relationship between federal tax law and provincial private law. He argued that:

> ...where the ITA employs concepts with established private law meanings that are not defined in federal legislation, relies on private law rules or principles to define the legal relationships to which specific provisions apply, or is silent on a matter that is governed by a specific provincial rule forming part of property and civil rights, Canadian bijuralism requires that courts refer to the private law of the applicable province in order to interpret the relevant concepts or provisions.[505]

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[504] See Kent McNEIL (1998) «Aboriginal Title and the Division of Powers: Rethinking Federal and Provincial Jurisdiction», (1998) 61 Sask. L. Rev. 431. See also Doug SANDERS, "The Application of Provincial Laws" in Bradford W. MORSE (ed.), *Aboriginal Peoples and the Law: Indian, Métis and Inuit Rights in Canada*, Ottawa, Carleton University Press, 1989; Noel LYON, "Constitutional Issues in Native Law" in Bradford W. MORSE (ed.), *Aboriginal Peoples and the Law: Indian, Métis and Inuit Rights in Canada*, Ottawa, Carleton University Press, 1989; Micheline PATENAUDE, *Le droit provincial et les terres indiennes*, Montréal, Yvon Blais, 1986.

[505] David G. DUFF, "The Federal Income Tax Act and Private Law in Canada: Complementarity, Dissociation, and Canadian Bijuralism", (2003) 51 *Can. Tax J.* 1,1. See also, Marc CUERRIER, Sandra HASSAN, and Marie-Claude GAUDREAULT, "Canadian Bijuralism and Harmonization of Federal Tax Legislation," (2003) 51 *Can. Tax J.* 133.

Still, the *Bills of Exchange Act* remains unique because of section 9, for which there is no comparable provision in other federal legislation. Indeed, section 9 is drafted in a rather peculiar manner because it purports to retain the common law as the law applicable to bills and notes. As we mentioned above, in discussing the nature of the BA, this has been the topic of doctrinal and jurisprudential controversy for over a century. For the most part, Quebec courts have limited the scope of this section to those matters of bills and notes in a strict sense. Recall that the distinction between the law of negotiable instruments in the strict sense and the law of negotiable instruments in the broad sense is not expressly referred to in section 9 of the *Bills of Exchange Act.* The distinction is premised on "the double nature of the bill or note as a 'negotiable instrument' governed by special law...and as a chattel and obligation governed by the general law of property and contract."[506] It is on this basis that the majority of doctrinal writers maintain that the proprietary and obligational elements of the instrument not dealt with by the Act - the law of bills and notes in the wide sense - ought to be governed by provincial law, specifically, the Civil Code of Quebec. However, there is nothing in the text itself that compels such an interpretation, and others, have questioned an interpretation of section 9 that would limit it thus.[507]

For some, the question on section 9 is strictly one of statutory interpretation, since it seems impossible to ignore the constitutional dimension of the issue. The entire distinction between bills and notes in a strict sense and in a wide sense is based on the double nature of the bill as property and contract on the one hand and as a negotiable instrument on the other. This double nature is problematic because it splits along

[506] B. GEVA, *loc. cit.*, note 153, p. 198.
[507] See, for example, Gerald Eric LEDAIN, "Book Review: Banking and Bills of Exchange by J.D. Falconbridge," (1956) 3 *McGill L.J.* p. 113, 118-19.

constitutional lines. The aspect of the BA that relates to property and contract falls within provincial legislative jurisdiction. Those aspects that relate to the negotiable instrument fall within the scope of federal legislative competence over bills of exchange. The competing heads of power are section 91(18) "Bills of Exchange and Promissory Notes" and section 92(13) "Property and Civil Rights in the Province."

The question of the interaction of provincial *jus commune* with the *Bills of Exchange Act* (and indeed any federal legislation, including the *Depository Bills and Notes Act*) is not limited to section 9 but may arise anywhere in the Act; in particular with respect to matters of capacity[508] and consideration.[509] However, understanding the scope of section 9 is important because those parts of the Act that appear to refer to provincial law are often ambiguous and confusing, especially once the French version is considered. Therefore, section 9 also becomes important for those situations where issues of drafting and language create uncertainty if there was, in fact, a reference to provincial law, specifically the problems of consideration (simple contract/ *contrat simple*) and of capacity. We must then turn to section 9 to help us with these issues as well.

We must also consider that the difficulty with the scope of the interaction between the federal *Bills of Exchange Act* and provincial law, with respect to BAs, is particularly salient in Quebec because its private law is based on the French civilian tradition, rather than English common law. It seems obvious that differences at the conceptual, institutional and linguistic level between the civilian private law tradition of Quebec and the common law of the other provinces makes it far more difficult to accommodate the Quebec system within a federal statute than trying to facilitate minor differences among

[508] B.E.A. of Exchange Act, R.S., 1985, c. B-4, s. 46.
[509] B.E.A., s. 52.

legal systems within the same legal tradition.[510] However, this issue is one related to the separation of powers in the constitution and federalism generally, the problem is not limited to Quebec.[511] As we know, when parliament deliberately enacts its own legislative default dictionary, provincial *jus commune* will not apply, whether it is Quebec civil law or Nova Scotia common law. [512]

For example, Justice Meredith., in discussing the liability of the parties, in the Ontario case of *Cook v. Dodds,*[513] stated:

> The Bills of Exchange Act does not deal with the consequences...These consequences, in my opinion, fall to be determined according to the law of the province in which the liability is sought to be enforced, and, inasmuch as in this province the common law rule as to joint contracts has been superseded by statutory enactment, R.S.O. 1897, ch. 129, s. 15, the provisions of the latter are to govern in determining the right of the respondent to sue in this province.[514]

Because of the constitutional division of powers, and parliament's exclusive jurisdiction over bills of exchange and promissory notes, any provincial legislation purporting to directly regulate bills, cheques and notes in the strict sense would be *ultra vires* and unconstitutional.[515] For example, in *Red River Forest Products Inc. v. Ferguson,*[516] the court considered the reach of provincial legislation (the *Gaming Act*) that declared a gambling debt to be illegal consideration for a bill of exchange. Helper found this legislation to be *ultra vires* because it infringed upon the exclusive power of

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[510] R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 486, p. 52.
[511] A. BARAK, *loc. cit.*, note 85, p. 72-73.
[512] R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 486, p. 49-50.
[513] (1903) 6 O.L.R. 608 (Div. Ct.).
[514] *Id.*, 613.
[515] B. CRAWFORD, *op. cit.*, note 34, p. 1185.
[516] [1993] 2 W.W.R. 1 (Man. C.A.).

the federal parliament to legislate on bills and notes pursuant to section 98(18) of the Constitution.[517] In summary, a provincial statute may change, modify or alter the *jus commune*, and thereby impact the effect of federal legislation regarding bills of exchange; it may not, however, purport to legislate on bills and notes.

As mentioned earlier, the problem of section 9 is not limited to Quebec, but may prove to be a problem for all provinces. Increasingly, legislation in other areas, notably tax and secured transactions, have highlighted the issue for lawyers in the other provinces. This led two Quebec academics to note:

> After a century of decrying (without much sympathy or understanding from their common law *confrères* and *consoeurs*) the misfit between federal commercial law statutes and general principles of the civil law, Quebec commercial lawyers witnessed in the 1980s the arrival of new allies. With the enactment of the *Personal Property Security Act* regimes, many jurists at last began to see and appreciate the difficulties created by systemic conflict between provincial and federal law (even though these new conflicts were trivial compared to those lived with for decades in Quebec).[518]

Nevertheless, section 9 will always be a greater problem for Quebec and its civil law system than for the rest of the provinces who follow common law.

A number of opinions have been offered for the interpretation of section 9 in support of one of two basic alternatives: (1) that section 9 requires the application of the common law, in a systematic fashion, to every aspect of a bill of exchange transaction, regardless of the difficulties or inelegance it creates or (2) that the common law rules

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[517] See also, *Attorney General of Alberta and Winstanley* v. *Atlas Lumber Co.*, [1941] R.C.S. 87, [1941] 1 D.L.R. 625; *Banque Royale du Canada* v. *Garber*, [1982] C.S. 1114.
[518] R. JUKIER and R.A. MACDONALD, *loc. cit.*, note 206, p. 380-381.

referred to in section 9 are understood in a restricted sense. Provincial law (the civil law in Quebec) will apply to the wider transaction, in its typical complimentary and suppletive role. In reality, arriving at an acceptable understanding and application of this section requires an interpretation that is more nuanced than the suggestions heretofore offered by some leading authors.

We will begin by identifying the key issues underlying this question of interpretation and examine them in more detail. This will enable us to evaluate the various interpretations that have been offered regarding section 9, with a view of determining which approach is most suitable with respect to this legislation. We will then be able to use this interpretation to arrive at a solution as to which law is applicable to BAs in a given situation.

## 4.1 Situating the Section 9 Question

The question of section 9 differs significantly from the questions of interpretation raised by other sections of the Act, such as section 46 (the capacity and authority of parties), section 52 (consideration), and section 179 (joint and several liability). To repeat, section 9 provides that the common law applies, *save in so far as it is inconsistent with the express provisions of this Act*. In this regard, we should consider what Lord Herschell believed to be the proper rule of construction for the *Bills of Exchange Act*:

> I think the proper course is in the first instance to examine the language of the statute and to ask what is its natural meaning, uninfluenced by any considerations derived from the previous state of the law, and not to start with inquiring how the law previously stood, and then, assuming that it was probably intended to leave it unaltered, to see if the words of the enactment will bear an interpretation in conformity with this view.... The purpose of such a statute surely was that on any point specifically dealt with by it, the law should be ascertained by interpreting the language used instead of, as before, by roaming over a vast number of authorities in order to discover what the law was, extracting it by a minute critical examination of the prior decisions....[519]

Lord Herschell's method simply directs us to focus on the text itself, before resorting to old case law to determine the law. One must distil the law from the text, and refer to jurisprudence forming the common law prior to codification only exceptionally and with great caution. Professor Côté distilled the essential point of Lord Herschell's remarks by stating that the words of the enactment should be given due attention; the

[519] *Bank of England* v. *Vagliano Brothers*, [1891] A.C. 107, 144.

authority of code should not be challenged by unnecessary reference to the law as it existed prior to codification.[520]

However, this rule of interpretation is not concerned with, nor does it affect, the scope of section 9. The rule is effectively saying that the common law, consisting of pre-existing law, is of no effect in light of an explicit legislative enactment. The law is expressed solely in the legislative provision. The previous case law is no longer an expression of the law, but rather, it can be used, in some cases, to help us determine the meaning of a particular provision, that is, legislative intent.

Section 9 is not concerned with this body of common law, (the body of common law that has been codified by the *Bills of Exchange Act*) as it would be "inconsistent with the express provisions of this Act." Rather, one might suggest that section 9 exists to preserve the common law with respect to all other aspects of the law of bills and notes. We must therefore be cautious in applying section 9. We must first determine the legislator's meaning from the specific provision itself, and be certain that a particular rule is not expressed in the Act itself. If it is not, we may then resort to applying section 9. Indeed, many of the eight topics listed by Professor Leclair[521] regarding bills of exchange and promissory notes could have been resolved by the courts of Quebec without making reference to section 9. The essential issue in most of those cases was the proper interpretation of bilingual legislation, not the scope of section 9.

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[520] Pierre-André CÔTÉ, *The Interpretation of Legislation in Canada*, 3rd ed., Scarborough, Carswell, 2000, p. 49.

[521] They are, 1) Capacity to contract (defence of incapacity by infants); 2) Liability of co-signers (joint and several); 3) Liability of endorsers; 4) Means of defence available against a holder in due course; 5) Cause or consideration, 6) Proof (admissibility of evidence given orally, or by a consort, onus of proof of good faith); 7) Procedure, 8) Prescription. See J. LECLAIR, *loc. cit.*, note 32, p. 695-696.

To illustrate this point, consider for example, *Roy v. Canadian Imperial Bank of Commerce*,[522] in which Roy - a minor - drew cheques payable to a language school (the payee) as part of a contract to receive English language instruction. The cheques were drawn on his chequing account, which he had at the Bank of Nova Scotia. The school, École Audio Vocale, did not provide the services it promised, and so Roy issued a stop payment on four cheques. However, before the stop payment could be made, the payee had endorsed the cheques and transferred them to the Canadian Imperial Bank of Commerce (CIBC). It was admitted that the respondent CIBC was a holder in due course. At trial, the bank's claim on the cheques was maintained.

The question at law was whether Roy could invoke his minority so as not to be liable to the bank. Justice Hyde, writing for the court, found that section 47 of the *Bills of Exchange Act* refers us back to the laws of the province. Justice Hyde rejected the decision in *Consumer's Acceptance Corp. v. Lebeau*[523] which stated the incapacity of a minor could be held up against a third party. He found that section 48 makes it clear that whatever the capacity of as minor under provincial law, the bill or note remains valid with respect to third parties. Because the incapacity of a minor is relative in the civil code, a bill or note made by a minor is valid, unless he or she can invoke lesion. Such an act is personal to the minor.

Crawford and Falconbridge detect that this judgement "...has repudiated the rule of English law and held that minority is not always a real defence available against holders in due course but must be given the various consequences in various

[522] [1971] C.A. 321.
[523] [1962] C.S. 352 (Que. S.C.).

circumstances required by the application of the distinct rules of the *Civil Code.*"[524] In Quebec, the defect in consent due to minority gives rise only to a relative nullity, and cannot be held against holders in due course.[525] Commenting on this decision, Leclair remarks, "En somme, si l'on se fie au raisonnement des juges de la Cour d'appel, une incapacité, source de nullité relative, ne pourra en aucune façon faire obstacle a la réclamation d'un détenteur régulier puisqu'elle ne sera jamais rien de plus qu'un moyen de défense personnelle."[526]

Justice Hyde refers to the civil law of Quebec because it is widely viewed (though not unanimously) as being incorporated by reference by virtue of section 47 (now section 46). That is, the determination of capacity is determined according to the civil law when this issue arises in Quebec because the Act *itself* makes it so. However, insofar as this provision provides a reference to provincial law, it is only with a view to determining whether the individual has capacity. Justice Hyde is careful to limit its scope, in that the effects of capacity are not imported by section 47 because the Act itself deals with these effects. Thus, how the Civil Code of Quebec deals with contracts made by those lacking capacity or those with relative capacity does not impact bills of exchange or promissory notes.

The point is that the issue of capacity did not require the Quebec Court of Appeal to resort to section 9, as the matter of capacity is referred to expressly in the Act. Rather, the real issue was the interpretation of the provisions concerning capacity in the Act.

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[524] B. CRAWFORD, *op. cit.*, note 34, p. 1347.
[525] See N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 456.
[526] J. LECLAIR, *loc. cit.*, note 32, p. 698.
See also case comments by S. ROBERT, "Droit Commercial – Lettres de Change," (1971) 3 *R.J.T.* 450; and Nicole L'HEUREUX, "Une nouvelle exception en matière d'incapacité du mineur dans les effets de commerce?" (1973) 14 *C. de D.* 557.

This, we believe, is the correct approach. Contrast this with cases of *Ricard v. Banque Nationale*[527] and *Morin v. Dion*[528]where the judges ignore the Act entirely and apply provincial civil law to the question of capacity.

In *Ricard v. Banque Nationale*, the appellant, Dame Henriette Ricard, made a promissory note to J.R. Weir, on his authority, and it was endorsed by both of them. She maintained that according to article 1301 of the Civil Code, "she could not bind herself either with or for her husband, otherwise than as being common as to property; any such obligation contracted by her in any other quality is void and of no effect."[529] She further alleged she had received no consideration for the note, and that the respondent knew of the circumstances under which the note was given. The trial judge found that Dame Ricard could not invoke article 1301 of the Civil Code of Lower Canada against a third-party holder of the note.

On appeal, Justice Lactose overturned the decision of the trial judge. Writing for the court, he found that the wife had in fact signed for the husband, without consideration, and that her husband had deposited the note, using the name M.M. Weir. He concluded that Dame Ricard was able to invoke article 1301 of the Civil Code of Lower Canada, which provides, "[a] wife cannot bind either herself either with or for her husband, otherwise than as being common as to property; any such obligation contracted by her is any other quality is void and of no effect." [530] The nullity established by this provision is of public order and can be invoked against third party holders in good faith.

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[527] (1893), 3 B.R. 161.
[528] [1957] C.S. 53. For a commentary on the case, see J.-G. CARDINAL (1957), "Billet souscrit par un mineur – nullité sans preuve de lesion – article 1009 C.c.", 59 *R. du N.* 561.
[529] (1893), 3 B.R. 162.
[530] *Supra,* 162.

Interestingly, Lacoste completely ignores the fact that as the case concerns a promissory note, one must turn first to the *Bills of Exchange Act*.[531] There is no mention of the Act in the judgement, which appears incorrect, because the capacity of a person to incur liability on a bill is dealt with in the Act (at article 46).[532] Nor was their any mention of section 74 (now 73(b)) which provides that, "The rights and powers of the holder of a bill are as follows...where he is a holder in due course, he holds the bill free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill."[533]

In *Morin v. Dion*,[534] a minor named Dion borrowed money from plaintiff Morin, to purchase an automobile. The loan was made through a note, which was used to make the initial down payment. The minor made several payments on the automobile loan, but then defaulted. The automobile was then repossessed and the lender sued for payment. The plaintiff/ lender claimed payment on the note plus interest; the defendant pleaded minority and lesion.

Justice Choquette found that Dion got involved in a transaction that was too burdensome, and which he did not have the means to complete. He could thus annul his contract on the basis of lesion. Moreover, he cited articles 297 and 1009 of the Civil

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[531] In fairness, the Bills of Exchange Act was fairly new legislation at the time the decision was rendered.
[532] In a similar case, concerning the capacity of a wife to bind here husband Justice Doherty referred to the Bills of Exchange Act with respect to liability, but not with respect to the capacity to incur liability. As in *Ricard* v. *Banque Nationale*, he applied article 1301 of the civil code. It should be mentioned, for the purpose of completeness, that from a practical perspective the status of married women has undergone tremendous change; they no longer raise any issues of capacity. As Falconbridge has pointed out that cases like *Ricard v. Banque Nationale*, "typically cited by English language texts on bills of exchange as examples of the incapacity of married women in the civil law of Quebec, have no further validity." (B. CRAWFORD, *op. cit.*, note 34, p. 1353, specifically note 7.)
Nevertheless, these cases remain useful in analyzing how provincial civil law interacts with the Bills of Exchange Act with respect to capacity.
[533] B.E.A., s. 73.
[534] [1957] C.S. 53.

Code, as well as jurisprudence, which supports the idea that lesion need not even be proved for a minor to avoid a contract, such as the one in this case. Given that the contract was null, the plaintiff could not exact the repayment of the money he lent because he had not shown that loan was turned to Dion's profit (as was required by article 1011 of the Civil Code). Again, interestingly, Choquette refers exclusively to the Civil Code to resolve the question at law, despite the fact that the capacity of a minor is central to the case. No mention is made of section 47 of the *Bills of Exchange Act.* He may have implicitly subscribed to the widely held view that section 47 (now section 46) incorporates provincial law, which led him to apply the civil law in Quebec to issue of capacity of minors.[535]

In the cases above, the question of whether civil law ought to apply was raised by express provisions of the Act, rather than as a result of the suppletive role of provincial law. In other words, civil law could be said to apply when (1) there is reference to the provincial law in the Act itself, or (2) provincial law takes on a suppletive role (requiring of course, a limited interpretation of the scope of section 9). There is a tendency to gloss over the distinction between these two major lines of inquiry when the question is framed as: Does common law or civil law apply to matters of bills and notes? For an example of another issue that might be resolved without reference to section 9, consider the case of *Entreprises Loyola Schmidt Ltée. v. Cholette.*[536] That case involved a note that was made

[535] Arguably, the failure to mention the Act at all seems to suggest that he didn't even consider the relevant sections of the Act, but simply applied provincial law in an unthinking manner without considering the interplay of the Act and provincial law. This is certainly a possibility; however, in a later case, *Rouleau* v. *Poulin*, dealing with the issue of consideration, Choquette, J. cites the relevant section of the Act, and yet applies the civil law anyways. With both capacity and consideration, the Act can be understood to be referring to provincial law, and so we impute this understanding to Choquette, J. in this case, based on his future decision, even though there is no mention of the Act itself in this earlier decision.

[536] [1976] C.S. 557. For a similar question, see *Montenay Inc.* v. *Imbrook Properties Ltd.*, [1989] R.J.Q. 846 (C.A.).

by three individuals, which they were later sued upon for failing to pay at maturity. One ground of defence raised by one of the defendants was that he was only liable for his share (one third) of the note. At issue were section 179 and the liability of multiple makers of a note set out therein. A problem arose from two different language versions of section 179 and the different meanings attributed to the words in the civil law and common tradition. The two versions of section 179 read:

> 179. (1) A note may be made by two or more makers, and they may be liable thereon jointly, or jointly and severally, according to its tenor.
> (2) Where a note bears the words "I promise to pay" and is signed by two or more persons, it is deemed to be their joint and several note.

> 179. (1) Un billet qui peut être souscrit par plusieurs personnes qui peuvent s'engager conjointement ou solidairement, selon sa teneur.
> (2) Le billet qui porte les mots "Je promets de payer" et la signature de plusieurs personnes rend les souscripteurs solidaires.

Bohémier and Richard describe the problem created by the text that states "jointly, or jointly and severally" in the English version, and "conjointement ou solidairement" in the French version.[537] They point out,

> ...[L]a comparison entre l'obligation conjointe et solidaire du droit civil et l'obligation *joint and several* du droit anglais peut, pour raisons de terminologie, prêter à confusion. D'abord, parce que la consonance du mot «*joint*» nous amène spontanément à référer mais erronément à l'obligation

[537] For a detailed analysis of the s. 179 problem, see John Delatre FALCONBRIDGE, *Banking and Bills of Exchange*, 6th ed., Toronto, Canada Law Book, 1956, p. 429 *ff.*

> conjointe du droit civil; ensuite, parce que ce réflexe est plus ou moins renforcé par les textes législatifs.[538]

Bohémier and Richard maintain, quite rightly it our opinion, that despite similarities between the terms *responsabilité conjointe* and *joint liability*, assimilating, or conflating the two concepts would be indefensible.[539] In the civil law of Quebec, a joint obligation is one in which each creditor is liable in proportion with his or her share of the debt.[540] Conversely, in the common law world, a joint obligation renders each party liable for the whole of the debt.[541] The conflicting meanings attributed to the term "joint" is but a symptom of a deeper problem inherent in federal legislation that is applicable in provinces whose systems private law systems differ from each other. Ruth Sullivan summed up the challenge of bijuralism in Canada in the following manner:

> Federal legislation in Canada is not only bilingual, but also bijuridical in the sense that it is applicable to persons, places and relations that are subject to the civil law in Quebec and to the common law in the rest of Canada... Although Quebec is the only province with a civil law system, the French version of federal legislation is meant to operate in all the provinces. This makes it impossible simply to reserve the English version of legislation for application in the common law provinces and the French version for application in Quebec.[542]

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[538] Albert BOHÉMIER and Louise-Hélène RICHARD, «Le billet brutalement présumé commercial *Montenay Inc. c. Imbrook Properties Ltd.*», (1990) 24 *R.J.T.* 153, 157-158.
[539] *Id.*, p. 174, cited in J. LECLAIR, *loc. cit.*, note 32, p. 705.
[540] Cc.Q., art. 1518.
[541] See Stephen Martin LEAKE, *Principles of the Law of Contract*, 4th ed., London, Stevens, 1902, p. 293-297. This text was cited by Paré, J. in *Entreprises Loyola Schmidt Ltée.* v. *Cholette*, p. 559-560.
[542] Ruth SULLIVAN, *Driedger on the Construction of Statutes*, 3rd ed., London, Butterworths, 1994, p. 235.

The problem is that we have two texts that rest on different conceptual bases, employ dissimilar legal institutions and terminology, and are expressed in different languages. Moreover, in this particular case, the terminology employed by the English words express a common law norm that does not correspond precisely to the civilian notion or solidarity of debtors.[543]

It is well known that the expression of a single legal norm in more than one language can create problems. Denis Tallon pointed out, "Certaines des contraintes viennent d'abord de la langue elle-même. Le schéma semble simple: à un mot dans une langue correspond un mot dans l'autre. Et, comme je l'ai déjà signalé, la langue de départ a été en general l'anglais. Et c'est là qu'on peut constater le poids de la langue de départ: le mot anglais appelle le concept anglais. C'est à l'autre langue de s'aligner. Et c'est d'autant plus difficile que les concepts ne coïncident pas toujours ou pas complètement (l'hypothèse la plus complexe)."[544] He went on to say that awkward or uneasy translations often indicate that a concept is too tied to a system to be properly understood by others.[545]

Jurists writing in the late nineteenth and early twentieth centuries, probably never contemplated the impact of the French version of the text. But because of the equally authoritative nature of each version,[546] there is a very complex issue of interpretation. Three discrete interpretive challenges arise from this legal bilingualism, "...uncertainty about the relative authority of the two versions; doubts about the degree to which either

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[543] Jean-Claude GÉMAR and Vo HO-THUY, *Difficultés du langage du droit au Canada*, Cowansville, Yvon Blais, 1997, p.65.
[544] Denis TALLON, «Le choix des mots au regard des contraintes de traduction» in Nicolas MOLFESSIS, (ed.), *Les mots de la loi*, Paris, Economica, 1999, p. 30 at page 32-33.
[545] *Id.*, p. 35
[546] See *Official Languages Act*, R.S.C. (1985), c. 31 (4th Supp.), s. 13 and the *Canadian Charter of Rights and Freedoms*, part I of the *Constitution Act, 1982* [annex B of the *Canada Act 1982* (1982, U.K., c. 11)], s. 18(1)

reflects the norm; and the embedded character of language."[547] In the words of one author, we must distinguish between problems of interpretation, which require us to opt for an interpretation of legislation from among a number of plausible meanings, and from those questions of interpretation which require us to choose between two equally authoritative versions of official text that must be applied within two separate legal systems.[548] This difficulty, which is pervasive in Canadian legislation, was explained quite lucidly by one author:

> If legal bilingualism presupposes equal authority of both versions of a text, how ought the interpreter to react when one such version is patently a derivative translation of the other? Given the draftsperson's necessary fidelity to textual symmetry, the implicit and symbolic meanings of the primary version will inevitably be lost, ignored or compromised for pragmatic reasons in any translation. For this reason, it is doubtful that legally significant one-to-one translations are even possible, even where the principal nouns in the norm are transliterated terms of art: contract, offer, acceptance, capacity, cause. Such an exercise is predicated upon the dubious proposition that words (and especially legal terms of art) carry with them detachable, fixed meanings that can be derived from a bilingual dictionary (footnotes omitted).[549]

The court's approach in resolving this problem has led Professor Côté to comment that, "[e]ven if, in the eyes of the law, the two versions are equally official, obviously one is sometimes nothing more than a translation of the other. This is not supposed to be considered by the courts. But what is the judge to think when one version is just a pale

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[547] R. A. MACDONALD, *loc.cit*, note 469, p. 119, 148.
[548] Rémi Michael BEAUPRÉ, *Interpreting Bilingual Legislation*, 2nd ed., Toronto, Carswell, 1986, p.40.
[549] R. A. MACDONALD, *loc. cit.*, note 469, p. 148.

imitation of the other? In law, the two are equal. In fact, one is often 'more equal' than the other."[550]

Nevertheless, any solution to this dilemma will ultimately depend on rules of interpretation, even though traditional cannons of construction are not particularly useful in interpreting bilingual legislation.[551] Thus, in looking at section 179, some would suggest that the utilization of terms and concepts exclusive to the civil law of Quebec in the French version of the act indicates parliament's intent that the civilian meaning be applied.[552] This has some support in the case law. In *Gulf Oil Canadian Ltd. v. Canadien Pacifique Ltée.*,[553] the court considered the legislator's intent. It asked, "A-t-il voulu conserver la notion de *common law* dans la traduction? Je crois que non, car, dans un tel cas, il n'aurait pas employé les mots 'cas fortuit ou de force majeure' qui n'ont pas la même portée juridique dans notre système de droit."[554]

In the opinion of some authors, when differences do exist between English and French versions of the law, they should be reconciled by finding a common meaning to both.[555] However, this is easier said than done. Others determine that giving the

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[550] P.-A. CÔTÉ, *op. cit.*, note 520, p. 331.

[551] One author suggests there are independent categories of rules (traditional and for bilingual legislation) that may conflict with each other. The traditional rules must then yield to the rules of his *interpretation croisée.* See Reynald BOULT, «Le bilinguisme des lois dans la jurisprudence de la Cour suprême du Canada», (1968-69) 3 *Ott. L.Rev.* 323, 324. Beaupré suggests that this view does not have jurisprudential support. Rather, he suggests these techniques have "fused into a single dynamic process of reading and applying bilingual legislation." See R. M. BEAUPRÉ, *op. cit.*, note 548, p. 41.

[552] J. LECLAIR, *loc. cit.*, note 32, p. 704.

[553] [1979] C.S. 72.

[554] *Id.*, p. 75. That case was the first to apply s. 8 of the Official Languages Act, which is no longer in effect. The Official Languages Act was repealed in 1988 and replaced by a new Act of the same name, *Official Languages Act,* S.C. 1988, 35-36 El. II c. 38, s. 110. The new statute does not have a provision that deals with the interpretation of bilingual legislation corresponding to s. 8. Nevertheless, though the provision has been repealed, the principle of interpretation it set out has been retained, as the s. 8 merely codified principles of interpretation already developed by Canadian courts. See R. BOULT, *loc. cit.*, note 551, p. 323.

[555] See P.-A. CÔTÉ, *op. cit.*, note 520, p. 324. Macdonald explains his own view on how we ought to practice legal bilingualism in Canada. He states, "Authoritative interpretation of legislative texts would reconstruct the expansive process of their drafting. Just as the drafters of bilingual legislation are engaged

provisions, "such fair, large and liberal construction and interpretation as best ensures the attainment of its objects"[556] will lead us to apply the common law meaning. However, any undue favouring of one version over another violates the equal authenticity rule and may appear to usurp parliament's legislative function.[557] It is thus true, and not surprising, that provisions such as section 179 of the *Bills of Exchange Act* have led to "a great deal of doctrinal friction and many contradictory decisions."[558]

But *Entreprises Loyola Schmidt Ltée. v. Cholette*[559] was not the first case to consider the problem of joint liability of debtors. A number of cases dealt with this matter shortly after the enactment of the *Bills of Exchange Act.* For example, the case of *Noble v. Forgrave*[560] concerned a plaintiff who sought to recover $203.33 (capital and interest) on a promissory note, by which Forgrave and Wilson, for value received, had promised to pay four months from the stipulated date, at the office of the Eastern Townships Bank. The plaintiff maintains that the defendants ought to be held liable *conjointement et solidairement.*

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in the translation of a single juridical idea into two natural languages, interpreters would come to accept that knowledge of one version alone is an insufficient point of reference for understanding the juridical idea in question. They would understand legislative texts as fully embracing both English and French connotations and contexts, and as necessarily meaning what both versions say. ***No longer would it be possible to speak of two texts being equally authoritative.*** To the extent that any formulation of a legal rule can be authoritative, it will be necessary to speak of one authoritative bilingual text in French and English. For this reason, formal incommensurability, or even substantive inconsistency, of legislative texts would pose no special interpretive problems. Interpreters would treat any apparent incommensurability of material presentation and substantive inconsistency between English and French versions of a statute no differently than they would treat any apparent commensurabilities and consistencies between them. In both situations, interpreters would construct, to the best of their ability, the legal norm immanent in the language of the two texts." R. A. MACDONALD, *loc. cit.*, note 486, p. 160-161.

[556] *Interpretation Act*, R.S., c. I-23, s. 12

[557] R. M. BEAUPRÉ, *op. cit.*, note 548, p. 40.

[558] R. JUKIER and R.A. MACDONALD, *loc. cit.*, note 206, p. 399.

[559] [1976] C.S. 557. For a similar question, see *Montenay Inc.* v. *Imbrook Properties Ltd.*, [1989] R.J.Q. 846 (C.A.).

[560] (1899) 17 C.S. 234.

The question at law debated was whether the plaintiffs were liable *conjointement et solidairement* on the note. Lemieux found that the obligation by the signers of the promissory note in question was only *conjoint* and not *solidaire.* The note did not contain any indication that the obligation of the defendants was *solidaire.* While it is true that the promissory note is a commercial debt, and thus according to article 1105 of the Civil Code of Lower Canada it is deemed to be *solidaire.*[561] Nevertheless, the provision makes exception for situations governed by "special laws." Lemieux went on to say that section 84 of the *Bills of Exchange Act,* 1890, stated: "A promissory note may be made by two or more makers, and they may be liable thereon jointly or jointly and severally, according to its tenor."[562] Thus, the obligation of multiple signatories of note is not always "joint and several" (clearly displacing the presumption in the code with respect to negotiable instruments governed by the BEA). Signatories are only liable *conjointement* if *solidarité* is not stipulated.

Leaving the actual reasoning aside,[563] what is important about this decision is not only that Lemieux recognized that this was a situation where conflicting norms came into play, given the different meanings in the civil and common law, but also that he did not feel the need to resort to section 10 (now section 9) to resolve the matter. Rather, he approached the question as simply a matter of dealing with the Act and distilling the

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[561] Note that presently, article 1525 of the Quebec Civil Code sets out a presumption of solidarity where the obligation is contracted for the service or carrying on of an enterprise.

[562] Supra 235

[563] This case is interesting for a number of reasons. Firstly, Lemieux, J. states that, "La distinction des obligations conjointes d'avec les obligations conjointes et solidaires est la même en droit anglais qu'en droit francais." He understands jointly and *conjointe*, as meaning the same thing, which is incorrect. "Jointly" in the common law is actually closer to the civil law conception of *solidaire.* It is also interesting, because the same judge, Lemieux, J. applied a civil law conception of joint liability, but in an earlier case, *Crépeau* v. *Beauschene* ((1898), 14 C.S. 495 (C. cir.)) he applied the common law. See B. CRAWFORD, *op. cit.*, note 34, p. 1837.

norm it sought to set out, be it the common law or Quebec civil law (by the Act's allusion to provincial law). Likewise, Justice Panneton, in *Cassaubon v. Bédard*[564] also makes note of section 179 before turning to the civil law of Quebec.

In that case, the plaintiff sought to recover three hundred dollars ($300.00), "*conjointment et solidairement*" from Therrien, Bédard and Brisson. The amount was in the form of three bills of one hundred dollars, dated April 29, 1914, and payable at four, five, and six months, respectively. Therrien alleges he was a minor at the time he signed the bill, that he received no benefit from the three hundred dollars ($300.00), and that he was not personally liable, as he signed as the secretary of the St-Louis Amateur Athletic Association, not in his personal capacity. The plaintiff alleges that Therrien did benefit from the aforementioned monies. Moreover, he maintained that signing the bills was a commercial act, and that for his commercial purposes, a minor is considered to be a person of the age of majority.

In dismissing the plaintiff's action, Justice Panneton noted that the notes in question stated, "We promise to pay" without adding "*conjointement et solidairement.*" He noted that the *Bills of Exchange Act* provides that a bill signed by two or more persons makes them liable either "*conjointment*" alone or "*conjointement et solidairement*" according to its tenor. Despite the fact that each simply provided a promise to pay, the defendants would be liable "*conjointement et solidairement*" if the bill was issued for a commercial debt. Therrien, a minor at the time of the signing, did not benefit personally; the money benefited the association. The association wasn't engaged in commerce, but rather entertainment and amusement. The sale of refreshments (in small quantities) was incidental, and the loan was therefore not for a commercial purpose.

[564] (1917) 54 C.S. 38

Therrien was found not liable for the amount of the note. One can infer from the reference to section 179 of the Act, and then to the civil law, that the provision itself led to the application of provincial law to the matter of joint and several liability. Recourse to section 10 [now section 9] became unnecessary. This idea is seen most recently in *Montenay Inc. v. Imbrook Properties Ltd.*[565] That case involved a note, dated November 29, 1979, to the order of Montenay Inc., promising to pay them $300,000, three years hence, with interest, for value received. The note was signed by Imbrook Properties Ltd. and 89826 Canada Ltd. The appellant had obtained judgment against the respondents at the trial of first instance, but appealed because the respondents were only held jointly liable in the Quebec civil law tradition. The appellant contended that the common law concept of "joint liability" should have been applied by the court. The difference, according to the court, was that under the English common law, each debtor would be liable for the totality of the debt, whereas in Quebec they would only be liable for their respective share.

The question at law was: were the two makers of that bill liable *solidairement*? The respondent filed a notice challenging the constitutionality of article 10 [now article 9] of the *Bills of Exchange Act*. The court, however found it unnecessary to address the constitutional question. Justice Nichols found that the court in the first instance had erred and that the parties were, in fact, liable *conjointement et solidairement*. He stated that nothing in the Act or code gives a bill a commercial or civil character. However, by nature notes are commercial, as they are *effets de commerce*, and as such they are subject to the presumption that commercial transaction gives rise to liability that is *conjointe et solidaire*, pursuant to article 1105 of the Civil Code. He went on to say that the

[565] [1989] R.J.Q. 846 (C.A.)

distinction between commercial and civil transactions exists only in the law of Quebec, not in the English common law. Neither the Civil Code nor the *Bills of Exchange Act* give any indication of the bill's nature. However, from its historical origins to the very present, all bills of exchange, regardless of the circumstances of their formation, are commercial and therefore subject to the presumption in article 1105. The appeal is thus allowed, and both makers are liable *conjointement et solidairement.*

From Justice Nichols' decision, it is clear that, in determining the "tenor of a bill" (to determine if the liability is joint or jointly and several) as per section 179 of the *Bills of Exchange Act*, he preferred to follow the jurisprudence and apply the presumption of commerciality for bills and notes. Therefore he relied on Quebec civil law (specifically article 1105) to create an obligation that is *conjointe et solidaire*, rather than import English law via section 10. Again, we see the focus remains on understanding the true import of the provision of the Act, rather than applying section 10 haphazardly.

Joint and several liability is not the only issue in the Act that has created controversy regarding the interpretation of the Act. The notion of "consideration" has also proved to be a contentious issue. The relevant sections of the Act read:

> 52. (1) Est à titre onéreux la lettre dont la cause:
>
> *a*) peut faire l'objet d'un contrat simple;
>
> 52. (1) Valuable consideration for a bill may be constituted by
>
> (*a*) any consideration sufficient to support a simple contract; or

Crawford describes the problem this way:

> A question arose almost from the start whether the Canadian Act's reference to "any consideration sufficient to support a simple contract" was to be interpreted the same way in Quebec as in the common law provinces. On the one side it was argued that the expression "simple contract" was a term of art in the common law and had been translated as such by Parliament in the French version of the Act as "contrat simple" rather than "obligation ordinaire" or simply "contrat"...On the other side it was pointed out that in Canadian constitutional law, the law of contract is within the competence of the provincial Legislatures as a matter of property and civil rights; the Act appeared to be expressed permissively only, and (perhaps most importantly) the Canadian case law appeared to recognize and give effect to the less stringent requirements of the Civil Code of Lower Canada governing the enforceability of promises.[566]

In *Re: Ross, Hutchison v. Royal Institution for the Advancement of Learning*,[567] the issue of consideration was raised. The plaintiff, the Royal Institution for the Advancement of Learning (which for the purposes of the action, was effectively McGill University), was the beneficiary of a promissory note made by J.K.L. Ross, whereby the latter promised to pay $100,000 after the date stipulated on the note. This amount represented half the outstanding amount of a subscription he made to the university in 1920. The amount promised was to be a donation for the construction of a gymnasium. Mr. Ross, however, went bankrupt, and so the petitioner sought the amount plus interest from the trustee in bankruptcy. The trustee denied the claim, saying that there had been no consideration for the note. Justice Panneton heard the case, and admitted the

[566] B. CRAWFORD, *op. cit.*, note 34, p. 1421-1422.
[567] (1931) 50 B.R. 107

petitioners claim, and admitted the university as a creditor of the estate. The case was appealed to the Quebec Court of Appeal.

In his judgement, Justice Dorion referred to section 53 of the Act. He found that consideration in the common law is much narrower than *cause ou consideration* in the civil law, and a donation will have *cause ou consideration* (which means simply "a reason" for the transfer) but not necessarily consideration as required by the Act. However, he notes, even though a contract without valuable consideration is a gratuitous contract, a moral obligation can be valuable consideration where the contract is onerous (*à titre onéreux*). Notwithstanding his attempt to bolster his conclusion by invoking section 10, it is clear that Justice Dorion's conclusion (that we must apply English law) does not depend on this section 10. Rather, it is evident from his words that it is section 53 of the Act itself that requires the application of common law principles. As he states, "[d]'après le texte anglais du statut je ne doute pas que les mots *simple contract* signifient le simple contract du droit anglais dans l'interaction de ceux qui l'ont rédigé."[568] Dorion explained the practical problem that the words created, and the reason he arrived at his conclusion.

The words "simple contract" is a technical term which has no particular meaning in the civil law of Quebec, but it is significant in common law. A simple contract is a contract not under seal, and accordingly it requires consideration, that is, valuable

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[568] CITE..... See also the concurring judgment of Bernier, J., who rejects the assertion that that "valuable consideration" must be interpreted, by virtue of s. 10, to mean valuable consideration as in the English common law, because 'consideration' is set out in article 53, which deals specifically with the "*cause ou considerations d'un contrat*" and therefore, the term must be interpreted according to provincial law. He concluded that McGill University could recover the amount, as there had been a natural obligation sufficient to support the note.

consideration. In Quebec, however, obligations can be constituted by cause or consideration, that is, it need not be valuable consideration.[569] This is an example of where the French text of the Act is an awkward and inelegant translation of the English version, and fails to use clear civilian language.[570] Despite numerous amendments of section 53 (now section 52),[571] the term "contrat simple" remains in the French version of the Act.

If the legislator intended English common law notions of consideration to be the rule, they could have adopted a provision similar to section 27(1)(a) of the *Ceylon Bills of Exchange Law*, which provides "any consideration which by the law of England is sufficient to support a simple contract" is sufficient consideration.[572]

Another important case illustrating this point is *Stephen v. Perrault*[573] involving a note made by the defendant to the order of the plaintiff, for $12,000, dated December 1, 1913. The balance owing on the note was $1,080 (with interest). The plaintiff maintained he had a number of shares, as a guarantee, but that he would return them upon the repayment of the debt. The defendant maintained there was a lack of consideration, as his reasons for having paid part of the note so far were "moral and sentimental," and thus could not constitute valuable consideration. The question at law was how we interpret whether, according to the *Bills of Exchange Act*, there was valid consideration.

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[569] *Id.*, p. 109.
[570] See Jean-Maurice BRISSON and André MOREL, «Les langues de la Loi sur les lettres de change et la common law au Québec, à travers le contentieux judiciare» in *Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Collection of Studies*, Ottawa, Department of Justice, 1997, p. 767 at page 771.
[571] For a description of the numerous changes, see J.-M. BRISSON and A. MOREL, *loc. cit.*, note 570, p. 787-789.
[572] See J. LECLAIR, *loc. cit.*, note 32, 741, who cites, Aharon BARAK, «The Requirement of Consideration for Bills or Notes in Israel», (1967) 2 *Isr. L. Rev.* 499, 508.
[573] (1918), 56 C.S. 54 (C. rev.)

Justice Panneton denied the appeal, upholding the judgement at trial. He found that according to section 53 of the *Bills of Exchange Act* (now section 52) consideration sufficient for a "simple contract" means, sufficient consideration as determined by each province. The defendant knew he was not responsible to the plaintiff, since he made no mistake. Panneton concluded that a moral debt can be consideration for a promissory note, and ordered the defendant to pay as per the original judgment.

Justice Lafontaine, on the other hand, looked to articles 948 and 1140 of the Civil Code to resolve the matter of consideration. He found that although the *Bills of Exchange Act* is a federal Act, drawn primarily from English law; nevertheless, section 53 of the Act directs us to apply provincial law in this regard.

Although both justices applied provincial civil law to determine the issue of consideration, neither Justice Panneton or Justice Lafontaine mentioned section 10 (now section 9) of the *Bills of Exchange Act* in their decision. They interpret the reference to contract in section 53 ("consideration sufficient to support a simple contract") as a legislative indication that provincial law (in this case, the Civil Code of Lower Canada) should apply to the matter. It is the Act itself which guides them to provincial law. This is expressed quite clearly when Justice Lafontaine declared, "...c'est tout de même notre droit français qui s'applique en la matière, en vertu d'une disposition expresse de cette loi, la clause 53, qui dit que toute cause suffisante pour donner validité à un simple contrat est une cause suffisante d'une lettre de change." [574] There is no need to resort to section 9 to apply provincial civil law in respect to consideration; it is simply a matter of interpreting the Act.

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[574] *Id.*, p. 61

Likewise, in *Morin v. Chambre de Commerce de St-Hyacinthe*,[575] where the plaintiffs sought payment on a promissory note against the Chamber of Commerce and one of the endorsers, the question at law was whether the chamber of commerce and the endorser were liable on the note. One of the issues concerned consideration on the note. Trahan found that section 53, dealing with "cause ou considération" for notes and bills of exchange, must be interpreted according to the laws in force in the provinces of Canada, and consequently, according to civil law in Quebec. Section 10 was not considered, because the case concerned the meaning of section 53 - an express provision of the Act.

Still, the consideration issue is another example of where provincial law – for example, the civil law in Quebec – might apply to bills and notes, without invoking section 9.[576] In considering section 9 we should not be concerned with whether to apply *either* common *or* civil law (because section 9 clearly requires us to apply common law), but rather the extent, that is, to what matters did the legislators wish us to apply common law by enacting section 9. Provincial law, in its suppletive role as *jus commune*, would then govern whatever falls outside the scope of section 9. In Quebec, civil law would govern those aspects, as the Quebec Civil Code is the *jus commune* of the province. In any case, determining what parliament intended through enacting section 9 is no easy task, as Leclair notes: "En effet, la ligne de démarcation qui sépare les sphères d'application du droit civil et de la *common law* en matière de lettres de change et de billets n'est pas toujours facile à tracer."[577]

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[575] (1934) 72 C.S. 323 (aff'd, 61 B.R. 244).
[576] It should be noted that Crawford does use s. 10 to bolster the argument "simple contract" is a term of art. See B. CRAWFORD, *op. cit.*, note 34, p. 1421-1422. However, the argument can be made even without invoking s. 10.
[577] J. LECLAIR, *loc. cit.*, note 32, p. 701.

Finally, in *Rouleau v. Poulin*,[578] Rouleau owed the plaintiff/respondent $840 before his bankruptcy. After the bankruptcy's liberation, he signed a promissory note for repayment of a debt that existed before the bankruptcy. On March 14, 1963, the plaintiff sought payment for the note, at which time the defendant alleged false representation and absence of consideration. He claimed, specifically, that the debt was incurred before the bankruptcy, and so there was no legal basis for the note. Moreover, he invoked article 1140 of the Civil Code to support his claim. He argued that under that provision, there can be no recovery for what was paid out in voluntary discharge of a natural obligation, but that it does not compel payment of what was only a promise to pay. The court rejected this defence and allowed the plaintiff's motion. The defendant appealed.

The question at law was whether the plaintiff could obtain the amount owed on the note. Justice Choquette, writing the majority opinion, found that the payment in question was in light of the original debt, not the one created after bankruptcy. Citing article 53 of the *Bills of Exchange Act*, he found that according to authors and jurisprudence, a bill or note can have a pre-existing natural or moral obligation. This moral or natural obligation to repay can persist even though the civil obligation was extinguished by the bankruptcy. As in his earlier decision in *Morin v. Dion*[579] Choquette, demonstrates that section 10 (now section 9) is not relevant for determining the applicable law when the Act itself discusses the matter. It simply becomes a matter of statutory interpretation.

Thus the question of whether common law should apply (by virtue of the technical term employed) or whether provincial law should apply (in light of the fact that

[578] (1964), [1965] B.R. 292. See Albert BOHÉMIER, Commentaire d'arrêt on Rouleau v. Poulin (1969) *R. du B.* 466, for a discussion of this decision.
[579] [1957] C.S. 53

consideration is an element of contract, which falls within the provincial legislative domain and changes in terminology in the Act from *considération valable*, to *cause* and *à titre onéreux*[580]) is a question of statutory interpretation of bilingual legislation.[581] In cases such as this, where legislation employs terminology known only to one legal system, the court seeks to ascertain what parliament's intent had been when it used a particular technical term, or term of art, and then extrapolating that intent to the other legal system.[582]

As challenging as this task appears to be, and notwithstanding the difficulties this type of exercise poses to the judiciary, section 9 cannot be used haphazardly to favour the common law when two versions of the Act are in apparent conflict. We must always focus on understanding the legislator's intent from the wording of the Act when dealing with an express provision. This idea was expressed by Justice Brossard in *Lavoie v. Abbott*.[583] In discussing whether the instrument in question was in the form of a promissory note defined in section 176 of the Act, he stated:

> The rules of the common law of England cannot be made applicable, under article 10 of the *Bills of Exchange Act*, to the question of the form of the instrument as any application of said law

[580] Indeed, the changes in terminology were likely the result of this judgement, and those similar to it. Dorion, J. found that a contract without valuable consideration is a gratuitous contract, but that a moral obligation can be valuable consideration where the contract is onerous (*à titre onéreux*). Consideration in the common law is much narrower than *cause ou consideration* in civil law, and a donation will have *cause ou consideration* (which means simply "a reason" for the transfer) but not necessarily consideration as required by the Act. Nevertheless, on the facts of the particular case, Dorion, J. concluded that this bill, in renewal of a previous one, had sufficient moral consideration to create a debt. See *Re Ross, Hutchison* v. *Royal Institution for the Advancement of Learning*, supra, note536, 107.

[581] Earlier cases have tended to allow civil law *cause* where the Act required consideration. See *Rouleau* v. *Poulin*, [1965] B.R. 292; *Verreault* v. *Harvey*, [1970] C.A. 753.

[582] R. M. BEAUPRÉ, *op. cit.*, note 548, p. 134.

[583] Supra, note 75.

> contrary to the above findings, would, in the Court's opinion, be inconsistent with the express provisions of the Act.[584]

Even though the interpretation of section 9 is different from questions arising from the other provisions of the Act, which is not to say that the interpretation of section 9 will have no bearing on how other provisions of the Act are understood. Indeed, in examining legislation "[e]very component contributes to the meaning as a whole, and the whole gives meaning to its parts."[585] Thus, judges will often look to section 9 to help them interpret other provisions of the Act.

For example, with respect to the question of "consideration" found now at section 52, Justice Bernier confirmes that, "On a prétendu dans la présente cause que d'après l'article 10 de la loi, ces mots *valuable consideration* doivent s'interpréter dans le sens qu'ils le sont sous le droit commun actuel en Angleterre, vu le texte même de cet article...[s. 10]"[586] Likewise, Justice Paré points out that the provisions of the *Bills of Exchange Act* should be interpreted in the spirit of the common law, as required by section 10 [now article 9].[587] He states:

> Les commentateurs de la *Loi sur les lettres de change* ont restreint, il est vrai, la portée de cet article 10 à ce qui est de l'essence même des lettres de change, laissant au droit provincial de déterminer le fond du droit sur lequel s'appuient les effets de commerce. Mais il faut dire aussi que le droit de la province ne doit recevoir d'application que si la *Loi sur les lettres de change* ne contient pas de dispositions particulières sur un sujet particulier. Or, l'article 179 contient précisément une disposition indiquant comment deux souscripteurs sont liés à l'égard du

[584] *Id.*, p. 603.
[585] *Dubois* v. *The Queen*, [1985] 2 R.C.S. 350, 365, as cited in P.-A. CÔTÉ, *op. cit.*, note 520, p. 308.
[586] *Re Ross, Hutchison* v. *Royal Institution for the Advancement of Learning*, supra, note 536, p. 116.
[587] See *Entreprises Loyola Schmidt* v. *Cholette*, supra, note 529, p. 560.

> détenteur. Il s'agit ici non pas d'appliquer une autre loi défaut de dispositions pertinentes dans la *Loi sur les lettres de change* mais d'interpréter les termes de la disposition elle-même qui contient l'article 179. Je crois ici qu'on doit appliquer l'article 10 dans de telles circonstances.[588]

What occurred in those cases was *not* the application of common law pursuant to section 10, but rather, section 10 was used as a tool to help interpret other sections of the Act, specifically to help resolve some of the difficulties created by bilingual legislation. We must also point out that most of the jurisprudence has demonstrated a tendency *not* to turn to section 9 to resolve difficulties with other provisions of the Act. Rather, the courts simply applied the civil law of Quebec in its suppletive role. For example, Newcombe stated:

> I would have thought that the question...would naturally fall to be determined by the law of Quebec, the province in which the parties resided and made the agreement and where it was meant to be performed ... It is true that the rules of the common law of England, including the law merchant, apply to bills of exchange and promissory notes, because the parliament of Canada has, by the Bills of Exchange Act, so declared in the exercise of its exclusive legislative authority over that subject; but the Dominion legislation does not and was not intended to affect a subscriber's liability to affect his subscription ....[589]

To summarize, despite the difficulties raised in the Act, the question of section 9 is distinct. The issues of capacity, consideration, and joint and several liability are really questions about interpreting bilingual legislation. Section 9 is often invoked to help

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[588] *Id.*
[589] *Re Ross, Hutchison* v. *Royal Institution for the Advancement of Learning*, [1931] 4 D.L.R. 689, 699; [1932] S.C.R. 57

interpret the other provisions, but its interpretation remains an independent concern. The two linguistic versions of section 9 do not create the same problem, as it is generally agreed that it expresses a single legal norm. The questions that remain, therefore, are as follows: What exactly is the norm being expressed? What is its scope and limitations? We will explore these questions in the following sections.

## APPLYING SECTION 9 (10) OF THE BEA

(1) The BA is an instrument governed by Federal laws.

(2) Interpreting section 9 (now 10) of the BEA, according to the civil and common law traditions.

(3) Unless otherwise provided by law, when a statute contains both civil law and common law terminology, then the meaning to be adopted shall be that of either the Province of Quebec or that of the common law provinces if applicable.

(4) The civil law meaning, emerging from the French version applies to Quebec and the common law meaning found in the English version, would applies to the rest of Canada.

(5) Particularly, section 9 of "The Bills of Exchange Act", provides that the "common law of England" shall apply. The courts have decided that this refers to both the civil and common law systems.

(6)In matters of issue, negotiation and discharge, common law applies. However, in issues affecting contracts and property, then in Quebec, the CCQ will also apply.

## 4.2 Approaches to the Interpretation of Section 9

In an attempt to understand its proper meaning and scope, we will now examine section 9 from the perspective of different interpretive approaches. First we will look at grammatical and textual arguments, followed by interpretive/ contextual and historical approaches. We will then turn to a constitutional analysis of section 9. Bear in mind that our intention is not to display a comprehensive review of statutory interpretation, but rather examine section 9 in light of these interpretive approaches. Thus, we will not explore such questions as what is "interpretation" and what *should* it be? We will conclude that there is no rule of interpretation that can be applied to determine the scope of section 9 with any degree of certainty, and therefore whether the common law or civil law apply to a matter relating to bills of exchange or promissory notes when the Act is silent.

Our discussion on this issue relies heavily on articles and cases from the United States, because there is a more extensive history of dealing with matters of interpretation there than in Canada. Although there are "glimmers of an enlivened discussion about statutory interpretation"[590] in Canada, American academics and jurists' interest in the subject blossomed earlier and led to a wealth of literature generated on the topic. With some exceptions, Canadian jurists have yet to show such interest.

The basic rules of interpretation emerged from "foundationalist" theories of statutory interpretation. In the last 50 to 60 years, legal scholars have preferred theories

[590] Stephen F. ROSS, "Statutory Interpretation in the Courtroom, the Classroom, and Canadian Legal Literature", (2000) 31 Ottawa L. Rev. 39, 41

that offer a unitary foundation for statutory interpretation. The three main theories posited today are, textualism (which focuses on the literal command of the text), intentionalism (the actual or presumed intent of the legislature enacting the statute), and purposivism (the actual or presumed purpose of the statute).[591] They have been described in these words:

> *Textualism* relies primarily on the judge's perception of the plain meaning of the statute's words, plus other grammatical and dictionary aids to interpretation and a "benign fiction" that the legislature intends that the entire *corpus juris* be read in a coherent manner. Textualism generally eschews the use of techniques that explore the legislative and political context in which the statute was enacted. *Intentionalism* is an approach that uses: the judge's understanding of the text; grammatical and other aids to linguistic interpretation; legislative history; and, the political context in which the legislation was enacted--all with an aim to effectuating the intent of the enacting legislature. *Purposivism* uses all of these techniques and a healthy dose of judicial judgment as to the public purposes that underlay the need for the legislation, in order to best carry out the statute's goals.[592]

These theories are labelled foundationalist "because each seeks an objective ground (foundation) that will reliably guide the interpretation of all statutes in all situations."[593] The theories seek to create comprehensive, coherent, and normatively attractive techniques for interpreting statutes. Let us examine each briefly, in turn.

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[591] See William N. ESKRIDGE, Jr. and Philip P. FRICKEY, «Statutory Interpretation as Practical Reasoning», (1990) 42 Stan. L. Rev. 321, 324.
[592] ROSS, *loc.cit* note 590.
[593] W. N. ESKRIDGE, Jr. and P. P. FRICKEY, *loc. cit.*, note 591, p. 321, 324-325.

## Textualism

As suggested in its name, textualism requires the interpreter to focus on the text, or the words, of the statute. It has been suggested that there are two types of textualism. The stricter version, associated with Oliver Wendell Holmes, states, "[w]e do not inquire what the legislature meant; we ask only what the statute means."[594] A second version of this approach draws on statutory language not in place of, but rather as the best guide to, legislative intent or purpose.[595] In other words, the legislature has presumptively said what it means. Therefore, the only way to discover what legislator "intends" is to look at the words it has enacted into law, nowhere else.[596]

In the last 20 years, textualism has been most closely associated with Justice Antonin Scalia of the United States Supreme Court.[597] Although his approach is actually a return to the Supreme Court's traditional approach before World War II.[598] To emphasize some of the differences, some academics have styled Scalia's approach the

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[594] Oliver Wendell HOLMES, *The Theory of Legal Interpretation,* (1899) 12 Harv. L. Rev. . 417, 419 (1899).
For a recent variation, see Frank H. EASTERBROOK, *The Role of Original Intent in Statutory Construction,* (1988) 11 Harv. J.L. & Pub. Policy, 59, 65 (we should replace the meaningless concept of legislative intent and "look at the statutory structure and hear the words as they would sound in the mind of a skilled, objectively reasonable user of words").

[595] See *United States* v. *American Trucking Associations*, 310 U.S. 534, 543 (1940), followed in *Huffman* v. *Western Nuclear Inc.,* 108 S. Ct. 2087, 2092 (1988).

[596] Harold SOUTHERLAND, *Theory and Reality in Statutory Interpretation*, (2002) 15 St. Thomas L. Rev. 1, 12.

[597] Antonio SCALIA, Common-Law Courts in a Civil-Law System: The Role of United States Federal Courts in Interpreting the Constitution and Laws, in A Matter of Interpretation 3, 3-37 (Amy Gutmann, ed. 1997).

[598] William N. ESKRIDGE Jr., «Textualism, The Unknown Ideal?», (1998) 96 Mich. L. Rev. 1509, 1521 ("This general principle is not original with Scalia; the British House of Lords and Justice Oliver Wendell Holmes followed the same idea in the late nineteenth and early twentieth centuries.")

"new textualism."[599] Nevertheless, these differences do not obscure the fundamental notion underlying the textualist approach. In the words of Professor Eskridge:

> Doctrinally, the new textualism's most distinctive feature is its insistence that judges should almost never consult, and never rely on, the legislative history of a statute. The rejection of legislative history and insistence that judges follow plain meanings even when unreasonable contribute to the overall theme of the Tanner Lectures: common law approaches, emphasizing purpose, policy, and history, are not appropriate for statutory interpretation in the modern administrative state. Consistent with this theme, Scalia has developed a rigorously text-based methodology that contrasts strikingly with the common law approach in Holy Trinity Church. Like Holmes, the new textualist starts with the meaning an ordinary reader would draw from the statutory language but delves more deeply than Holmes usually did into what other textual sources might teach us. Thus, the Scalian interpreter also considers which interpretation is most consistent with the statute as a whole; whether similar language has been used elsewhere in the U.S. Code and, if so, how it has been interpreted; and regular rules of grammar, syntax, and word use. When textual analysis is done thoroughly, it can actually persuade a hostile audience, a feat hard to accomplish under other approaches to statutory interpretation [citations omitted].[600]

In short, by emphasizing the statutory words chosen by the legislature, rather than (what seems to be) more abstract and judicially malleable interpretive sources, textualism appeals to the values of legislative supremacy and judicial restraint. On the other hand, textualism has been subject to an abundance of criticism.[601] Textualism, and the rules of

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[599] See William N. ESKRIDGE Jr., «The New Textualism», (1990) 37 UCLA L. Rev. 621, 623-624; William N. ESKRIDGE Jr., Philip P. FRICKEY, Elizabeth GARRETT, Legislation and Statutory Interpretation, New York: Foundation Press, 2000; see also Frank EASTERBROOK, «Legal Interpretation and the Power of the Judiciary», (1984) 7 Harv. J.L. & Pub. Policy 87.

[600] W. N. ESKRIDGE Jr., *loc. cit.*, note 598, p. 1509, 1512

[601] Justice Scalia's position has attracted much of the attention. See W. ESKRIDGE, *loc. cit.*, note 599, p. 1509, 1512; Cass R. SUNSTEIN, «Justice Scalia's Democratic Formalism», (1997) 107 Yale L.J. 529, Richard J. PIERCE, Jr., «The Supreme Court's New Hypertextualism: An Invitation to Cacophony and

interpretation that stem from it, such as the plain meaning rule, are based on a number of questionable assumptions. Firstly, there are problems inherent to language itself. Words, text and language generally are indeterminate, they do not have a "plain meaning"; the act of imbuing words with meaning – that is, interpretation – is largely subjective, which can lead to uncertainty and confusion.[602] Moreover, there are many different forms of "meaning" (e.g., literal meaning, technical meaning, common sense meaning, etc.) each of which is understood and employed differently by different judges.[603]

Furthermore, textualists cannot escape the fact that the meaning of words is heavily influenced by context. The United States Supreme Court reminds us to always remember that, "Words are not pebbles in alien juxtaposition; they have only a communal existence; and not only does the meaning of each interpenetrate the other, but all in their aggregate take their purport from the setting in which they were used...."[604] As another author suggested, all communication is indeterminate. No word can adequately portray the depth of our reality; no word can truly encapsulate the fullness and vibrancy of human existence.[605] If this is the case, textualism rests on shaky foundations.

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Incoherence in the Administrative State, », (1995) 95 Colum L. Rev. 749; William POPKIN, «An "Internal" Critique of Justice Scalia's Theory of Statutory Interpretation, », (1992) 76 Minn. L. Rev. 1133. For a Canadian perspective, see Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 *Ottawa L. Rev.* 175.

[602] See W. N. ESKRIDGE, Jr. and P. P. FRICKEY, *loc. cit.*, note 599, p. 321, 341 and Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 Ottawa L. Rev. 175, 187.

[603] Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 Ottawa L. Rev. 175, 193.

[604] Shell Oil Co. v. Iowa Department of Revenue, (1988) 488 U.S. 19; 109 S. Ct. 278, 281, quoting Learned Hand in National Labor Relations Board v. Federbush Co., 121 F.2d 954, 957 (2d Cir. 1941).

[605] Anthony D'AMATO "Counterintuitive Consequences of 'Plain Meaning'" (1991) 33 Arizona Law Rev. 529; 530-531

## Intentionalism

Different from textualism, intentionalism includes a wide variety of intent-based theories, but they all generally involve some form of imaginative reconstruction, in which the interpreter seeks to determine what the legislator meant.[606] Intentionalism posits that legislative intent is primary in interpreting the statute in question. From this perspective, the statute is only a piece of evidence leading the court back to the legislature's intent. Thus, those who support intentionalist theories of interpretation believe statutes should be interpreted to reflect legislative intent, as it is this intent that makes statutes authoritative.[607]

This view was expressed by McLachlin in a dissenting opinion in *R. v. McIntosh*.[608]

> The point of departure for interpretation is not the "plain meaning" of the words, but the intention of the legislature. The classic statement of the "plain meaning" rule, in the *Sussex Peerage Case* (1844), 11 C. & F. 85, 8 E.R. 1034 (H.L.), at p. 1057, makes this clear: "the only rule for the construction of Acts of Parliament is, that they should

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[606] This is referred to as "archaelogical" intentionalist analysis. "Hypothetical" intentionalist analysis Hypothetical intentionalism, on the other hand, asks not what the legislature's answer was but rather what it would have been had the legislature considered the specific problem before the court. See Martin H. REDISH & Theodore T. CHUNG, «Democratic Theory and the Legislative Process: Mourning the Death of Originalism in Statutory Interpretation», (1994) 68 Tul. L. Rev. 803, 813.

[607] Adrian VERMEULE, «Interpretive Choice», (2000) 75 N.Y.U.L. Rev. 74, 84. For an overview of intentionalism, see Adrian Vermeule, «Legislative History and the Limits of Judicial Competence: The Untold Story of Holy Trinity Church», (1998) 50 Stan. L. Rev. 1833, 1834-35.

[608] [1995] 1 S.C.R. 686 at 712-713

> be construed according to the intent of the Parliament which passed the Act". To quote *Driedger, supra*, at p. 3: "The purpose of the legislation must be taken into account, even where the meaning appears to be clear, and so must the consequences." As Lamer C.J. put it in *R. v. Z. (D.A.)*, [1992] 2 S.C.R. 1025, at p. 1042: "the express words used by Parliament must be interpreted not only in their ordinary sense but also in the context of the scheme and purpose of the legislation." The plain meaning of the words, if such exists, is a secondary interpretative principle aimed at discerning the intention of the legislator. If the words admit of only one meaning, they may indeed "best declare the intention of the lawgiver" as suggested in the *Sussex Peerage Case* at p. 1057, but even here it is the intention, and not the "plain meaning," which is conclusive. But if, as in the case of s. 34(2), the words permit of doubt as to the intention of Parliament, other matters must be looked to determine that intention.

Thus, according to this theory, the text itself is not the repository of legislative intent, but rather a means of accessing that intent. Thus, it makes sense to look beyond the statute to that which makes the legislation authoritative – the legislator's intent. Like textualism, intentionalism is subject to its fair share of criticism. The classic discussion put forth by Max Radin, very clearly states that legislative intention is "undiscoverable in fact, [and] irrelevant if it were discovered."[609] Basically, his view is that legislative history provides notoriously malleable evidence of legislative intent.

Furthermore, courts often seek the intent of the legislature, but it is not clear how one ought to go about finding that intent. Indeed, it is not even clear if one can properly speak of the intent of the legislature, as any legislature is compromised of many individuals, often with different perspectives, desires and intentions. As another author

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[609] Statutory Interpretation (1930) 43 Harv. L. Rev. 863, 872.

stated more recently, "[i]ntent is elusive for a natural person, fictive for a collective body."[610] Neither does an examination of legislative history help us very much. Before one can turn to legislative history as a guide:

> ...[t]he interpreter must first answer, even if only implicitly, a series of empirical questions: Does legislative history in fact supply evidence about some suitably specified notion of legislative intent (for example, the understanding of the median legislator) in a broad range of cases? Even if it does, will judges of limited competence do better at identifying legislative intent with legislative history or without it? The answers to these questions will determine whether to adopt rules or standards governing the use of legislative history and what the content of the rules or standards should be.[611]

But perhaps the greatest difficulty with intentionalism is that imaginative reconstruction seems to be far more imaginative than reconstructive.[612] It deals in hypotheticals and speculation, which casts doubt on its correctness or reliability. Authors have pointed out that in some cases; courts have adopted "strained or implausible interpretations" in attempting to interpret the statute in conformity with their understanding of the legislator's intent.[613] Critics have maintained that the courts are overstepping their bounds by modifying the text this way in what is effectively judicial

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[610] Frank H. EASTERBROOK, «Text, History, and Structure in Statutory Interpretation», (1994) 17 Harv. J.L. & Pub. Pol'y 61, 68

[611] Adrian VERMEULE, «Interpretive Choice», (2000) 75 N.Y.U.L. Rev. 74, 84. "The widespread expectation that judges will consult legislative histories leads to [their] distortion ... and makes them unreliable indicators of congressional intent." See Note: Why Learned Hand Would Never Consult Legislative History Today (1995) 105 Harv. L. Rev. 1005, 1012. Professor Vermuele explains that the heterogeneity of legislative history is also problematic in that it increases the possibility of error in several ways. See Adrian VERMEULE, Legislative History and the Limits of Judicial Competence: The Untold Story of Holy Trinity Church, (1998) 50 Stan. L. Rev. 1833, 1873 *ff.*

[612] Paul MICHELL, «Just do It! Eskridge's Critical Pragmatic Theory of Statutory Interpretation», (1996) 41 McGill L. J. 713, 723

[613] See Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 *Ottawa L. Rev.* 175, 184.

amendment of the law. "C'est au législateur et non aux tribunaux que revient la tâche de déterminer ce qui constituera une restriction souhaitable à la réalisation du but de la loi. Autrement le domaine de celle-ci risquerait de ne connaitre aucune limite et d'outrepasser l'intention de son auteur d'origine."[614]

[614] Jeanne SIMARD, L'interprétation législative au Canada: la théorie à l'épreuve de la pratique (2001) 35 R.J.T. 549, 592

## Purposivism

Compared to the other theories, purposivism, or modified intentionalism as it is occasionally referred to, aims to discover the purpose of a statute or legislative enactment. It then seeks an interpretation of the text that most harmonious with this purpose.[615] It is important to note, however, that purpose is distinct from intent although the difference between intent (as meaning) and purpose is easily obscured. As James Landis pointed out, "[p]urpose and meaning commonly react upon each other. Their exact differentiation would require an extended philosophical essay...."[616] Indeed, in Canadian case law, there is no systematic distinction between intentionalism and purposivism.[617]

Purposivism maintains the "democratic pedigree" element of intentionalism, without the "rigidity and definitional problems of intentionalism."[618] In the view of Hart and Sacks, law is a purposive activity and the role of the court is to find that purpose.[619] Karl Llewellyn would have agreed. He wrote that "if a statute is to make sense, it must be read in the light of some assumed purpose. A statute merely declaring a rule, with no

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[615] P. MICHELL, *loc. cit.*, note 612, p. 713, 723-724

[616] James LANDIS, «A Note on "Statutory Interpretation"», (1930) 43 *Harv. L. Rev.* 886, 888. For a discussion of the difference between intent and purpose, see Gerald C. MacCALLUM, «Legislative Intent», (1966) 75 Yale L.J. 754, *757ff.*

[617] Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 *Ottawa L. Rev.* 175, footnote 2.

[618] See W. N. ESKRIDGE, Jr. and P. P. FRICKEY, *loc. cit.*, note 599, p. 321, 332 and P. MICHELL, *loc. cit.*, note 612, p. 713, 724.

[619] Henry M. Hart, Jr. & Albert M. Sacks, *The Legal Process: Basic Problems in the Making and Application of Law*, Tentative ed. (Cambridge, Mass.: Harvard University, 1958) at 1411.

purpose or objective, is nonsense."[620] In a similar vein, Professor J.A. Corry noted that by interpreting statutes in light of their objectives, courts are acting consistently with the proper role of an unelected judiciary in a democratic society.[621] By focusing on the purpose, we can interpret the legislation in a clear and coherent manner.

The purposivist approach is not immune from criticism either and is subject to many of the same difficulties as intentionalism. Purposivism rests on questionable assumptions about the nature of the legal process, for example, the notion that the legislature produces purposive statutes. Modern political theory on the legislative process suggests that rational legislators responding to rational interest groups will not, in fact, produce purposive statutes.[622] Moreover, legislative purpose is assumed, especially in cases where the issue at hand was not contemplated by the legislature. Like legislative intent, it is an easily malleable concept, unconstrained by statutory language.[623] It is extremely difficult, if not impossible to determine a single purpose, let alone *the* purpose.

Purposivism enables the court to ascribe a purpose to the statute which may not have been intended at the time, and thus effectively modify the law. The possibility of a shifting purpose runs contrary to the idea that the law ought to be transparent and predictable.[624] There is a concern that a purposive approach allows courts to move too far beyond the words of the legislation. Consequently, "[I]f courts are permitted to look behind the words of a statutory text and search for legislative intention or purpose, laws may be enacted through strategic 'winks and nudges' by members of the legislature as

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[620] Karl N. Llewellyn, Remarks on the Theory of Appellate Decision and the Rules or Canons about How Statutes Are To Be Construed, (1950) 3 Vand. L. Rev. 395, 402 *ff.*
[621] See J.A. CORRY, «Administrative Law and the Interpretation of Statutes», (1936) 1 *U.T.L.J.* 286, 289.
[622] W. N. ESKRIDGE, Jr. and P. P. FRICKEY, *loc. cit.*, note 599, p. 321, 333.
[623] P. MICHELL, *loc. cit.*, note 612, p. 713, 724.
[624] See W. N. ESKRIDGE, Jr. and P. P. FRICKEY, *loc. cit.*, note 599, p. 321, 337.

opposed to properly enacted written statutes. This subverts predictability and accountability and undermines the rule of law."[625]

We will now examine how these foundational theories, as contained in various rules of interpretation, can be applied to an analysis of section 9 and help us understand the case law that has developed around this provision of the *Bills of Exchange Act*.

[625] P. MICHELL, *loc. cit.*, note 612, p. 713, 725.

### 4.2.1 Grammatical Method or Textual Arguments

Even though in Canada the principal articulation of the theory has been in the form of the plain meaning rule, textualism exists in many forms.[626] The "plain meaning rule" is referred to as the "literal rule." Interpreting statutes under this approach means that we must understand them "as they are" and word for word. It emphasizes a very textual approach to the legislation. As we mentioned, from this perspective, the text of a law is of utmost importance; it will be the most decisive factor to understanding a law. When the text is clear, the written words are given priority to the exclusion of other factors.[627] Although the literal approach appears to be quite straightforward, it has been expressed in a number of ways that do not always mean the same thing. Consider the following statement from *Sweeney v. Lovell*:

> Considering that the statute is clear, we cannot go...beyond the letter of law on the pretext of discovering its spirit; general rules of interpretation are only applied when the technical or ordinary meaning of the words or provisions is obscure, and we cannot rely upon the spirit of statute to contradict the formal text....[628]

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[626] Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 *Ottawa L. Rev.* 175,182

[627] See P.-A. CÔTÉ, *op. cit.*, note 520, p. 282.

[628] *Sweeny* v. *Lovell*, (1901), 19 Que. S.C. 558, 561.

Pierre-André Côté explains that there are three different features of the rule in that statement of Lemieux. First, if the language of the statute is clear, it will not be necessary to seek its interpretation. Second, a clear text should not be interpreted, and third, legislative intent should be found within the text itself.[629] In any case, pursuant to the literal approach, the text of the *Bills of Exchange Act* must be interpreted literally. Consider then, the wording of section 9:

> The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques.

This provision seems quite clear. Bills of exchange, and consequently BAs, are to be governed by the common law. Only where the common law is inconsistent with the Act does it not apply. Interestingly, the Act seems to make applicable the whole of common law with respect to bills and notes. Accordingly, a Quebec civil law court would have to apply the common law argued by civil lawyers. Undoubtedly, this would prove to be a rather awkward situation, since it is highly unlikely that the jurists in Quebec would be very familiar with the rules of the common law system.

Despite the problems it might present, in *Banque Canadienne Nationale and Berubé v. Gingras,*[630] Justice Pigeon stated in an *obiter dictum* that perhaps the common law of conversion might apply in Quebec if one considered section 10 (now section 9) of the *Bills of Exchange Act*, despite the contrary view, unanimously held by the rest of the court. He said:

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[629] See P.-A. CÔTÉ, *op. cit.*, note 520, p. 282. All three manifestations of the Literal Rule are controversial.
[630] [1977] 2 R.C.S. 554

> Although it is in no way necessary in the case at bar, in view of the basis on which it was brought and decided, I see no reason to refrain from saying that I am not completely sure it was correct to state in *Norwich Union* that the common law rules on conversion could not be applied in Quebec. In fact, not a word was said of s. 10 of the Bills of Exchange Act, and no reference to it is to be found in the factums, although appellant's whole argument was based on English cases.[631]

Justice Pigeon, from his subtle rebuke to counsel, was open to a straightforward, literal interpretation of section 10 (now section 9) that would apply the common law to all matters of bills and notes. Had section 10 been pleaded, it might have effectively precluded the application of civil law in place of existing common law rules. In his treatise on bills of exchange and promissory notes, Russell stated:

> *The Bills of Exchange Act is* the law for the Province of Quebec as it is for the rest of the Dominion. Where it is silent, recourse is to be had to the rules of the common law of England, including the law merchant. It is difficult to see that any place whatever is left for any rules of law peculiar to the Province of Quebec....[632]

Justice Pigeon goes on to cite the decision in *Noble v. Forgrave* as evidence of his proposition. In *Noble v. Forgrave*, [633] the Supreme Court of Quebec maintained that the enactment of this section had modified the former law of Quebec by introducing into that province the law of England. Justice Lemieux stated, "C'est-à-dire que les règles du droit

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[631] *Id.*, p. 564
[632] B. RUSSELL, *op. cit.*, note 356, p.22.
[633] (1899) 17 C.S. 234.

commun en Angleterre s'appliqueront *entièrement* aux billets, excepté dans les cas ou elles seront incompatibles avec les édictions de notre acte des lettres de change[634]...."

Additionally, Justice Flynnin in *Larochelle v. Bluteau*,[635] stated, "Le droit anglais, qui s'applique en matière de lettres de change et billets promissoires, pour les cas non prévus par notre loi, permet cette preuve testimoniale, dans un cas de letter de change, ou billet."[636] He does not mention section 10 (now section 9) of the *Bills of Exchange Act* explicitly, but it seems that he considered the section in making this statement. Justice Bernier, in his dissenting opinion, seems to take a literal approach to section 10, simply stating that it introduces common law to Quebec. Several years later, as part of the majority opinion in *Re: Ross, Hutchison v. Royal Institution for the Advancement of Learning*, [637] Justice Bernier maintained the view that the effect of section 10 was to apply common law, insofar as it did not conflict with the Act.

In *Bank of Montreal v. Amireault*,[638] Justice Barclay concluded his judgment by affirming that he did not rely on cases from Quebec, because English law was applicable. He was of the opinion that "the doctrine of estoppel, at least so far as negotiable instruments are concerned, is in force in this Province, in view of section 10 of the *Bills of Exchange Act.*" [639] He seems to adopt a literal approach to the section, which explains why his judgement contains no consideration of provisions of the civil code. Likewise, the court in *Blais v. Mathieu*[640] also seems to have adopted the literal approach to section 10 (now section 9). The court was clear that common law alone applied to bills and notes;

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[634] Supra 236

[635] (1923), 34 R.L. (N.S.) 328 (B.R.)

[636] *Id.*, p. 338

[637] *Re Ross, Hutchison* v. *Royal Institution for the Advancement of Learning*, supra, note 536, 107.

[638] (1938) 65 B.R. 1

[639] *Id.*, p. 15-16

[640] (1918) 56 C.S. 3 (C. rev.).

there was no room for the application of the civil code and the code of civil procedure. On the facts of the case however, the laws of evidence represented an exception to this general rule because of the specific legislative provision of another federal Act, namely, the *Canada Evidence Act.*[641]

Since the French and English versions of the Act are equally authoritative,[642] it raises the possibility that the two texts establish two different legal rules. In any case, it is doubtful that authors such as Russell, writing in the early twentieth century, contemplated the implications of a French version of the text. The reality of two authoritative texts highlights some of the limitations to the literal rule, which it shares with the grammatical or textual approach, generally. For example, there is the problem of the "open texture" of language, which suggests that most words do not have a clearly delineated content, creating doubt as to what the word(s) in the statute are referring to.[643] This problem flows from a basic flaw in the foundational theory of textualism upon which the literal approach is based. Although normatively appealing, "Textualism ignores the inexactitude of language generally and American English in particular as a medium of precise and effective communication; in this it puts on language a burden it simply cannot bear."[644]

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[641] Section 40 of the *Canada Evidence Act*, R.S.C. (1985), c. C-5 is the current provision. It provides:

> In all proceedings over which Parliament has legislative authority, the laws of evidence in force in the province in which those proceedings are taken, including the laws of proof of service of any warrant, summons, subpoena or other document, subject to this Act and other Acts of Parliament, apply to those proceedings.

This represents an exception to the general rule stated in s. 9 that Common law ought to apply to all matters relating to Bills and notes.

[642] *Canadian Charter of Rights and Freedoms*, supra, note 454, s. 18(1)

[643] See P.-A. CÔTÉ, *op. cit.*, note 520, p. 279-280.

[644] H. SOUTHERLAND, *op. cit.*, note 596, p. 1, 12

As Professor Southerland explains:

> Text alone, isolated from its larger context - its purpose, object, the circumstances that called it into being - can never make meaning wholly clear. Text alone can never make meaning wholly clear because the words that compose it are themselves never wholly clear. No matter how common or ordinary a word, its usage inevitably reflects the unique subjectivity of the writer; the reader's understanding of the word is likewise freighted with a unique subjectivity. The meaning of text is in the eye of the beholder, and each eye is different. Text can never do better than approximate meaning, and this inherent imprecision should tell us that textualism, like any other method of statutory interpretation, can be manipulated in the service of result-oriented decision making. Language changes with changing conditions in society, and even a text that seems clear enough today is likely to seem less so tomorrow. No text can anticipate every eventuality, foresee every twist and turn in a road stretching into an uncertain future.[645]

Given the uncertainty surrounding language, we may question whether the "common law" referred to in section 9 refers to the common law as a legal system, or the common law as *jus commune*. Proponents of the latter view might argue that section 9 imports the civil law (in its primary manifestation, the Quebec Civil Code) as the *common law* of Quebec.[646] This position must be dismissed, as the French version of the Act clearly refers to "Les règles de la *common law* d'Angleterre..." not the "*droit commun* d'Angleterre." In *Re Évaporateur Portneuf Inc.; Angers v. Malouin*,[647] the court found that "[b]y putting the English in parentheses, the legislator had shown a clear

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[645] *Id.*, p. 46-47
[646] This notion of the civil law as the common law of Quebec can be found in the decision of Beetz, J. in *Laurentide Motels Ltd. v. Beauport (City)*, [1989] 1 R.C.S. 705, 720 and 724.
[647] [1962] B.R. 218

intention that the English version should receive special weight."[648] Thus, it is clear, the common law, not the *droit commun* of Quebec, must be applied.

Furthermore, despite the jurisprudential support, there are other difficulties with the literal approach. Taking a literal approach to interpreting the Act requires recognition that the Act refers to the common law of *England*. It does not appear that any of the jurisprudence or doctrine deals with this issue.[649] As Canadian common law diverges from the English common law, this may become an interesting point. A literal interpretation would have Canadian courts applying judgments of the House of Lords instead of the Supreme Court of Canada, with respect to bills of exchange and promissory notes. Would the expression "*common law* of England" exclude statutory law, such as statutes of limitation? It has been suggested that the "common law" alluded to in section 9 likely refers to equity, but not statute law,[650] although it is not definitive, as there has been no judicial pronouncement on this particular issue.

Taking a literal approach to interpreting the Act required in this case would lead to an absurd result. In truth, the courts have had little difficulty in manipulating the plain and obvious meaning to escape the consequences of such results. For example, in *Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce*,[651] the court considered section 165(3) of the *Bills of Exchange Act*, which states:

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[648] R. M. BEAUPRÉ, *op. cit.*, note 548, p. 135.
[649] See B. CRAWFORD, *op. cit.*, note 34, p. 1218.
[650] *Id*, p. 1216.
[651] [1996] 3 S.C.R. 727,

165. (3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.[652]

Justice Iacobucci made the following comments:

The respondent submits that, within the plain meaning of s. 165(3), it has acquired the rights of a holder in due course, since the cheques in question were indeed "delivered to a bank for deposit to the credit of a person", and since the CIBC credited the person "with the amount of the cheque." At first blush, this interpretation seems to be attractive. However, the consequence of this approach would be far-reaching and overly broad. If the respondent's interpretation were adopted, a bank would never need to require an endorsement . . . . A bank would always be immune from the consequences of having accepted unendorsed cheques into third party accounts. This result cannot be supported.[653]

The court went on to interpret the word "person" to mean "a person who is entitled to the cheque" a definition which is clearly not derived from the plain meaning of the word. Thus, taking a literal approach to section will be of little assistance here where the result of doing so may lead to "absurd" consequences.[654]

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[652] B.E.A., s. 165(3).
[653] [1996] 3 S.C.R. 727, 764
[654] See Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 Ottawa L. Rev. 175,199-200, where this case is discussed.

### 4.2.2 Interpretive/Contextual

The "contextual" approach is concerned with context. In using the word "context" here, we include the entire statute of which some disputed word or phrase is a part of. What we mean by "out of context" is taking the entire statute itself out of context: the context of its origin, its reason for being, the evil or mischief it was meant to combat, all as reflected in the history of the times, committee reports, successive drafts, hearings, debate, or any other material that seems credible and reliable in understanding the purpose the statute was intended to serve. In considering context, we will not only examine the historical context of the legislation, but today's context as well (i.e. the current environment in which the words of the enactment take their meaning).

The contextual approach is part of the systematic or logical method of interpretation. It assumes that the legislator is rational and that any output by this legislator is coherent and logical. Naturally, interpretations that are congruent with legislative coherence and rationality are preferred over those that would lead to incoherence and inconsistency.[655] We must be prepared to move beyond the words of the text itself to get at the true legislative intent. In *City of Victoria v. Bishop of Vancouver Island,* Lord Atkinson referred to context as an important factor in interpreting statutes:

[655] See P.-A. CÔTÉ, *op. cit.*, note 520, p. 307.

> In the construction of statutes their words must be interpreted in their ordinary grammatical sense, unless there is something in the context, or in the object of the statute in which they occur, or in the circumstances with reference to which they are issued, to show that they were used in a special sense different from their ordinary grammatical sense.[656]

In *Lusher v. Lacroix*,[657] in limiting the scope of section 9 to *l'essence même* of bills and notes, Justice Martineau, remarked:

> Pour arriver à déclarer qu'en vertu de ce texte toutes les questions pouvant se rattacher à un titre quelconque aux lettres de change et billets promissoires, on doit avoir recours à la loi commune anglaise, il faut supposer que le parlement fédéral tout en désirant résoudre toutes les difficultés qui soulèvent généralement ces contrats, a préféré s'en remettre simplement à la loi anglaise pour les régler plutôt que le faire lui-même...L'opinion que la loi commune anglaise s'applique seulement dans les limites de l'acte fédéral me paraît plus *rationnelle* [emphasis added].[658]

According to Justice Martineau, a rational legislature would not have intended section 10 (now section 9) to apply English common law to every aspect of bills and notes. In *La Banque d'Hochelaga v. Leger*,[659] the court pronounced that section 10:

> ne veut pas dire qu'il faut avoir recours à la loi anglaise pour décider la question de responsabilité du défendeur comme endorsseur, quelque soit à ce sujet les lois de cette province, mais que le droit anglais doit s'appliquer seulement à tout ce qui est de l'essence même des lettres de change et billets et des chèques....[660]

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[656] [1921] 2 A.C. 384, 387
[657] (1914), 23 R.L. (N.S.) 212 (C.S.)
[658] *Id.*, p. 214-215.
[659] (1918) 25 R.L. (N.S.) 158 (C. rev.)
[660] *Id.*, p. 160-161

In a similar spirit, Crawford suggests that "[i]t appears necessary to limit the operation of s. 10 to the law of bills, notes and cheques in the strict sense so that the section may not have the effect of making the common law of England applicable to all transactions or phases of transactions in which bills, notes or cheques are involved."[661] In *Reisler v. Kulcsar*,[662] Justice Rivard adopted Perrault's position (cited, *infra*) to establish that the civil code would govern the appellant's obligation. He stated:

> In the absence of a formal provision, it is more *logical* and more legally acceptable to conclude that Parliament wished its statute of 1890 to be amplified by the common law only where matters of form, characteristics and particulars relating to these three types of instruments are concerned leaving the common law of each Province to continue to govern other matters not covered by the Federal statute (emphasis added).[663]

In a Supreme Court of Canada decision, Justice Newcombe declared, "It is true that the rules of the common law of England, including the law merchant, apply to bills of exchange and promissory notes because the Parliament of Canada, has, by the *Bills of Exchange Act*, so declared in the existence of its exclusive legislative authority over that subject; but the Dominion legislation does not and was not intended to affect a subscriber's liability to implement his subscription, and as I understood the argument, no contention to the contrary was submitted."[664]

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[661] B. CRAWFORD, *op. cit.*, note 34, p. 1217.
[662] [1965] B.R. 334, 57 D.L.R. (2d) 730 (hereinafter cited to D.L.R.)
[663] *Id.*, 737. Rivard, J. translated the quote he excerpted from, A. PERRAULT, *op. cit*, note 155, p.173-174.
[664] *Re Ross, Hutchison* v. *Royal Institution for the Advancement of Learning*, supra, note 536, 699.

This jurisprudence has demonstrated that judges have refused a literal reading of section 9 in favour of what they believe to have been the true legislative intent. The majority of doctrinal writers have done the same. The Honourable Justice MacLaren, in describing section 10, stated:

> This section would not introduce into the province of Quebec any part of the common law of England to interfere with the civil law of that province in cognate matters within provincial jurisdiction that may arise in connection with bills, notes or cheques; nor would it interfere with the law of any province as to such matters.[665]

Similarly, Dean Falconbridge explains the scope of section 10 (now section 9) in a more detailed manner:

> The result would appear to be that, notwithstanding s. 10 of the *Bills of Exchange Act* which purports to make the common law of England applicable to bills, notes and cheques, in cases not expressly provided for by the statute itself, effect is given to this provision in Canada only within the limits of what may be called the law of bills and notes in the strict sense, including of course the form, issue, negotiation and discharge of bills or notes, but not including all the consequences of, or all the rights and liabilities resulting from, the contracts entered into by parties to bills or notes. Beyond these limits there is a field of law in which the rights and liabilities of parties to a bill or note transaction may be governed by the law of a particular province in accordance with the ordinary rules of the conflict of laws.[666]

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[665] John James MACLAREN, *MacLaren's bills, notes and cheques*, 6th ed., Frederick READ, ed., Toronto, Carswell, 1940, p.36. The key words in that statement is *would not introduce,* as opposed to could not. It is thus an interpretive approach, not a constitutional argument.

[666] John Delatre FALCONBRIDGE, *Banking and Bills of Exchange*, 7th ed., Toronto, Canada Law Book, 1969, p.435; B. CRAWFORD, *op. cit.*, note 34, p. 1220.

This passage (as it was found in previous editions of his Falconbridge's treatise) has been cited with approval in *Jean v. Banque Canadienne Nationale.*[667] In deciding that case, Justice Archambault maintained:

> L'article 10 de la loi des lettres de change, qui dit que les règles de la loi commune d'Angleterre s'appliquent aux lettres de change, aux billet à ordre et aux cheques, ne veut pas dire qu'il faut avoir recours à la loi anglaise pour décider toutes les questions de négociabilité, de libération, de novation, de compensation, de mandat...quelles que soient à ce sujet les loi provinciales, mais doit s'entendre dans ce sens que la loi commune anglaise doit s'appliquer dans les limites de la loi fédérale, c'est-à-dire, à tout ce qui est dans l'essence des lettres de change, des billets à ordre et des chèques.[668]

Likewise, Justice Barclay, in *Banque Canadienne Nationale v. Turcotte,*[669] in discussing section 10, maintained that "[i]t has been said, and I think rightly said, that the effect of this section is to introduce the common law of England into the different Provinces only when the question is, properly speaking, one of bills of exchange, cheques or promissory notes, but only within the limits of the law of bills and notes in a strict sense, and that the common law of England is not to be applied to all problems connected with bills of exchange or notes."[670] Perrault expresses a slightly different view than Dean Falconbridge. He stated:

> En l'absence d'une disposition formelle, il est plus logique et plus juridique de conclure que le parlement fédéral ne voulut compléter sa loi de 1890 par la Common Law que relativement à la

[667] (1930), 69 C.S. 66
[668] *Id.*, p. 69
[669] [1942] B.R. 383
[670] *Id.*, p. 401-402

> forme, aux caractéristiques et particularités de ces trois écrits, laissant le droit commun de chaque province continuer de régir les autres aspects non couverts par cette loi fédérale.[671]

According to Justice Barclay's treatise, the common law of England applies solely when the issue concerns, "forme, les caractéristiques ou les particularités des letters de change et billets"[672] which is to say, "les aspects qui donnent à ces titres un caractère particulier dans l'économie du droit."[673] Falconbridge believes Perrault to mean that:

> the question whether a document is a bill, cheque or note, or something else, is determined by the law of England, in the absence or incompleteness of provisions of the statute, but as regards the juridical basis on which an instrument of credit rests and the definition of the rights and obligations which the instrument connotes, including matters of capacity, consideration and prescription, recourse must be had to provincial law.[674]

According to Falconbridge, Perrault's definition of what is included in the law of bills and notes in a "strict sense" is narrow, and his tendencies are to apply provincial law in cases of even the slightest uncertainty.[675] Thus it can be said that Falconbridge and Perrault agree in principle in a broad sense, but do not espouse the same position.

The difference can be illustrated by examining their positions on the defence of *non est factum*, as they disagree over its effect in Quebec.[676] In this case, Falconbridge views *non est factum* as a real defence, part of bills and notes in a strict sense, subject

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[671] A. PERRAULT, *op. cit.*, note 155, p. 174.
[672] *Id.*, p. 171.
[673] *Id.*, p. 180.
[674] John Delatre FALCONBRIDGE, «The Bills of Exchange Act in Quebec», (1942) 20 *Can. Bar Rev.* 723, 729. See also, A. PERRAULT, *op. cit.*, note 155, p. 174-175.
[675] J. D. FALCONBRIDGE, *loc. cit.*, note 666, 729-730.
[676] See B. CRAWFORD, *op. cit.*, note 34, p. 1525.

therefore to the common law of England as provided for in section 9 of the Act. Perrault, however, maintains that *non est factum* is basically an error as to the nature of the contract (a relative nullity in Quebec) and consequently no more than a defect of title pursuant to the Act.[677]

Drawing the line between what is a matter of a bill or note in a strict sense or wide sense is not always easy.[678] In any case, we must keep in mind the following:

> [I]n construing...statutes, and all written instruments, the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified, so as to avoid that absurdity and inconsistency, but no farther.[679]

These words uttered by Lord Wensleydale in *Grey v. Pearson* became the "Golden Rule" of interpretation. The "Golden Rule" essentially permits judges to depart from the ordinary meaning of a word to preserve the coherence of the provision or law and prevent absurdity. What emerges is that the incoherence of the provision forces an alternative understanding of the words or expression employed. It is difficult to argue that the wording of section 9 is in some way repugnant or inconsistent with the rest of the *Bills of Exchange Act*, or indeed suggests anything other than the true legislative intent.[680] As LeDain suggests, "there is nothing on the face of section 10 to justify any restriction or qualification...."[681]

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[677] For a full discussion, see G.E. LEDAIN, *loc. cit.*, note 507, 120-125.
[678] See B. CRAWFORD, *op. cit.*, note 34, p. 1220; G.E. LEDAIN, *loc. cit.*, note 507, p. 120.
[679] *Grey* v. *Pearson*, (1857) 6 H.L.C. 61,106; 10 E.R. 1216, 1234.
[680] P.-A. CÔTÉ, *op. cit.*, note 520, p. 308.
[681] G.E. LEDAIN, *loc. cit.*, note 507, p.118

### 4.2.3 Historical Approach

Professor Pierre-André Coté, in describing the historical approach to interpretation, explains, "[i]n order to interpret a legislative enactment, it is permissible and even advisable to consider the historical context in which the law was adopted."[682] This approach shares certain similarities with the "archaeological" approach, in which it is said the role of judges is to unearth and enforce the original intent or expectations of the legislature that created the statute.[683] The historical approach was accepted by the Supreme Court of Canada. Nesbitt stated:

> The general rule which is applicable to the construction of all other documents is equally applicable to statutes and the interpreter should so far put himself in the position of those whose words he is interpreting as to be able to see what those words related to. He may call to his aid all those external or historical facts which are necessary for this purpose and which led to the enactment and for those he may consult contemporary or other authentic words and writings.[684]

Considering the historical context of the evolution of commercial law in Canada, and its effect on provincial law, some judges have deemed it necessary that we refer exclusively to the common law when interpreting the *Bills of Exchange Act*, especially in

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[682] P.-A. CÔTÉ, *op. cit.*, note 520, p. 414.
[683] See William ESKRIDGE, «Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation», 74 Va. L. Rev. 275, 275. Professor Eskridge attributes the archeological metaphor to Professor T. Alexander Aleinikoff.
[684] *Canadian Pacific Railway Co.* v. *James Bay Railway*, (1905) 36 R.C.S. 42, 89-90.

light of section 9. As Justice Demers stated in *Coté v. Brunelle*,[685] "La jurisprudence en Angleterre n'est donc pas douteuse et notre loi étant basée sur la loi anglaise, nous devons suivre la jurisprudence anglaise."[686] There is clearly a common law tenor to the *Bills of Exchange Act*, being as it was, of English inspiration.[687] It was paradigmatic of legislation described by Brierley and Macdonald, when they stated, "...legislation enacted in the simple exercise of federal jurisdiction was often grounded in Common law theoretical assumptions, drafted in a manner of a Common law statute, and subsequently interpreted in accordance with those assumptions."[688] There have been judges and authors that have felt that due to its historical development, the legislative intent of section 9 (or section 10, as it was) was to apply common law to matters pertaining to bills of exchange, in part to harmonize this area of law across the country and, consequently, that common law should apply.[689]

An expression of this can be discerned in *Guy v. Paré*, [690] wherein Justice Davidson rendered an important decision, albeit in dissent. He stated:

> The rules of the common law of England, including the Law Merchant, save in so far as they are inconsistent with the express provisions of the said Act, as hereby amended, shall apply, and shall be taken and held to have applied from the date on which the said Act came into force, to bills of exchange, promissory notes and cheques [54-55 Vic., chap 17, s. 8]. This I believe, to be simply a re-expression of the intent of 12 Vict., the Consolidated Statutes of Quebec, and in a more emphatic sense of the Civil Code. It was the intention of the legislators to have a common system

[685] (1916) 51 C.S. 35.
[686] *Id.*, p. 37
[687] J. LECLAIR, *loc. cit.*, note 32, p. 703.
[688] John E.C. BRIERLY and Roderick Alexander MACDONALD, *Quebec Civil Law: An Introduction to Quebec Private Law*, Toronto, Emond Montgomery, 1993, p. 646. See also R. JUKIER and R.A. MACDONALD, *loc. cit.*, note 206, p. 396.
[689] J.D. FALCONBRIDGE, *op. cit.*, note 537, p. 425.
[690] (1892) 1 C.S. 443 (C. rev.)

run throughout these provinces in relation to negotiable instruments which were being incessantly interchanged between them.[691]

What Justice Davidson did is fairly "common practice." We may "...refer to the text that an enactment has replaced, repealed or amended, or to the statute that served as its inspiration, and in this way study what might be called its legal pedigree. This approach is legitimate to the extent that the prior legislation is part of the context of enactment, and therefore makes its true meaning more accessible."[692]

If this "unity of legislative purpose" is the animating spirit of the Act, then it is clear that section 10 (now section 9) would import common law to *all* matters concerning bills and notes in Quebec. The examination of previous enactments is consistent with the historical approach, which can help demonstrate legislative intention.[693] We find this idea expressed in *Entreprises Loyola Schmidt Ltée. v. Cholette*[694] as well. Justice Paré was unambiguous in discussing the difficulties raised by two linguistic versions of the Act with respect to section 179. He rationalized that the English (common law) version of the Act should take precedence, because, "D'autre part, sans même qu'il soit nécessaire de se servir de cet article 10, l'historique de la Loi sur les lettres de change indique de toute évidence, par les sources dont elle s'inspire, les bases pertinentes à la définition de ses termes."[695] If the other provisions of the Act are permeated with the legislation's common law history, it is clear that section 10 (now section 9) can mean nothing else than common law was intended to apply to *all* matters of bills and notes.

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[691] *Id.*, p. 451. 54-55 Vic., chap. 17, s. 8, was the precursor of s. 10, and the current s. 9 of the Bills of Exchange Act.
[692] P.-A. CÔTÉ, *op. cit.*, note 520, p. 419.
[693] See the decision of Pigeon, J. in *Gravel* v. *City of St-Léonard*, [1978] 1 R.C.S. 660, 667.
[694] *Entreprises Loyola Schmidt* v. *Cholette*, supra, note 529.
[695] *Id.*, p. 560-561.

In brief, the historical approach exposes its "purposivist" foundation, in that it reveals that the purpose of legislation was to synchronize the law of all the provinces with respect to bills and notes, and thus common law should be applied in all situations. Jean Leclair suggests a different argument based on section 97(2) of the English *Bills of Exchange Act* (1882), the English statute that served as the model for the Canadian *Bills of Exchange Act*. In fact, as we have mentioned, the Canadian version is virtually a replica of its English predecessor. Leclair's approach is in line with the historical approach which permits us to look "to the statute that served as its inspiration" to determine its true meaning. The provision reads:

> 97(2) The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the specific provisions of this Act, shall continue to apply to bills of exchange, promissory notes and cheques.

Leclair finds it curious that the English *Bills of Exchange Act* (1882) would have stated that the common law "shall continue to apply" to matters of bills and notes. Indeed, England is a unitary state with Common law as the *jus commune*. Legislation is generally viewed as an exception to the common law, and thus it is evident common law would have continued to apply even without the express mention in section 97(2). Leclair suggests, therefore, that the English *Bills of Exchange Act* (1882) did not seek to codify the entire common law susceptible of applying to bills and notes, but only the branch of law that constitutes bills of exchange.

He thus explains:

> L'expression «shall continue to apply» faisait, de toute évidence, référence à ce droit antérieur à la codification. Quant aux termes «save in so far as they are inconsistent with the express provisions of this Act,» ils témoignent de la nature toute spéciale de la *common law* visée par le législateur. Puisque la loi en question codifie uniquement cette portion particulière de la *common law* constituée par le droit des effets de commerce, ce ne peut être, selon nous, qu'à ces règles que font référence les mots précités. En analysant la jurisprudence, nous verrons que le paragraphe 97(2) autorise le renvoi aux règles de common law relatives au droit des effets de commerce au sens strict.... Selon nous, il devrait en aller de même de l'article 9 de la *Loi sur les lettres de change.*[696]

Leclair suggests that looking to section 97(2) of the English *Bills of Exchange Act* (1882) helps us understand that section 9 was never intended to apply to anything other than bills and notes in a strict sense. On the other hand, although Canadian parliament adopted a virtual replica of the *British Act*, it may have had a different legislative intent in enacting the legislation. This proposition gains greater weight when we consider the fact that section 10 (now section 9) was *omitted* from the *Canadian Bills of Exchange Act* of 1890 and restored by the amending statute in 1891.[697] Furthermore, legislation by reference, such as section 9, is problematic because "[s]uch provisions may be partially incompatible with those of the statute containing the reference. They may require adaptation in order to apply appropriately to the new context. If the legislator does not provide for modifications as circumstances dictate, the courts may refuse to undertake such changes and, therefore, deny implementation of the incorporated enactments."[698]

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[696] J. LECLAIR, *loc. cit.*, note 32, p. 745.
[697] See J.D. FALCONBRIDGE, *op. cit.*, note 537, p. 427.
[698] P.-A. CÔTÉ, *op. cit.*, note 520, p. 75-76

Leclair's suggestion is interesting but if the intent of the English *Bills of Exchange Act* (1882) was to preserve only the portion of common law relating to negotiable instruments, it would have made more sense for section 97(2) to read: "In all matters relating to bills of exchange, promissory notes and cheques not provided for in this Act, recourse must be had to the rules of the common law of England, including the law merchant." In fact, this would be similar to article 2340 of the Civil Code of Lower Canada respecting bills of exchange, which is also a codification that provides for any lacunae that might occur. In fact, the wording of the provision is curious because it is effectively saying that common law will govern bills, notes and cheques; it will not apply only if there is an express provision in the Act that it is inconsistent with. Thus, on this reading, one may well conclude that section 9 aims to preserve the law of bills and notes in a wide sense. Moreover, recall that Justice Locke pointed out that "The Act, while intended as a code, did not exhaustively deal with all of the rights given to persons desiring to contract in this manner or to the holders of these instruments under that branch of the common law referred to as the law merchant. These rights were reserved by s. 97(2) and are reserved to the holders of such instruments by s. 10."[699]

[699] *Duplain* v. *Cameron*, [1961] R.C.S. 693 at 707, 30 D.L.R. (2nd) 348, Locke, J. dissenting.

### 4.2.4 Constitutional Approach

The constitutional approach is not really an independent method of interpretation, but rather a part of the systematic and logical method. Whereas the contextual approach sought to determine parliament's true intention (what parliament *wished* to do by enacting section 9), the constitutional approach seeks to determine what parliament *can* do, that is, the true scope of its constitutional power to legislate on bills and notes. It is these constitutional constraints imposed by the division of power among legislative bodies, federal and provincial, that shape the interpretation given to section 9, rather than parliament's intention.

However, unlike other forms of external evidence of legislative intent, constitutional considerations are sufficient to justify a departure from the plain meaning even for some textualists. Justice Lamer affirmed a "plain meaning" approach to statutory interpretation, but went on to say that:

> The presumption that a statute's literal meaning, as construed in the context of the statute as a whole, best reflects legislative intention is valid in ordinary circumstances. However, the presumption is not irrebuttable. In cases where special circumstances exist, these circumstances can lead a court to conclude that a statutory provision's apparent literal meaning does not, in fact, provide an accurate reflection of the legislature's intentions, and that an alternative understanding of the words in the statute would be more appropriate, provided that the words of the statute reasonably bear such an alternative interpretation. One situation where such special circumstances

can occur is in cases where a statutory provision would be unconstitutional if it were to be interpreted literally. In such cases, the presumption that the legislature intended that effect to be given to the plain meaning of its enactments can be countered by the competing presumption that the legislature ordinarily does not intend to violate the constitution. If the words in the statutory provision at issue reasonably bear an interpretation other than a literal reading, this second presumption will justify rejecting the literal interpretation in favour of the non-literal reading, when the former (but not the latter) interpretation would render the legislation unconstitutional.[700]

According to G. V. V. Nicholls, the proper interpretation of section 10 (now section 9) is, in the final analysis, a constitutional question. He stated:

In Canada, in Quebec, section 10 of the *Bills of Exchange Act* cannot be taken too literally. It cannot accurately be said that the rules of the common law of England always "apply" to all situations in which bills of exchange are involved, except to the extent that they are inconsistent with the express provisions of the Act. To begin with, the section in that broad sense is almost certainly *ultra vires* the Dominion. It is true that by section 91-18 of the British North America Act the Dominion has exclusive authority to legislate on bills of exchange and promissory notes. And it is also true that the Dominion might by legislation that was ancillary to, or necessarily incidental to its right to legislate on bills of exchange and promissory notes interfere with the right granted to the provinces by section 92-13 of the British North America Act to make laws in relation to property and civil rights in the provinces. But to grant the Dominion that power is far from saying that it has the right to provide that the rules of the common law of England shall apply in Quebec, for instance, to all situations in which a bill of exchange is involved, however remotely.[701]

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[700] Per Lamer, C.J. in *Ontario* v. *Canadian Pacific Ltd.* [1995] 2 S.C.R. 1031, 1050-1051
[701] G. V.V. NICHOLLS, *loc. cit.*, note 266, p. 396, 397-398.

In a subsequent article, Nicholls explained:

> The possible conflict between the exclusive authority of the Dominion granted by section 91 (18) of the British North America Act, to legislate on bills of exchange and promissory notes, and the right of the provinces under section 92(13) to make laws in relation to property and civil rights in the provinces, has led the jurisprudence to a distinction. It is said that the effect of section 10 is to introduce the common law of England into the different provinces only where the question is properly speaking one of bills of exchange, cheques or promissory notes, only within the law of bills and notes in a strict sense.[702]

At first glance, Nicholls could be said to be advancing an interpretive approach, similar to Falconbridge's own position, and this appears to be Perrault's view of what Nicholls has done.[703] Falconbridge, however, is keen to point out that in fact Nicholls does not subscribe to this distinction as set out in the jurisprudence, but rather is summarizing it.[704] In support, he quotes the passage in Nicholls' article that follows the above-mentioned statement. Nicholls continued, "It is suggested that this distinction, correct perhaps so far as it goes, is not particularly helpful and may actually be misleading."[705] Thus, Nicholls could not be said to adopt the position attributed to him. Nevertheless, although it is not Nicholls own position, it is not without support. A number of writers have adopted the distinction proposed by Falconbridge, namely, that the common law of England, by virtue of section 9, applies only to matters of bills and

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[702] George V.V. NICHOLLS, «The Bills of Exchange Act and Novation in the Province of Quebec», (1938) 16 *Can. Bar Rev.* 602, 603
[703] See A. PERRAULT, *op. cit.*, note 155, p. 177.
[704] J. D. FALCONBRIDGE, *loc. cit.*, note 537, p. 728.
[705] G.V.V. NICHOLLS, *loc. cit.*, note 702, p. 603

notes in a strict sense. However, these writers consider the impact of the *Constitution Act*, 1867 in limiting the scope of section 9.

Professor Geva, for example, maintains that the expression "matters coming within bills and notes" is broad enough to cover the entire law of bills and notes, in its wide as well as strict sense. On the other hand, because the dual nature of bills and notes means that it may be subject to the general law of property and obligations, he finds that provincial law could apply, but is defeated by federal paramountcy. That is, provincial law respecting bills and notes in a wide sense, is clearly *valid*, being *intra vires* the powers of the provinces by virtue of section 92(13). However, provincial laws are rendered *inoperative* on the basis of federal paramountcy, by virtue of section 10 (now section 9), which creates a conflicting federal law.[706] However, because Geva adheres to Falconbridge's position that section 9 is limited to bills and notes in a strict sense, the common law is only paramount over provincial law in matters of bills and notes in a strict sense.[707]

Authors in Quebec have espoused a similar view. With respect to the idea that section 9 (section 10, as it was then) is limited to bills and notes in a strict sense, Maximillien Caron states:

> Si une telle interpretation doit prévaloir, c'est qu'elle est plus ou moins inseparable du problème d'ordre constitutionnel. On doit présumer, en effet, que le Parlement fédéral, en adoptant l'article 10, a voulu se limiter aux seules questions qui se rattachent essentiellement au droit des lettres de change.[708]

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[706] See Benjamin GEVA, «Preservation of Consumer Defences: Statutes and Jurisdiction», (1982) 32 *U.T.L.J.* 176, 200 and B. GEVA, *op. cit.*, note 153, p. 256.
[707] See J. D. FALCONBRIDGE, *op. cit.*, note 537, p. 456-467.
[708] See also M. CARON, *op. cit.*, note 155, p. 15

This perspective can be discerned in the judgement of Mercier in *Boyer v. Sambeau.*[709] He stated:

> ...quand on considère que la question qui se soulève en cette affaire se présente dans une cause qui relève d'une loi édictée par le parlement fédéral, comportant des dispositions spéciales quant à tout ce qui peut concerner, la solution en est moins facile, en égard au conflit existant, «au point de vue de la loi de la preuve», entre une loi provinciale générale et une loi fédérale spéciale se rapportant à un sujet sur lequel, en vertu de l'acte de l'Amérique britannique de Nord de 1867 et ses amendments, le parlement fédéral a une jurisdiction exclusive de celle des législatures provinciales.... Considérant que l'art. 10, ch. 119 S. rev. [1906], constituant la «loi des lettres de change, chèques et billets à ordre»...élimine conséquement l'application de notre droit civil en pareille matière, pour y substituer l'application du droit commun d'Angleterre et du droit commercial anglais, et ce sans distinguer, aussi bien au point de vue des lois de la preuve qu'à tout autre point de vue.[710]

Falconbridge's view has been subject to a different interpretation by Gertrude Wasserman. She claimed the distinction drawn by Falconbridge between bills and notes in a strict sense and wide sense is one based on the difference between substance and procedure. According to her:

> Section 10 makes no reference to procedure. In the matter of civil (as distinguished from criminal) law, procedure is assigned exclusively to the provinces under head 14 of section 92 of the *British North America Act.* It follows logically that section 10 of the *Bills of Exchange Act* has reference

[709] (1919) 57 C.S. 79
[710] *Id.*, p. 81-82

only to the form and negotiability of a commercial instrument, such as a cheque or promissory note. This is in substance the view of Falconbridge."[711]

Putting aside the question of whether this view can truly be imputed to Falconbridge, Wasserman's proposal is problematic for a number of reasons. Firstly, determining what is a procedural matter and what is substantive is not an easy task. There are problems inherent in distinguishing procedure from substance. It has been suggested that the line between "substance" and "procedure" does not exist in a vacuum, but rather must be drawn to better carry out the underlying purpose of making the distinction.[712] The "substance-procedure" dichotomy is a function of the purpose of the context in which the characterization is made. Thus, any given rule or law may be "procedural" in one context yet "substantive" in another.[713] On this issue, the Supreme Court of Canada[714] has cited Walter Wheeler Cook, who commented, "[i]f we admit that the 'substantive' shades off by imperceptible degrees into the 'procedural', and that the 'line' between them does not 'exist', to be discovered merely by logic and analysis, but is rather to be drawn so as best to carry out our purpose...."[715]

Moreover, it is not clear if what Wasserman had in mind as "procedural" would be characterized as such today. In *Tolofson v. Jensen; Lucas (Litigation Guardian of) v. Gagnon*,[716] the Supreme Court of Canada decided that limitation periods ought to be characterized as substantive law, despite the fact that the common law has always

[711] Gertrude WASSERMAN, «The Bills of Exchange Act: its application in the Province of Quebec», (1967) 27 *R. du B.* 653, 661.
[712] See Walter Wheeler COOK, « "Substance" and "Procedure" in the Conflict of Laws», (1933) 42 Yale L.J. 333., 343, 352, 356
[713] See *Sun Oil v. Wortman*, (1988) 486 U.S. 717 at 727
[714] *Tolofson* v. *Jensen; Lucas (Litigation Guardian of)* v. *Gagnon* [1994] 3 S.C.R. 1022, 1068.
[715] The excerpt was from Cook's book, *The Logical and Legal Bases of the Conflict of Laws,* (Cambridge, Mass.: Harvard University Press, 1942), p. 166
[716] [1994] 3 S.C.R. 1022

considered limitation periods as procedural rules. There is no reason to believe that this type of re-characterization is limited to limitation periods, or to matters of private international law.[717]

In any case, the above-mentioned approaches were questioned by Gerald LeDain, in an article written before he joined the Supreme Court of Canada:

> Technically, the question is one of statutory interpretation, but in searching for that will-o-the-wisp "the intention of the legislature" and making what is in the final analysis a decision of policy, one is naturally influenced by the current distinctions of constitutional law. Did Parliament in enacting section 10 intend to cover only those matters not covered by express provision in the Act which fall within its exclusive legislative jurisdiction or did it intend as well to occupy the occupiable field? As far as this reviewer is aware, the courts have not formulated any rule of interpretation to deal with this problem. There is presumably no reason in principle why the occupiable field should not be occupied in wholesale fashion – and there is nothing on the face of section 10 to justify any restriction or qualification – but as a matter of policy.[718]

LeDain understood that the Constitution alone cannot resolve the issue of the scope of section 10 (now section 9). The constitutional division of powers would permit the federal government to legislate in the occupiable field; if section 9 is to bear a restricted application, it is not compelled by the constitution. Nothing in the *Bills of Exchange Act* or the constitution purports to limit the applicability of section 9 to matters

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[717] With respect to determining issues of legislative competence, with matters of bills and notes for example, there is the possibility of the re-characterization of what was traditionally conceived of as substantive and procedural. Recall, that the U.S. Supreme Court stated that the purpose of the substance/procedure dichotomy in the context of the Full Faith and Credit Clause, was to delimit spheres of state legislative competence. See *Sun Oil* v. *Wortman*, (1988) 486 U.S. 717 at 727.

[718] G.E. LEDAIN, *loc. cit.*, note 507, 118.

of bills and notes in a strict sense. Bohémier and Richard agree with LeDain. According to them:

> ...la véritable question n'est pas d'ordre constitutionnel mais qu'elle en est plutôt une d'interprétation. On ne peut, nous semble-t-il, douter réellement du pouvoir du parlement fédéral de légiférer sur l'étendue des obligations des personnes qui participent à la creation et à la circulation des effets de commerce. Cela paraît peu discutable.[719]

In other words, from a constitutional perspective, as long as the dominant feature (the "pith and substance" of the federal legislation in question), falls within the enumerated heads of power in section 91 of the *Constitution Act*, 1867, the fact that it has an incidental effect on the legislative sphere of provincial governments is irrelevant for constitutional purposes. Thus, for example in *Bank of Toronto v. Lambe* (1887),[720] the Privy Council upheld a provincial law imposing tax on banks, as validly enacted legislation under section 92(2) even though it affected banking, which falls within federal jurisdiction under section 91(15).[721] Apparently, the government can create whatever rules it wishes to " apply to bills, notes and cheques" even though it will affect the provincial domain of "property and civil rights" in section 92(13). As Professor Hogg points out, "[i]t is important to recognize that this "pith and substance" doctrine enables one level of government to enact laws with *substantial* impact on matters outside its jurisdiction" [emphasis added].[722] Indeed, Geva admits that it is unlikely the Constitution

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[719] A. BOHÉMIER and L.-H. RICHARD, *loc. cit.*, note 538, 160.
[720] (1887) 12 App. Cas. 575
[721] See Peter HOGG, *Constitutional Law of Canada*, Toronto, Carswell, 1997, n° 15.5(a), p. 360.
[722] *Id.*

Act of 1867 (BNA Act) purported to deprive the Parliament of Canada of the power to legislate in relation to the property and the obligatory elements of the instrument."[723]

The sole constitutional limitation is that the law must be enacted within competence of the enacting legislature. Thus, Nicholls is correct in asserting that granting the federal government the power to legislate in matters of bills and notes does not mean "it has the right to provide that the rules of the common law of England shall apply in Quebec, for instance, to all situations in which a bill of exchange is involved, however remotely."[724] Indeed, if the legislation is characterized as being in relation to something outside the federal government's legislative domain, it will be found as *ultra vires*.

However, the law of bills and notes in a wide sense is not necessarily "remote." There is nothing to suggest that what is part of bills and notes in a wide sense (such as prescription or procedure) cannot fall within federal legislative competence over bills of exchange and promissory notes. It appears that this is what LeDain means when he refers to the legislator "occupying the occupiable field."[725] The strict/wide dichotomy corresponds to the dual nature of bills and notes (*strict* corresponding to the negotiable instrument aspect, *wide* referring to the contractual and property aspects), not what is essential in its operation. That which is part of bills and notes in a wide sense is no less an "integral element" of bills of exchange and promissory notes than those in a strict sense, it simply relates to a different aspect of the bill or note.

In summary, laws relating to bills and notes that are too remote and will not fall within the power of section 91(18) granted to the federal Parliament 91(18), that is, they

[723] B. GEVA, *loc. cit.*, note 706, p. 198
[724] G.V.V. NICHOLLS, *loc. cit.*, note 260, p. 397-398
[725] G.E. LEDAIN, *loc. cit.*, note 507, p. 118.

will fall outside the occupiable field. As a result, such legislation will be unconstitutional. However, it is not unconstitutional simply because it infringes on the provinces' legislative domain. Thus, a provision regarding liability of the parties, prescription, procedure, and evidence, would appear to be *intra vires* parliament. The question becomes, therefore, how do we know what falls within the occupiable field? Nicholls stated:

> ...[n]o *a priori* rule can be given for the proper interpretation of section 10 of the *Bills of Exchange Act.* All that can be done is to examine the civil law in its possible applications to bills of exchange, cheques and promissory notes, to weigh the propriety of applying the civil law or the common law in each instance, and to evolve from that examination a series of particularized rules-of-thumb to cover the most common situations that might arise.[726]

LeDain called this the "safest statement" ever made about section 10.[727] Like Nicholls, LeDain eschews a universal test. At the end of the day, when a question arises regarding whether an aspect of bills and notes is governed by the common law by virtue of section 10, we must undertake a constitutional analysis to characterize the law in question. "What are the criteria of importance that will control or at least guide this crucial choice? ...in the hardest cases the choice is not compelled by either the nature of the statute or the prior judicial decisions. The choice is inevitably one of policy."[728] It would seem that Professor LeDain best described the constitutional approach to bills and notes as essentially one of policy:

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[726] G.V.V. NICHOLLS, *loc. cit.*, note 702, p. 603.
[727] G.E. LEDAIN, *loc. cit.*, note 507, p. 120.
[728] P. HOGG, *op. cit.*, note 721, n° 15.5(g), p. 372.

> ...there is nothing on the face of section 10 to justify any restriction or qualification – but as matter of *policy*, in view of the obvious impropriety of introducing a whole body of English common law in this way into a provincial legal system, particularly the civil law system of Quebec, without a careful consideration of the detailed implications, it is probably reasonable to hold as most of the cases and commentators have in effect done, that this cannot be presumed to have been the intention of Parliament. This interpretation is not open variance with the language of section 10; it merely gives it a restricted application. Parliament may have in fact thought that it was providing a uniform system of law to cover every aspect of bills and notes but there are practical limits to the extent to which this can be carried out in a bi-legal country. *So long as we frankly acknowledge that this is ultimately a decision of policy and do not try to dress it up in a pseudo-legal proposition, we avoid argument at cross-purposes*. [emphasis added][729]

According to Hogg, the policy choice must be guided by the principle of federalism.[730] Simeon has suggested community, efficiency and democracy as the criteria of choice in a federal system[731] but although they are the subject of much disagreement and controversy. In a later article, LeDain discussed some important criteria:

> It is sufficient here to stress the continuing importance in Canada, under any foreseeable circumstances of constitutional or political accommodation, of comparative legal method at the judicial as well as the legislative level, in the interests of a workable jurisprudence adapted to economic realities in the field of commercial law. The necessity of achieving a working relationship and indeed as large a measure of uniformity of result as possible, between the civil law and common law in the commercial field is not a problem peculiar to Canada.... In this larger

[729] G.E. LEDAIN, *loc. cit.*, note 507, p. 118-19
[730] P. HOGG, *op. cit.*, note 721, n° 15.5(g), p. 372
[731] See Richard E.B. SIMEON, «Criteria of Choice in Federal Systems», (1983) 8 *Queen's L.J.* 131.

context, Quebec has an important stake in the maintenance and development of a legal system that is as commercially serviceable as any other.[732]

Hogg suggests that "[t]his distinction must be drawn in the light of the operational realities of legislative regulation in a particular field, and these are most likely to be perceived by judges familiar, through daily experience, with the effects of legislation and the practical issues which arise in the various areas of law."[733] This distinction must be based on what would be a "sound result" in the particular field of federal law, having regard to the commercial expediency of as much uniformity of result as possible.[734]

Because the constitution permits that the federal competence in matters of bills of exchange may extend to rules, which ordinarily fall within the provincial legislative domain (such as the rules on prescription, capacity, etc.), we are left evaluating the propriety of giving an extended scope to section 9, issue by issue. In brief, the constitution offers no indication as to how far the federal government intends its legislation to extend into and to affect the provincial government's sphere of legislative power. The Constitution cannot tell us which aspects of a bill or note are governed by federal legislation (i.e., the BEA) and which aspects remain in the provincial domain (i.e., the common law of Canada and the Quebec Civil Code). This is left for jurists to determine on the basis of policy considerations.

Professor Leclair has most recently made a statement on the constitutional issue. He seeks to re-establish a firm constitutional basis for interpreting section 9. He wants to show that the approach taken by many eminent jurists and judges is "juste et raisonnable"

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[732] Gerald Eric LEDAIN, «Concerning the Proposed Constitutional and Civil Law Specialization at the Supreme Court Level», (1967) 2 *R.J.T.* 107, 115

[733] *Id.*, p.110

[734] *Id.*

from a constitutional perspective,[735] and reassert "un fondement constitutionnel à l'interprétation restrictive donnée jusqu'ici par les tribunaux à l'article 9 de la *Loi sur les lettres de change*."[736] After examining the current state of the law, the various problems that exist, and the interpretive approaches adopted until now, Leclair turns his attention the constitutional matter. He aims to demonstrate that the provincial law regarding prescription of negotiable instruments is constitutional. In his words, "[t]outefois, nous verrons maintenant que rien n'empêche l'application des délais de prescription provinciaux d'application générale, et ce, parce que la prescription ne fait pas partie du «droit des lettres de change au sens strict."[737]

It is unclear why Leclair devotes considerable emphasis to demonstrating provincial law could apply to bills of exchange and promissory notes. It seems to be uncontested. He attributes to LeDain the view that provincial law on prescription of negotiable instruments is unconstitutional because it falls within exclusive federal jurisdiction under section 91(18).[738] However, it is unclear upon what basis he makes this assertion. After all, LeDain clearly states:

> It appears reasonable to take the view that the exclusive federal jurisdiction over bills and notes covers the law of bills and notes in a strict sense...If any matters affecting bills and notes fall to be regulated by provincial law it is clearly not in virtue of section 10, which in its terms, far from mentioning provincial law, makes a sweeping reference to the English common law, but because

[735] See J. LECLAIR, *loc. cit.*, note 32, p. 710.
[736] *Id*, p. 711.
[737] *Id*, p. 724.
[738] Id, p.711 and 737.

*provincial law on these matters is valid* in virtue of section 92 of the BNA Act [emphasis added].[739]

These provincial provisions may be rendered *inoperative*, on the basis of federal paramountcy, but that is hardly saying they are unconstitutional. In any case, according to Leclair, the problem as to the scope of section 9 depends on the constitutional limits on the power of one legislature to encroach on the domain of the other legislature, by exercising its accessory power (which permits an incidental effect on the legislative sphere of the other legislature).[740] After all, LeDain believes this ability to intrude on the legislative sphere helps define the occupiable field.

This issue is based on the case of *General Motors of Canada Ltd. v. City National Leasing*[741] where the question of encroachment was a central issue. The court set out that once a provision is shown *prima facie* to intrude on provincial powers, the question becomes to what extent does it intrude? The degree of intrusion is necessary to determine its possible justification.[742] In determining whether a provision can be justified constitutionally by reason of its connection to valid legislation, Justice Dickson stated that we must first determine what test of "fit" is appropriate. By this he meant "how well the provision is integrated into the scheme and how important it is for the efficacy of the legislation."[743] Justice Dickson, listed a number of tests cited in the jurisprudence,[744] but concluded that the test of encroachment varies with the serious of the encroachment. Thus for example, "[f]or minor encroachments, the rational connection test is appropriate.

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[739] G.E. LEDAIN, *loc. cit.*, note 507, p. 118
[740] See J. LECLAIR, *loc. cit.*, note 32, p. 737.
[741] [1989] 1 R.C.S. 641, 58 D.L.R. (4th) 255 [hereinafter cited to S.C.R.]
[742] See *General Motors of Canada Ltd.* v. *City National Leasing,* [1989] 1 S.C.R. 641, 667.
[743] *Id.*, p. 668
[744] *Id.*, p. 670-671

For major encroachments, a stricter test (such as 'truly necessary' or 'essential') is appropriate."[745]

In assessing the seriousness of the encroachment, Justice Dickson lists three criteria that should be considered in this case, namely; (1) the provision in question was remedial, which by its nature is less intrusive, (2) the provision provided for a limited scope of action; its application limited to the Act and (3) the federal government was not precluded from creating rights of action where warranted.[746] He found that the provision in question intruded in a limited manner, and thus a strict test, such as "truly necessary" or "integral," was not appropriate.[747]

On the basis of the principles established by this case, Leclair examines the scope of section 9. He questions whether an intrusion as important as the one effected in section 9 is constitutionally valid. Firstly, he acknowledges that the power of parliament to intrude on the provincial domain is great. It seems to him that section 9 could support a generous interpretation, but that it lacks the clarity and precision required to justify a large intrusion into the provincial domain.[748] However, Leclair concludes that the arguments he makes are not conclusive as to whether the restricted meaning given to section 9 is the correct one. This, he determined, depends on the motives a person ascribes to parliament. According to him, "[c]es motifs nous amènent à penser que l'adoption de cette disposition de renvoi ne représente pas l'exercice par le Parlement

[745] P. HOGG, *op. cit.*, note 721, n° 15.9(c), p. 392.
[746] See *General Motors of Canada Ltd.* v. *City National Leasing*, supra, note 711, p. 672-673.
[747] *Id.*, p. 683.
[748] See *loc. cit.*, note 32, p. 742.

fédéral d'un pouvoir accessoire qui avait pour objet de régir la presque totalité des facettes contractuelles d'un effet de commerce."[749]

Despite the constitutional arguments and the supporting line of reasoning, Leclair effectively suggests it comes down to a matter of interpreting legislative intent. It seems that where Leclair and LeDain differ is on the following point. For LeDain, the focus is purely one of statutory interpretation. In his view, the constitution neither aids nor hinders the quest to determine legislative intent. Leclair on the other hand, focuses on the fact that section 9 entails an encroachment into the provincial legislative sphere. Accordingly, policy alone would not justify occupying the occupiable field; rather, we must utilize the criteria set out in the jurisprudence to determine the extent of the encroachment. As this inquiry essentially involves interpreting the constitution, the interpretation of the scope of section 9 takes on a constitutional dimension.

It should be pointed out that despite the validity of Leclair's argument, there are issues of concern which should be noted. Firstly, the General Motors decision, upon which Leclair bases his reasoning, has been the subject of a serious critique. In the words of Professor Hogg:

> The *General Motors of Canada Ltd. v. City National Leasing* judgement is a valiant attempt to give coherence to the inconsistent approaches of the Court. With respect, however, it is not satisfactory. *If a provision is a rational, functional part of a federal legislative scheme, why should it be regarded as 'encroaching' or 'intruding' on provincial powers?* Indeed, it may be doubted whether the provincial Legislatures would have been competent to enact the civil remedy provision that was under attack, since its purpose was to improve the enforcement of a federal law. *The idea of encroachment or intrusion, however appealing in common sense, does not stand up to*

[749] J. LECLAIR, *loc. cit.*, note 32, p. 743.

> *analysis*. If I am wrong on this, there still remain serious difficulties. How is the encroachment or intrusion, once found to be measured? And, once measured, how is the unique test for validity to be formulated for that particular encroachment or intrusion? In my view, the *General Motors* approach makes the answer to a simple question too complicated, too discretionary, and therefore too unpredictable [emphasis added].[750]

Caution must be exercised in classifying provisions as encroaching on the provincial legislative domain. In other words, with respect to BAs, a provision that does not deal exclusively with bills and notes in a strict sense (that is, it deals with bills and notes in a wide sense) should not necessarily be said to be encroaching or intruding into provincial legislative sphere, because it may be a "rational, functional part of a federal legislative scheme." Secondly, accepting Hogg's alternative argument, we must contest the seriousness of the intrusion on the provincial legislative sphere.

Leclair asks:

> Un empiétement aussi important pourrait-il être considéré comme étant constitutionnel? De prime abord, on peut affirmer qu'un débordement législatif de cette nature serait manifestement grave, ce qui entraîne dès lors l'impossibilité de recourir à la théorie de l'aspect. En effet, l'introduction massive du droit commun privé anglais en matière de capacité de contracter, de consentement, de responsabilité des parties à un effet de commerce et de cause pouvant en fonder la licéité constituerait très certainement une atteinte majeure aux pouvoirs des provinces en matière de propriété et droits civils.[751]

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[750] P. HOGG, *op. cit.*, note 721, n° 15.9(c), p. 393.
[751] J. LECLAIR, *loc. cit.*, note 32, p. 740.

At first glance, section 9 appears to be a major encroachment on provincial powers, as Leclair suggests. However, upon closer analysis, it is not clear that this is the case. The question of intrusion is a qualitative question, not a quantitative one. By this we mean that a given piece of legislation may have a number of provisions that "encroach" to some extent, but the totality of these slight intrusions do not constitute a "massive intrusion" into the provincial legislative domain.

Given this, consider firstly that issues of capacity to contract and consideration are not properly speaking section 9 issues, as mentioned above, because they are dealt with in other provisions of the Act. Secondly, insofar as prescription, procedure and evidence are concerned, it is clear that the intrusion into the provincial sphere, if any, is limited to prescription, procedure and evidence of bills and notes. Indeed, in assessing the seriousness of encroachment in *General Motors*, Dickson determined that the limited scope of action was an important factor. [752] He noted that the section in question did not create a general action for damages, and was therefore a limited encroachment *intra vires* parliament. Likewise, it is obvious that parliament did not intend to legislate on prescription, procedure and evidence generally, but only as they relate to bills, notes and cheques. Granted, section 31.1 of the *Combines Investigation Act* at issue in the *General Motors* case was clearly circumscribed to the Act itself, whereas section 9 is very broad. However, although section 9 is drafted in sweeping terms, it is not very specific. It does not clearly intrude on any given aspect of exclusive provincial jurisdiction. It does not purport to alter the law of a matter falling within provincial legislative competence. Furthermore, we must remember the presumption of constitutionality. In the words of Hogg:

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[752] See *General Motors of Canada Ltd.* v. *City National Leasing*, supra, note 711, 672-673.

> [t]he "reading down" doctrine requires that whenever possible, a statute is to be interpreted as being within the power of the enacting legislative body. What this means in practice is that general language in a statute which is literally apt to extend beyond the power of the enacting Parliament or Legislature will be construed more narrowly so as to keep it within the permissible scope of power.[753]

Indeed, in *Duplain v. Cameron*,[754] Cartwright stated, "[T]he rule is well settled that, if the words used permit, the statute must be construed in accordance with the presumption which imputes to the legislature the intention of limiting the operation of its enactments to matters within its allotted sphere."[755] Thus, section 9 must be read in a manner that will not violate the constitution. However, we must bear in mind that reading down is only done to maintain the *constitutionality* of a piece of legislation. A provision need not be read down to limit it to what is in the exclusive jurisdiction of the enacting legislature.

In summary, if there is an intrusion or encroachment on exclusive provincial jurisdiction by virtue of section 9, it is a limited one that should not raise any constitutional difficulties. The presumption of constitutionality requires us to read section 9 so as to keep it within constitutional limits.

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[753] P. HOGG, *op. cit.*, note 721, n° 15.7, p. 376.
[754] Supra, note 668
[755] *Id.*, p. 709. Cited in, J. LECLAIR, *loc. cit.*, note 32, p. 741.

# CHAPTER 5. Resolving the Law Applicable to Bankers' Acceptances

In our analysis, we have seen various approaches to interpreting section 9 of the *Bills of Exchange Act*. In most situations, statutes are clear enough to apply according to their terms. Usually, the plain meaning of a statute will provide the same result as would the consultation of that statute's purpose. However, thorny statutory provisions often require a more subtle analysis, engaging a number of interpretive approaches. Section 9, one of the most controversial provisions, may not be answerable by any one of these approaches alone, since it is equally amenable to several interpretations. However, problems such as those posed by section 9 are inevitable whether by "...inadvertence (because the legislature did not contemplate the concrete situation now before the court or tribunal) or by design (because the legislature deliberately left open an interpretive question in order to forestall controversy or to ensure that passage of a statute would not be stalled by disagreements over interpretation)"[756] Still, this is little consolation or help to a judge who must interpret a statute arising from actual litigation.

The fact that there is no single definitive, authoritative rule of interpretation for section 9 is clearly a problem. Judges are faced with a diverse array of approaches to statutory interpretation, which, in many cases, are contradictory. In the words of one author, the question is, "[h]ow should judges choose doctrines of statutory interpretation?

[756] P. MICHELL, *loc. cit.*, note 612, p. 713 at 720

Judges explicitly or implicitly choose interpretive doctrines - canons of construction, rules governing the admissibility and weight of extrinsic sources, and rules about the force of statutory precedent."[757]

Similarly, with respect to the other provisions of the Act, we are confronted with two authoritative texts, (the English and French versions) and no clear rule on how discrepancy or conflict between the two ought to be resolved. At most, interpretive approaches tell us that both common law and civil law meanings *can* be applied, but they do not provide a legal rule that determines when either *should* be applied. The constitutional approach, though somewhat more useful, leaves us with the same problem. The issue of interpretive choice is that judges "will often be unable to choose interpretive doctrines without making empirical and predictive claims (whether explicit or implicit) about the consequences of the choice."[758] Interpretive choice is really at the heart of interpreting the meaning and scope of section 9. Professor Vermeule explains the significance of the interpretative choice it in the following way:

> The importance of interpretive choice is that the choice of an interpretive aim (such as capturing legislative intent) tells the interpreter surprisingly little about the proper contours of interpretive doctrine. Which of the plausible candidate doctrines would best promote the specified interpretive aim will often prove to be a difficult question: The selection of one candidate will depend upon empirical and predictive premises about the sources used in statutory interpretation, the competence and capacities of the judges and other officials who must implement interpretive doctrine, and the behaviour and anticipated reactions of legislatures and agencies.[759]

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[757] Adrian VERMEULE, «Interpretive Choice», (2000) 75 N.Y.U.L. Rev. 74, 74.
[758] *Id*, Rev. 74, 76.
[759] *Id*, Rev. 83-84

In other words, if a judge views the legislature's will as the authoritative source of law, his or her approach to interpretation will differ significantly from the judge who views the text itself as the only legitimate source of law. The theory of interpretation relied upon will by a Judge will naturally impact which considerations are chosen. It follows that justifying a judicial decision requires a judge to have adopted a line of reasoning that demonstrates congruence between statutory interpretation and its practice.

In the outcome of a given case, the absence of clear guidelines on how to approach the task of statutory interpretation leads to great ambiguity. Moreover, it is not clear that interpretive guidelines will resolve difficulties created by the most contentious of provisions. A recent attempt to sketch concrete and feasible methods of interpretive choice recognized that the various techniques and strategies drawn from decision theory, political science, philosophy, and rhetoric, can fruitfully be applied to the judicial choice of statutory interpretation, "but these strategies are weakly determinate and thus provide only imperfect guidance."[760]

We are therefore left with the problem stated at the outset: Drawing the line of application between common law and Quebec civil law is not necessarily obvious. There is no strictly *legal* basis for applying provincial law to bills of exchange, aside from a decision of policy, expediency or common sense. How much this lacuna matters is debatable. Authors have suggested that, although many law professors posit abstract "grand theories" containing a single foundational basis for statutory interpretation, lawyers and most judges approach the project of interpreting statutes in an eclectic way. They look at the text, legislative history, the context of the original enactment, the overall

[760] *Id, Rev.* 74, 78.

legal landscape, lessons of common sense, and good policy.[761] This is in line with Eskridge's "practical reasoning" to interpretation. This approach has been described in the following manner:

> Briefly, this tradition, with its Aristotelian roots, emphasizes practical reasoning and wisdom, experimentation, and approaching a problem from different angles in order to reach the best solution. At the core of this approach is a healthy scepticism about all theoretical approaches and a measure of uncertainty as to whether the answer chosen is the correct one. At the same time, however, critical pragmatism is concerned to get the job done, not to equivocate or temporize. Seen from this perspective, the essential problem of statutory interpretation is to apply a general, abstract statutory provision to a concrete factual situation. Circumstances often arise which the enacting legislators did not or could not have contemplated. Interpreters, on this account, must do what works best, by reference to the 'web of beliefs' that surrounds a statute.[762]

This practical reasoning approach seems to share similarities with the 'pragmatic' approach adopted by the Supreme Court of Canada. As Ruth Sullivan has pointed out:

> Anyone who has read the recent case law of the Supreme Court of Canada dealing with statutory interpretation must certainly agree that the pronouncements of the Court on this subject are confusing and contradictory. However, the problem in my view is not methodological. In fact, the interpretive *practice* of the Court is sound and is often exemplary; and overall this practice is consistent. While it is true that in particular cases judges emphasize sometimes textual meaning, sometimes intended meaning or purpose, and sometimes compelling policy concerns, in doing so their approach is consistently pragmatic. Using a pragmatic approach, each judge takes advantage

[761] See Stephen F. ROSS, «Statutory Interpretation in the Courtroom, the Classroom, and Canadian Legal Literature», (2000) 31 Ottawa L. Rev. 39, 41 citing W. N. ESKRIDGE, Jr. and P. P. FRICKEY, *loc. cit.*, note 593, p. 321.
[762] P. MICHELL, *loc. cit.*, note 612, p. 713 at 731.

of the full range of interpretive resources available to interpreters and deploys those resources appropriately given the particulars of the case.[763]

The pragmatic (or practical reasoning) approach is usually rejected in favour of one of the other approaches because it is viewed as granting judges too much discretion in arriving at an interpretation. Arguably, this is not the case, as judges already have that discretion by virtue of their position in the trial process. This approach merely acknowledges this reality and tries to bring to light the true reasoning in any given decision.[764] We must recognize that this process of choosing among competing methods of interpretation is inescapable; judges are required to choose between alternative implementing doctrines.[765]

Given this stark realization about the statutory interpretation generally, and the difficulty with section 9, what is (or ought to be) the applicable law for a BAs in Quebec, and on what basis do we apply it? Concerning the difficulties raised by the provisions of the Act, it would appear that the matter has now been conclusively resolved with the entry into force of the Federal Law - *Civil Law Harmonization Act*, No. 1.[766] Section 8 of the *Harmonization Act* amended the *Interpretation Act.* Section 8.2 of the *Interpretation Act* now reads:

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[763] Ruth E. Sullivan, «Statutory Interpretation in the Supreme Court of Canada», (1998-1999) 30 Ottawa L. Rev. 175,178

[764] *Id,* p. 175,227.

[765] Adrian VERMEULE, «Interpretive Choice», (2000) 75 N.Y.U.L. Rev. 83, 90.

[766] 2001, c. 4. It is interesting to note that a similar problem, that is, disparities between legal systems exists at the international level as well. New rules set forth in the United Nations Convention on International Bills of Exchange and Promissory Notes are an attempt at reaching compromise between different legislation, emanating from different legal systems, regarding commercial paper. For an analysis of the acceptability of this compromise for practitioners in each system, see Martin PINAULT, «La reconciliation des irréconciliables: la Convention des Nations Unies sur les lettres de change internationales et les billets à ordre internationaux», (1997) 38 *C. de D.* 503. The harmonization that occurs in a bijural, bilingual country is quite different because it recognizes *both* civil and common law rules, rather than trying to create a single legal norm. This can be explained largely by the principle of federalism.

RULES OF CONSTRUCTION

Property and Civil Rights

8.1 Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.

8.2 Unless otherwise provided by law, when an enactment contains both civil law and common law terminology, or terminology that has a different meaning in the civil law and the common law, the civil law terminology or meaning is to be adopted in the Province of Quebec and the common law terminology or meaning is to be adopted in the other provinces.[767]

Section 8.1 would presumably resolve the problem raised by section 46(1) regarding liability being based on the capacity to contract. Section 46 gives no indication of the law by which it should be determined; however, since the capacity to contract is generally governed by the provinces, section 46(1) has been viewed for the most part as a reference to provincial law.[768] Thus, according to section 8.1, capacity would be determined by the Civil Code in Quebec and by the common law in other provinces. Thus, "[t]he latter part of cl. 8.1 therefore makes express what has heretofore been an implicit constitutional principle, namely, that provincial common law and civil law

[767] R.S.C. (1985), c. I-21, ss. 8.1,8.2

[768] See for example, *Ricard* v. *Banque Nationale*, (1893) 3 B.R. 161; *Dagneau* v. *Décarie*, (1906) 8 R.P. Que. 141 (C.S.); *Morin* v. *Dion*, [1957] C.S. 53; *Consumers Acceptance Corporation*, v. *Gendron* (1961), [1962] C.S. 203; *Roy* v. *Canadian Imperial Bank of Commerce*, [1971] C.A. 321.

underlie and offer interstitial support for many of the private law elements of federal enactments."[769]

However, there have been opinions that have maintained section 46(1) is not a reference to provincial law, and that capacity should be determined according to the common law by virtue of section 10 (now section 9).[770] In that case, section 8.2 would resolve the difficulty. Because the phrase "capacity to contract" entails different things in the civil law than in the common law[771] when cases concerning capacity to contract arise in Quebec, capacity must be understood in the sense of the Quebec Civil Code.

Furthermore, section 8.2 would seem to handle the difficulties raised by competing versions of the *Bills of Exchange Act*. Thus, section 179 which uses the term "jointly/ conjointement" with different meanings in the civil law and common law would no longer be problematic. The civil law meaning, emerging from the French version, would apply in Quebec and the common law meaning, found in the English version, would apply in the rest of Canada. In other words, the liability of joint makers of a note would correspond to the province in which the note was made. The same would be true of consideration. The use of the terms *cause* and *à titre onéreux* – which are civilian in nature – found in the French version of section 52 would lead us to apply the civilian notion of consideration (i.e., *cause ou considération*) in Quebec, while the common law understanding of consideration as valuable consideration would be the rule in the rest of the provinces.

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[769] H.L. MOLOT, *loc. cit.*, note 497 14-15. See also, *Canadian Charter of Rights and Freedoms*, supra, note 441, s. 18.
[770] For a discussion of the issue of capacity and the different approaches, see B. CRAWFORD, *op. cit.*, note 34, p. 1334 *ff.*
[771] See B. CRAWFORD, *op. cit.*, note 34, p. 1342 and 1347.

The *Harmonization Act* has thus provided a clear rule for resolving the problems associated with bilingual legislation, much like section 8 of the *Official Languages Act*, prior to its modification.[772] The purpose of the *Harmonization Act* is "to ensure that each language version takes into account the common and civil law...Harmonization aims to ensure that the existing provisions of federal laws are brought into line with existing civil law."[773] Indeed, the full name of the Act is *A First Act to harmonize federal law with the civil law of the Province of Quebec and to amend certain Acts in order to ensure that each language version takes into account the common law and the civil law.* Section 8, which amended the *Interpretation Act,* went a long way to reducing the issues created by legislation that does not adequately take account of both Civil and Common law legal traditions. This was an important step to resolving the myriad of difficulties that arise from the *Bills of Exchange Act* and its interpretation.

As L'Heureux, Fortin and Lacoursière pointed out :

> [p]ar ailleurs, le droit bancaire canadien, en raison des ses origines, se rattache en grande partie à la *common law*. Si on ne peut ignorer cette réalité, on doit également tenir compte du fait que le contrat bancaire conclu au Québec doit être interprété selon les principes du droit civil. Cette approche sera dorénavant péremptoire dans l'interprétation de toute loi fédérale depuis les modifications introduites aux articles 8.1 et 8.2 de la *Loi d'interprétation*. C'est une autre caractéristique que nous voulons souligner.[774]

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[772] R.S.C. 1970, c. 0-2. The Act contained a provision that created a rule of construction for bilingual legislation, but it had been amended, and the rule of construction established in section 8 was repealed. See *supra*, note __ (currently fn 475).

[773] Luc GAGNÉ, «Bill C-50: Federal Law – Civil Law Harmonization Act, No. 1» online: <http://www.parl.gc.ca/36/1/parlbus/chambus/house/bills/summaries/c50-e.htm>

[774] N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 54, p. 1-2
James Crossely VAINES, *Personal Property*, 5th ed., London, Butterworths, 1973, p. 161.

Although the *Harmonization Act* is an important step in reconciling federal law with provincial law, specifically the civil law of Quebec, it still leaves us in doubt with respect to the interpretation of section 9. Section 9 is a highly unusual provision, quite idiosyncratic, which creates a problem not easily resolved by the *Harmonization Act.* Recall that the preamble to the Federal Law – *Civil Law Harmonization Act*, No. 1, provides that, "the provincial law, in relation to property and civil rights, is the law that completes federal legislation when applied in a province, unless otherwise provided by law." Section 9, however, may represent one instance where provincial law should not apply, because the BEA provides explicitly that the common law of England shall apply, and both section 8.1 and 8.2 apply only if it is not "otherwise provided by law."

Previously, we mentioned that Parliament "may explicitly decide the meaning they wish to give to the terms deployed in their statutes. For example, the Parliament of Canada might provide that the meaning of a term in one of its enactments is to be found by reference to a specific definition within that statute itself, or even by reference to the law of another jurisdiction such as England or France."[775] Thus, insofar as section 9 may represent an explicit derogation from the application of provincial law, the *Harmonization Act* would be of little assistance in resolving the difficulties of interpreting the provision in question.

Consequently, can the rules of interpretation created by the *Harmonization Act* help us in resolving the problem of section 9? It seems that it all depends on one's reading of section 9. One possibility contemplates that the "common law of England" referred to in section 9 means quite simply the common law, as a system, not a restricted body of law specific to a particular jurisdiction. According to this view, the expression

[775] R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 496, p. 49.

"the common law of England" is not a term of art, but merely a way of referring to the common law by a more formal designation. Granted, this would be contrary to a literal interpretation (focused on the wording) of the Act, which refers to the "common law of *England.*" However, we must remember that,

> When having recourse to pre-Act cases, the Canadian courts have not construed strictly the reference to the common law "of England." They have, without comment or discrimination, looked for guidance to earlier decisions in their own province, as well as from other provinces and other countries, as a supplement to existing English jurisprudence, in the absence thereof and, when justified by special circumstances, in preference therefore.[776]

Therefore, given that section 9 includes the common law of the provinces, and is not limited to the law of England, section 8.1 of the *Interpretation Act* could then be understood in the following manner: "if in interpreting an enactment [that is, in interpreting section 9] it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights" That is, we must look to provincial law of prescription, procedure, etc. to give meaning to the provision. Then "reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied." We must look to the law of the province, i.e., the Civil Code of Quebec when the problem arises in Quebec, and the common law in the rest of Canada.

Note also that the French version of section 8.1 provides *"en vue d'assurer l'application d'un texte..."* which offers quite different meaning than "interpretation" and

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[776] B. CRAWFORD, *op. cit.*, note 34, p. 1218.

sheds some light on what is intended.[777] In other words, we can understand it this way: In trying to ensure the application of section 9, we must turn to provincial law, that is the law of the provinces on matters of prescription, procedure, etc.; and we must turn to the provincial law in force at the time, namely the Quebec Civil Code, and the common law in the other provinces.

Although *prima facie* this appears to resolve the problem, a closer examination of the rule of interpretation reveals that this is not the case. The applicability of the latter part of section 8.1 turns on whether "in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights." Section 8.1 requires that it be *necessary* to refer to provincial rules, principles or concepts. This means "[i]f a federal enactment, expressly or impliedly, relies on a provincial rule, concept or principle that relates to 'property and civil rights', it may not be possible to fully understand and apply the federal enactment without recourse to that provincial rule, concept or principle. Reference to the latter is therefore 'necessary' in order to accurately interpret and apply the federal enactment."[778]

But this is not the case with section 9. There is nothing in the words of section 9 that indicate a reference to provincial law; nor is such a reading constitutionally required. Parliament's power to legislate on matters of bills and notes would certainly allow it determine the law governing matters of bills and notes, even if it had an incidental effect on the provincial sphere. There is certainly no *necessity* to refer to provincial law, when section 9 can easily be read as legislation by reference, with reference to the law of particular jurisdiction, namely, England.

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[777] H.L. MOLOT, *loc. cit.*, note 497, 14
[778] *Id.*

It seems therefore, that ultimately, the scope of section 9 must be determined on the basis of policy. The policy choice of most authors and judges seems to be that, for matters dealing with bills and notes in a strict sense, common law will apply. Civil law will apply where the matter is "contractual" or "proprietary," that is, bills and notes in a wide or broad sense. We believe this is the correct approach and should be adopted. Although the distinction between bills and notes in a wide sense and bills and notes in a strict sense is not found within the Act itself, and moreover, some jurists maintain that it is incompatible with the language of that section,[779] we nevertheless agree with Barak that, "...the distinction has proved a political and legal means of limiting the incidence of sec. 10 and restricting its application to an absolute minimum."[780]

Although we recognize that nothing compels this approach to section 9, we nevertheless believe that a restricted application of the wording of section 9 is justified on grounds of policy. Though we agree with LeDain that a restricted interpretation of section 9 is ultimately based on policy, we disagree on which policy should inform the interpretation. As we mentioned above, LeDain leans towards uniformity as it recognizes the "economic realities in the field of commercial law."[781]

Firstly, this aspiration to uniformity expressed by LeDain is often questioned. Professors Macdonald and Scott maintain that toleration of diversity in legislative policy is in fact a principal justification for federalism.[782] We thus concur with Perrault who

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[779] A. BARAK, *loc. cit.*, note 85, 73. Barak was referring to Falconbridge. Falconbridge states, "***Notwithstanding*** s. 10...effect is given to this provision in Canada only with the limits of what may be called the law of bills and notes in a strict sense" [emphasis added]. See J.D. FALCONBRIDGE, *op. cit.*, note 537, p. 435.

[780] A. BARAK, *loc. cit.*, note 85, p. 73.

[781] G. E. LEDAIN, *loc. cit.*, note 507, p. 115

[782] See R. A. MACDONALD and F.R. SCOTT, *loc. cit.*, note 496, p. 42. Their primary concern is the divergence of legislative policy, but rather that policy divergence need be expressed in non-congruent legislative language.

maintains that, "il est exagéré de prétendre qu'en matière de lettres de change, chèques et billets le parlement fédéral voulut uniformiser le droit canadien concernant toutes les conséquences juridiques découlant de la rédaction et de la mise en circulation de l'un ou l'autre de ces écrits."[783]

We maintain that the criteria which guide us in the policy choice of characterizing statutes should be the same as those that guide us in interpreting section 9. The policy choice that lies at the heart of this issue must be guided by the concept of federalism. In other words, we must ask ourselves what aspects of bills and notes should be legislated upon at the federal level and which aspects at the provincial level. The former should be deemed to fall within the scope of section 9, and the latter should be governed by provincial law. In making this policy decision, "[t]he only 'political' values which may be accepted as legitimate... are those that have a constitutional dimension to them, that is, values that may reasonably be asserted to be enduring considerations in the allocation of power between the two levels of government."[784] Note that this does not mean that this decision is required by the constitution, but rather that the constitutional division of powers becomes the framework through which we analyze, and ultimately make a policy decision, as to the interpretation of section 9.

The policy fits well with the double nature of the bill or note. We saw that the BA is an obligation (contract) contained in a tangible piece of paper (property), as well as a negotiable instrument.[785] The identification of the right to possess a bill or note and the right to sue thereon corresponds to the double nature of a BA as a negotiable instrument

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[783] A. PERRAULT, *op. cit.*, note 155, p. 173.
[784] See generally, P. HOGG, *op. cit.*, note 721, n° 15.5(9), p. 372. See also, William R. LEDERMAN, *Continuing Canadian Constitutional Dilemmas*, Toronto, Butterworths, 1981, p. 241.
[785] See A. BARAK, *loc. cit.*, note 85, 67.

on the one hand, and as a chose in action and a chattel on the other (or an intangible obligation and moveable property in civilian terminology). This double, or rather triple nature of a negotiable instrument has long been recognized. From a constitutional perspective, the contractual and proprietary aspects of the bill fall within provincial legislative competence, whereas the negotiable instrument aspects fall within federal legislative competence. The strict/ wide dichotomy fits well with the constitutional division of powers. The policy of restricting the interpretation of section 9 can thus be justified by preserving the various aspects of bills and notes within their proper constitutional spheres.

It is important to recall what we have mentioned earlier, namely, that the constitutional division of powers would permit the federal government to legislate on matters of bills and notes in a wide sense; if section 9 is to bear a restricted application, it is *not* compelled by the Constitution. What we are suggesting here is simply that using the constitutional division of powers as a framework, we can *interpret* section 9 to apply only to bills and notes in a strict sense. Determining that the scope of section 9 is limited to bills and notes in a strict sense however is only part of the solution. We must pay heed to the concern expressed by Nicholls. He stated:

> It is suggested that this distinction, correct perhaps so far as it goes is not particularly helpful and may even actually be misleading. It is not helpful because it always gives rise to the further question as to what is a problem of bills, cheque and notes in a strict sense...and it may be misleading because, for instance, as was shown in the case of prescription, a question that on any

grounds is one of bills, cheques and notes in a strict sense may still fall to be decided by the civil law of Quebec.[786]

Generally speaking, when we refer to the law of bills and notes in a strict sense, we are referring to the set of laws which includes the form, issue, negotiation, and discharge of bills and notes. The law dealing with the property and obligatory elements of the instrument is the law of bills and notes in the wide sense. [787] This categorization is deceptively simple. It does not capture the difficulty of characterizing particular matters as part of the law of bills and notes in a strict sense or wide sense.

Not every issue is problematic. Still, some are confounding. For example,

"[a]lthough it is not always easy to determine what comes within the law of bills and notes in a strict sense, if anything would appear at first sight to fall into this category, apart from such obvious matters as the form and negotiation of the instrument, it is the classification of defences and the determination of where a particular defence stands in the classification, for this goes to the very essence of negotiability. It is what makes the rights of the holder in due course what they are, as distinct, for example, from those of the ordinary civil law assignee."[788]

Recall that the disagreement between Falconbridge and Perrault over the effect of the defence of *non est factum* in Quebec was premised on a question of whether it formed part of the law of bills and notes in a strict sense.

The difficulty with the distinction is enduring, leading Nicholls to eschew a universal test as we mentioned above, and examine, "the propriety of applying the civil

[786] G.V.V. NICHOLLS, *loc. cit.*, note 260, 603
[787] See B. CRAWFORD, *op. cit.*, note 34, p. 1220. See also, B. GEVA, *op. cit.*, note 153, p.256; N. L'HEUREUX, E. FORTIN and M. LACOURSIÈRE *op. cit.*, note 57, p. 421.
[788] G.E. LEDAIN, *loc. cit.*, note 507, 120.

law or the common law in each instance, and to evolve from that examination a series of particularized rules-of-thumb to cover the most common situations that might arise."[789] LeDain agreed. He found that, "[i]t is wiser not to attempt to formulate in positive terms a general statement of what is governed by provincial law."[790]

[789] G.V.V.NICHOLLS, *loc. cit.*, note 260, 603.
[790] G.E. LEDAIN, *loc. cit.*, note 507, 119-120

## 5.1 Step-by-step Approach to Resolving the Law in Bankers' Acceptance Transactions

In Chapters 1 to 4, we have set out the various issues arising in determining the law applicable to BAs. In this section, we will lay out a proposed method to answering questions that may occur in dealing with bankers' acceptances. This approach will then be illustrated by its application to a fictional case.

It is important that when looking at any problem arising in a BA transaction, the following approach to arriving at the proper law should be adopted:

1. At the first stage of resolving a BA issue, it is important to keep in mind that with respect to matters specifically in the Act, if the statute is unambiguous, it is the sole guide to the applicable law.

   1.1 In determining the law, we must also be careful not to refer to pre-Act case law. The rules emerging from these cases are law only to the extent they are "accurate and logical deductions from the general propositions of the statute."[791] Such jurisprudence should be used with caution, and in a limited fashion. For example, in cases where, "a provision be of doubtful import...Or, again, if in a code of the law of negotiable instruments words be found which have previously

[791] J.D. FALCONBRIDGE, *op. cit.*, note 537, p. 427.

acquired a technical meaning, or been used in a sense other than their ordinary one..." These examples, however, are not exhaustive.[792]

2. Once steps 1 and 1.1 have been completed and it has been found that the provision in question is ambiguous, it must be interpreted. The interpretation of the Act should follow the statutory rules and basic principles of interpretation. For example, in reading the *Bills of Exchange Act*, one is unsure if the statement, "No clerk, teller or agent of any bank..."[793] refers to *all* employees of a bank (that is, managers and directors as well). One would have to turn to the rules of statutory interpretation (e.g., the *Interpretation Act*, or cannons of construction such as *noscitur a sociis*, *esjudem generis*, or *expressio unius*).

2.1 Section 8 of the *Interpretation Act* should be used to interpret the enactment if, in interpreting the Act, reference is necessary to rules, principles, or concepts forming part of the law of property and civil rights of a province, or the provision contains terminology that contains both civil law and common law terminology, or terminology that has a different meaning in the civil law and the common law.[794] According to section 8 of the *Interpretation Act*, when an enactment contains terminology that has a different meaning in the civil law and the common law, the civil law terminology or meaning is to be adopted in the Province of Quebec and the common law terminology or meaning is to be adopted in the other provinces. Thus, when the Act refers to makers being

[792] *Bank of England* v. *Vagliano Brothers*, supra, note 490, 144-145.
[793] B.E.A.,, s. 12
[794] See R.S. 1985 c. I-21, ss. 8.1,8.2

"jointly/conjointement" liable on a note, they will each be liable only for their proportionate share of the note in Quebec (pursuant to the civil code of Quebec meaning of "joint")[795] but will be liable for the entire amount in the remaining common law provinces[796] (unless the common law meaning of "joint" has been modified or altered in those provinces).

If, however the matter is not dealt with in the Act, then:

3. The issue being dealt with must be confirmed as one of bills and notes, in either a strict sense (i.e., concerning the form, issue, negotiation, and discharge of bills and notes) or wide sense (i.e., dealing with the property and obligatory elements of the instrument). That is, the BA usually operates as part of a wider transaction (as part of a larger financing scheme or credit facility) which involves many parties and different interactions. Not all these are properly matters concerning bills and notes (even in its broadest sense). For example, the credit agreement is a part of the overall transaction between the bank and customer in setting up BA financing, but it cannot be said to fall within the occupiable field, that is, it does not form either part of the law of bills and notes in a strict or wide sense. It is too remote to be governed by the *Bills of Exchange Act*, and will thus be governed by the appropriate provincial law, as are all other contracts.

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[795] C.C.Q., art. 1518.
[796] A. BOHÉMIER and L.-H. RICHARD, *loc. cit.*, note 538, 155-156; B. CRAWFORD, *op. cit.*, note 34, p. 1833.

4. As well, the issue affecting the BA must not be regulated by other federal legislation. The issue (e.g., evidence) must be examined along with other federal statutes to see if they regulate the issue. For example, evidentiary issues regarding bills and notes must be governed by provincial law (even though they could be said to constitute part of the law of bills and notes in a strict sense) due to section 40 of the *Canada Evidence Act*, which provides:

> In all proceedings over which Parliament has legislative authority, the laws of evidence in force in the province in which those proceedings are taken, including the laws of proof of service of any warrant, summons, subpoena or other document, subject to this Act and other Acts of Parliament, apply to those proceedings.[797]

Evidence has been the only issue that the courts have dealt with to date in respect to bills and notes that has been subject to other federal legislation. However, with new legislation, or modifications to existing legislation, there may be other issues concerning the BA that will come to be governed by federal law, aside from the *Bills of Exchange Act* (or indeed, the *Depository Bills and Notes Act*).

5. Section 9 shall apply if neither of the above conditions is met. Accordingly, one must determine if the issue is properly one of bills and notes in a strict sense, including the form, issue, negotiation, and discharge of bills and notes, or wide sense, dealing with the property and obligatory elements of the instrument is the law of bills and notes. The latter shall be governed by provincial law in its

[797] Supra, note 610, s. 40. See also, *Blais* v. *Mathieu*, supra, note 609; *Boyer* v. *Sambeau*, supra, note 678.

suppletive role as the *jus commune*; the former shall be governed by the common law. The strict/ wide analysis should be done with the federalism and constitutional principles in mind, that is, the division of powers and the notion of what would best enacted at the federal and provincial levels, respectively.

The application of the common law in most provinces raises no difficulty. However, when an issue that is part of bills and notes in a strict sense requires the common law to be applied in Quebec, which "common law" is to be applied? We know, for example, courts have looked to various jurisdictions in applying the common law. Nevertheless, as perplexing as this question seems at first glance, it is hardly as problematic as it may seem. Firstly, as we have mentioned earlier, it is accepted that the common law includes equity, but not statute law. Accordingly, the concepts and institutions of common law – unaltered by statute – are virtually identical in every common law jurisdiction. It is highly unlikely that applying the common law of one jurisdiction will be any different than applying the law of another. In those rare instances where the expression of the common law differs, we suggest that the expression of the common law articulated by the Supreme Court of Canada should be the one applied. If the Supreme Court has not addressed the particular issue, we suggest that reference be made to the common law of England. Reference to the common law of a particular province, over any other, would require a justification, and thus should be avoided. We must remember, however, that discrepancies in the common law, unaltered by statute, are likely to be minimal, and even less likely to be significant in those very small number of issues that form part of the law of bills and notes in a strict sense and that are dealt with in the Act itself.

To see this approach applied, we return to the example of BASE International discussed in our introduction. Consider the following information about BASE International:

> A Montreal-based operation, BASE International, is a registered partnership of Mr. Louis O'Dell and his son Eugene. Eugene is 17 years old. BASE needs money in order to purchase the resources it needs to complete the order for its customer in Spain, and so it chooses to finance the purchase by way of bankers' acceptance.
>
> Louis O'Dell negotiates a credit agreement for BASE International with the representatives of Bank ABC of Montreal. In turn, Bank ABC sends a copy of the credit agreement and completed drafts for the other partner, Eugene, to sign as well. The bank representatives never met Eugene, nor were they aware that he was a minor.
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> The documents and drafts were signed by both partners on January 16, 1995, and returned to the bank on the same day. The face value of the BA was one million dollars ($1,000,000) with a maturity set at 90 days. On January 20, 1995 Louis O'Dell traveled to Sri Lanka to conclude the purchase of the necessary goods. The following day, Louis O'Dell disappeared. The transaction was never completed.
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> Without the goods from India, Eugene could not generate sufficient funds to honour the terms of the credit agreement. At maturity, the BA is presented for payment by a holder in due course, and the bank duly paid the acceptance, as it was required to do. The bank initiates an action against Eugene O'Dell, as drawer of the bill, for the recovery of the $1,000,000.

In this matter, the questions of law are: Is Eugene liable to the bank and if so, for how much? The first question involves two separate questions, namely, is Eugene liable pursuant to

the underlying credit agreement he signed, and secondly, is Eugene liable on the draft as a drawer of the BA?

Using the steps set out above, we see that the underlying credit agreement is not dealt with in the Act. Moreover, it seems clear that such an agreement is distinct and independent from the operation of the bankers' acceptance. Accordingly, it does not constitute part of the law of bills and notes, even in its widest sense, and falls to be governed by provincial law. Since the credit agreement was signed in Montreal, we must turn to the Civil Code of Quebec to determine the matter. We might look first to the section dealing with the capacity of persons to determine the capacity of Eugene, who is a minor.[798] For example, the bank might argue that Eugene may not bring an action in nullity or reduction of his obligations because the damage he suffered is the result of a fortuitous and unforeseen event.[799] In any case, if capacity is established, we might examine the provisions dealing with qualities and defects in consent. For example, lesion may be argued.[800] The codal provisions concerning obligations will determine whether Eugene incurred any liability on the underlying agreement.

Concerning Eugene's ability to incur liability on the draft, the rule is expressed in a provision of the BEA, namely, section 46(1), which provides, "capacity to incur liability as a party to a bill is coextensive with capacity to contract." As we know, this provision creates uncertainty because it gives no indication of the law by which it should be determined. However, because section 46(1) is understood as a reference to provincial law, it engages the rule of interpretation found at section 8.1 of the *Interpretation Act*, and accordingly capacity must be determined by the Civil Code of Quebec, as the

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[798] C.C.Q. art. 155 *ff.*
[799] *Id.*, art. 164.
[800] C.C.Q., art. 1399 and 1406

question arose in Montreal. The inquiry into capacity will thus be the same for the underlying agreement as it is for the BA.

Nevertheless, once we have determined that Eugene *can* incur liability pursuant to the Act, we must determine *if*, and on what basis, such liability would arise. It is clear that, as a drawer, Eugene engaged his liability to any holder or any endorser who is compelled to pay the BA if it is dishonoured. In this case, the BA was not dishonoured, nor is Bank X a holder or endorser. It seems that the liability of a drawer to the acceptor is not stated clearly in the Act. Consequently, because the relationship between drawer and acceptor appears to be part of the law of bills and notes in a strict sense (and there does not appear to be any legislation dealing with the matter), we may invoke section 9, and apply the common law of England. Remember that Bank X is also an accommodation party on the bill, and that as an accommodation party it holds a common law right to indemnification from the party accommodated (in this case, Eugene O'Dell). This common law right of indemnification extends to bankers' acceptances made in Quebec by virtue of section 9 of the Act [801] because the Act is silent on the matter, and the relationship between drawer and acceptor forms part of the law of bills and notes in a strict sense.

Eugene's capacity to enter into the underlying agreement and the BA will be determined by Quebec civil law, although the basis of liability will differ in both instances. With respect to the underlying agreement, Eugene's liability will be determined by Quebec civil law, whereas common law will govern his liability pursuant to the BA. However, this does not resolve the matter conclusively. Recall that both Louis and Eugene O'Dell signed the underlying agreement and the draft. This raises the question of whether their liability was joint or joint and several. The amount for which Eugene is liable is at stake.

[801] See B. CRAWFORD, *op. cit.*, note 87, p. 878; E. RAZIN, *loc. cit.*, note 10, 221-222

There is no provision equivalent to section 179 regarding joint and several liability of drawers of a bill. Indeed, the Act does not discuss multiple drawers; although in discussing the conditions for the validity of notice of dishonour, the Act refers to drawers in the plural,[802] and it has been suggested that two or more persons may act as drawers on a bill.[803] The silence of the Act (and other federal legislation) makes this question a section 9 issue. It is clear that the structure of liability of parties is part of the law of bills and notes in a strict sense, but what about their modalities?

We must therefore decide if this matter is part of the law of bills and notes in a strict sense or wide sense. The law of bills and notes in a strict sense does not include, "all the consequences of, or all the rights or liabilities resulting from, the contracts entered into by parties to bills and notes."[804] Moreover, recall that the constitutional division of powers should aid us in making this determination. Since the modalities of obligations fall within the provincial legislative sphere, and it would not impact the form, issue, negotiation or discharge of the BA, it seems appropriate to allow provincial law to govern whether the liability of drawers is joint, several or joint and several, or in civilian terminology, whether the obligation is joint, solidary, divisible or indivisible. We recognize that the "right to sue, force payment, or to recover on funds owing on a bill or note is of the very essence of bills of exchange This is one of the essential characteristics of a bill or promissory note."[805] However, whether the liability is joint or several does not impact the right of Bank X to sue or enforce payment, and at most will incidentally affect

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[802] B.E.A., s. 96(d)

[803] See B. CRAWFORD, *op. cit.*, note 34, p. 1249. Moreover, it has been suggested that their liability is probably joint, though it is not clear on what basis this is asserted.

[804] See B. CRAWFORD, *op. cit.*, note 34, p. 1220. See also, A. PERRAULT, *op. cit.*, note 155, p. 1088-89.

[805] *Attorney General of Alberta and Winstanley* v. *Atlas Lumber Co.*, supra, note 438, 101

its right to recover (where for example, one of the drawers cannot be found and the other is only liable for his or her share of the debt).

Consequently, in Quebec, the amount Eugene would be held liable for would depend on the provisions of the civil law of Quebec. For example, the nature of the partnership, between Louis and Eugene O'Dell as general, limited or undeclared would determine whether Eugene would be jointly or solidarily liable, that is, whether he would be liable for the sum of $1,000,000, or $500,000. Likewise, had BASE International operated in Ontario, and entered into a BA in that province, Eugene's liability would depend on the nature of his partnership and the corresponding liability structure set out in the *Partnerships Act* of Ontario.[806]

[806] R.S.O. 1990, c. P-5.

**RESOLVING THE PROBLEM OF THE LAW APPLICABLE TO A "BA"**

(1) Is a law in the Bill of Exchange Act clear?

If yes, then it must be applied fully.

If not, then we must determine the applicable law to complete the ambiguity.

Remember, when resolving this type of problem:
- Careful usage of pre-act case law,
- Reference is made to the rules of statutory interpretation,
- Section 8 of the Interpretation Act is applied when an enactment contains terminology, having different meaning in the civil law and the common law, the civil law meaning or the common law. In such cases, the civil law meaning should apply depending if we are in Quebec or in another province.

(2) Does the Bill of Exchange Act not deal with a particular problem?

If it does not deal with a particular problem, then:

(a) Does it involve the "credit agreement between the bank and its customer?" if yes, then provincial laws pertaining to contracts should apply.

(b) Is the issue one of the BA's form, issue, negotiation, discharge (strict sense). If yes, then the Federal Bills of Exchange act as well as the Depository Bills & Notes Act apply

(c) Is the issue one whose jurisdiction is Quebec?

(d) Is the issue one of property or obligatory elements of the BA (wide sense?)
If yes are there any federal laws affecting the said issue?
If yes, reference must be made to them and to the common law of each province.
If not, then the matter is governed by provincial laws and in Quebec, that means the Civil Code of Quebec.

# Conclusion

The purpose of this study was to determine the law applicable to BAs, particularly which aspects of BAs are to be governed by provincial law. In resolving these questions, we have analyzed doctrinal opinions and relevant jurisprudence, as well as proposing a technique to resolve the various issues that may arise in determining the law applicable to BAs. The discussion of the history, development and evolution of a bill from a form of payment into the BA, which may be part of highly sophisticated transactions, helps us understand that new challenges may arise in relation to the BA as commercial practices change over time.

To recapitulate, the *Bills of Exchange Act* is federal legislation, enacted under the power granted to Parliament pursuant to section 91(18) of the *Constitution Act*, 1867. The BA instrument, however, is part of a wider transaction involving a number of parties in different relationships, as demonstrated in Chapter 3. Several of these relationships are governed by the Act, and some are not. Moreover, there is confusion in the Act itself due to section 9, which has lead to conflicting jurisprudence. Judges and jurists alike have attempted to understand what was meant when the legislator stated, "[t]he rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques."[807] Many judges of the courts in Quebec have either limited the application of section 9 or ignored it altogether in applying civil law to matters arising on bills of exchange and promissory notes.

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[807] R.S. 1985, c. C-5, s. 9.

Is section 9 to be interpreted literally, requiring us to apply English common law to every issue that might arise in connection with bills and notes? Did parliament mean this provision to apply equally to Quebec, whose private law is based on the civil law system? These issues have plagued the jurisprudence for over a century. Our study looked to other interpretive approaches, offering a variety of different solutions, to the problem of section 9, but has found them wanting. In addition to the problem of section 9 and its interpretation, there are issues arising from the enactment of bilingual legislation in a bijural country. These issues have slowly been recognized over the last few decades. Fortunately, the *Harmonization Act* amended the *Interpretation Act*, in an attempt to recognize and give effect to both language versions, in order to give expression to both the common law and the civil law. This has resolved a few of the problems we face with the *Bills of Exchange Act*. Unfortunately, it cannot, and was likely never intended to, help assist us with the peculiar provision that is section 9.

Our analysis has led us to adopt the opinion advocated by the majority of jurists, but with the recognition that our approach to section 9 is based on reasons of policy. We have adopted the strict/ wide dichotomy, realizing the challenges inherent in determining where one ends and the other begins. We adopted this approach on the basis of our analysis in Chapter 2, which demonstrated that the complex character and multifaceted nature of the BA is premised on its dual nature (as a negotiable instrument on the one hand, and as a specie of contract and property on the other), which corresponds the strict/ wide dichotomy.

We believe that the method we suggested is the most reasonable and pragmatic, and would prove quite valuable in solving problems arising with BAs. But in the final

analysis, our approach to section 9 is simply one among many. It is hard to imagine impugning a decision in which a judge offered a careful and considered judgment based on a different interpretive approach to section 9, or in fact arriving at a different conclusion as to what constituted a matter of bills and notes in a strict or wide sense. Section 9 is clearly problematic, yet despite numerous changes to the Act, section 9 has endured. There have been sixteen (16) modifications, and five (5) revisions of the *Bills of Exchange Act*, none of which effectively dealt with the issues we have seen in this paper. Seven (7) have concerned holidays or modified the meaning of "juridical day"; two (2) others corrected typographical errors.[808] Many involved reformulations of the French version, leaving the English version virtually unchanged.[809]

Therefore, in our opinion, there are two (2) possible solutions. Firstly, there is the possibility that section 9 could be repealed. In this case, all matters not expressly dealt with in the Act would fall to be governed by provincial law, as is the case with other federal legislation. In these cases, Quebec Civil Law takes on a suppletive role in applying a federal law in Quebec. However, repealing section 9 would introduce Quebec Civil Law notions as the law of those aspects of form, issue, negotiation and discharge that had not been mentioned in the Act. Effectively, this would mean that the law of bills and notes, in its strict sense, that is, the law relating to the negotiable instrument aspect of BAs, would be different across the country. While the policy we have expressed above suggests that provincial law should govern proprietary and contractual aspects of bills and notes, it is equally true that those core aspects of bills and notes (in a strict sense)

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[808] See B. CRAWFORD, *op. cit.*, note 34, p. 1178.
[809] See J.-M. BRISSON and A. MOREL, *loc. cit.*, note 539, 772.

concerned with its negotiability, that is, with the bill as a negotiable instrument, should be governed by uniform law - the law of negotiable instruments. Since such a law of negotiable instruments can only be provided by parliament, given the constitutional division of powers, we believe that matters of bills and notes in a strict sense should not be left to be governed by provincial law in the silence of the Act.

Rather, it appears to us that modifying as opposed to repealing section 9 while incorporating the strict/ wide dichotomy is the preferable solution. Therefore, we suggest that the provision reads as follows: "The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills, notes and cheques in a strict sense. For greater certainty, bills and notes in a strict sense include the form, issue, negotiation and discharge of bills, notes and cheques." The modification of section 9 should reflect the practice of the BA transaction. Notably, that the amendment combines the qualities of a negotiable instrument governed by federal law, as well as the aspects of property and contracts governed by provincial law. The Law Reform Commission should consider drafting a legislation consisting of a more elaborative and clear wording that guides us in understanding the strict and wide interpretation of section 9. In Chapter 3, we elaborated on how the Depository Bills and Notes Act, (DBNA) came into force on June 11, 1998, to bring clarification to the BEA for matters pertaining to electronic negotiable instruments. Although the DBNA was seen as a temporary measure, still until today, it is in force and has been very useful in dealing with electronic acceptances. In the same way that the DBNA has joined the BEA as a further law concerning the creation and transformation of the BA into a negotiable

instrument. Similarly a new legislation on the strict/wide understanding of section 9 can also join these ranks.

This short Act could be named the Bankers Acceptance Act *(BAA)*, and explain the dichotomy between the strict and wide sense of section 9. For example, the Commission could group elements relating to the strict interpretation of the BA, such as issue, negotiability and discharge into a single provision and define those elements in further detail under federal law. In another provision which will be more challenging to formulate then the first, the Commission could lay down the wide aspects of the BEA that the courts and doctrinal authors have examined and have classified as wide in light of the Quebec Civil Code and Common law. Particularly, capacity to contract (e.g., incapacity by minors); liability of co-signers (joint and several) and of endorsers; means of defence available against a holder in due course; cause or consideration; proof (e.g., the admissibility of evidence given orally, or by a consort, onus of proof of good faith); procedure and prescription". With such a law in place, jurists can interpret the matters set above according to the applicable federal and provincial laws. Supposing that the Commission would only choose to create the provision that explains the strict sense of section 9, then that in itself would be an advancement and would further our comprehension of the BA.

Another way of codifying the strict/wide dichotomy would be until the Legislator decides on creating an Act, a group of bankers, lawyers and legal authors could compile a set of rules and practices based on case study and research, which in turn would be applied by Canadian banks as a code of conduct to all BA transactions. For example, the Uniform Practices and Customs (UCP) rules concerning letters of credit was a law

adopted not by a Legislator, but by merchants, traders and bankers and is viewed as the *lex mercatoria* (Commercial Law) since it regulates issues involving letters of credit transactions. Considering that a similar codification for the BA would not have the same effect as an Act created by Parliament, we still support the idea of establishing rules which would avoid confusion as to the application of provincial law regarding BA transactions.

These types of changes would assist in clarifying the law, and strike the appropriate balance between the application of federal and provincial law regarding bankers' acceptances. This approach is best "adapted to economic realities in the field of commercial law [and will assist in] achieving a working relationship, and indeed as large a measure of uniformity of result as possible, between the civil law and common law in the commercial field...."[810]

[810] G. E. LEDAIN, *loc. cit.*, note 507, 115.

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