2000

Date: 20020107
Docket: S.H. No. 167373

IN THE SUPREME COURT OF NOVA SCOTIA
[Cite as: Toronto-Dominion Bank v. J.F. Fennell Enterprises Ltd., 2001 NSSC 194]

BETWEEN:

THE TORONTO-DOMINION BANK

PLAINTIFF

-and-

J.F. FENNELL ENTERPRISES LIMITED

DEFENDANT

DECISION

HEARD BEFORE: The Honourable Justice Robert W. Wright at Halifax, Nova Scotia on December 6, 7 and 12, 2001.

WRITTEN RELEASE OF DECISION: January 7, 2002

COUNSEL: For the Plaintiff - Geoffrey Saunders and Penny Dankner

For the Defendant - Michael Power

Wright J.

INTRODUCTION

[1] This proceeding was commenced on November 15, 2000 for the recovery of an outstanding loan in the sum of $64,624.07 (plus interest) that had been advanced by the Toronto-Dominion Bank ("the Bank") to a former customer, J.F. Fennell Enterprises Limited ("FEL"), and in default of payment, an order for foreclosure on a collateral mortgage held as security. The lands which were encumbered by the collateral mortgage have since been sold by FEL and the amount of $78,000 has been paid into court as substitute security, pending the outcome of this litigation.

[2] At the opening of trial, two amendments were made to FEL's defence pleadings with the consent of counsel. First, the plea is added that a certain Promissory Note from FEL to the Bank in the principal amount of $65,000 dated January 19, 1999 was signed under duress. Secondly, it is now pleaded that all or part of the monies lent by the Bank which are in issue were for the account of another company, Smartrac Communications Limited ("Smartrac"). The latter amendment has evolved into the main issue to be decided in this case.

SYNOPSIS OF THE EVIDENCE

[3] The two principal witnesses who testified at trial were Mr. Hal Greenwood, the Commercial Account Manager of the Bank responsible for the FEL account for most of the time period with which we are concerned, and Mr. John Fennell who is the sole principal of FEL. Mr. Fennell was also one of three principals of Smartrac whose business activity will be addressed later in this decision.

[4] Mr. Greenwood assumed responsibility for the FEL account in 1993. At that time, the main business operation of FEL was a Coca-Cola distributorship for the South Shore area of Nova Scotia. Since becoming a customer of the Bank in 1985, FEL arranged a number of loan facilities to finance its operations, the most significant of

which was a Demand Operating Loan which was designed to finance FEL's receivables. The Operating Loan essentially acted as an overdraft for FEL's commercial chequing account, known as a current account. Whenever cheques were written that created an overdraft in the current account, advances were automatically made in increments of $5,000 from the Operating Loan account to the current account. The authorized limit of the Operating Loan rose to $250,000 during the early 1990's but advances made had to be supported by a sufficient level of FEL receivables on which it was required to report monthly to the Bank for monitoring purposes.

[5] In the ordinary course, the Bank required and was provided with a security package to secure this financing. The security package consisted of a demand debenture, a general assignment of book debts, a collateral mortgage on FEL's commercial property in Bridgewater, a section 427 security under the *Bank Act*, and an unlimited personal guarantee from Mr. Fennell.

[6] It was business as usual until August of 1995 when FEL sold its distributor rights back to Coca-Cola. From the sale proceeds, FEL was able to pay its Operating Loan down to a zero balance which took place during the month of September. Under the terms of the transaction, FEL was able to continue, as an independent business, in the lesser role of servicing Coca-Cola's vending machines in the South Shore area.

[7] Because of this dramatic change in its business operations, a line of credit of $250,000 was no longer needed. As a result of discussions between the Bank and FEL, that credit limit was reduced to $25,000 in or about April of 1996. That level of financing was still required to finance FEL's inventory, parts and accessories associated with its vending machine service operation, pending receipt of monthly receivables from Coca-Cola. Indeed, it is to be noted that FEL began drawing down further loan advances only three days after reducing its Operating Loan to a zero balance as aforesaid. The Bank also in April of 1996 discontinued the requirement of monthly presentations of FEL's receivables and inventory declarations, but continued to hold the

various security instruments above listed.

[8] Having sold his main business venture, Mr. Fennell began to look around for other business opportunities. In the spring of 1996, he became involved with two other business associates in the formation of Smartrac to pursue sales opportunities in the prepaid cellular telephone industry. The development of such a business required considerable startup costs, mostly related to business travel and presentations, which Smartrac as a fledgling company had no independent ability to pay. As an accommodation, Mr. Fennell arranged to fund Smartrac's expenses through advances drawn on the FEL Operating Loan. By December of 1996, FEL had underwritten Smartrac's expenses to the tune of $40,000 which amount coincided with the outstanding balance of FEL's Operating Loan at the 1996 year end.

[9] Sometime during the fall of 1996, Mr. Fennell approached Mr. Greenwood about securing an Operating Loan for Smartrac that was intended to be set up in the same fashion as the FEL Operating Loan. The amount of the loan requested was $40,000 to which the Bank was receptive so long as its security requirements were met. Those security requirements essentially consisted of an assignment of book debts (to be supported by sufficient levels of actual receivables to be monitored by the Bank), personal guarantees from the three Smartrac principals, and the usual Business Credit Service Agreement with the Bank.

[10] In furtherance of the loan application, the Bank prepared the required security documents and although they are all dated the blank day of December, 1996, the parties are on common ground that the general assignment of book debts, the Service Agreement and Mr. Fennell's personal guarantee were signed on the 19th of that month. The personal guarantees of the other two principals followed shortly thereafter.

[11] Where the parties are not on common ground is their respective understandings of the status of that loan application once the security instruments were signed. Mr. Greenwood testified that the purpose of the loan was to finance Smartrac's receivables, which Smartrac would be required to report on monthly so that the Bank could monitor the account. Because Smartrac was then still in a development stage, and not yet generating receivables, Mr. Greenwood simply held the Smartrac documentation in abeyance pending confirmation that the business was in fact up and running and a request that the loan account be activated. In order to do this, he also emphasized that Smartrac would be required to present a list of accounts receivable to satisfy the Bank's margin requirements. Neither ever came.

[12] Mr. Fennell, on the other hand, testified that he thought that he had the $40,000 credit facility parked and ready to go and that it was simply a matter of deciding when to engage it. His plan was to continue using the FEL Operating Loan to fund Smartrac expenses and to eventually transfer those borrowings to the Smartrac Operating Loan at some time in the future. He acknowledged in cross-examination, however, that he knew that any advances under the Smartrac Operating Loan had to be supported by a sufficient level of receivables.

[13] By February of 1997, Smartrac was paid its first significant receivable of approximately $26,000 generated by its initial sales activities. By a letter to Mr. Greenwood dated May 1, 1997 Mr. Fennell reported that this money had been received and allocated to Smartrac's expenses of which approximately $11,000 had been applied to the FEL Operating Loan. Mr. Fennell also advised in that letter that he was trying not to use the Smartrac line until he had more confirmed orders from Bell and that Smartrac was still in the development stage.

[14] Unfortunately for Smartrac, its venture into the prepaid cellular telephone business soured and by the late summer of 1997, as Mr. Fennell put it, "we ran out of steam". By this time, the FEL Operating Loan was substantially over its authorized limit

and the Bank was pressing to have that rectified. In the course of their discussions over this, Mr. Fennell apprised Mr. Greenwood of the problems Smartrac was experiencing. According to his testimony, it was then that he learned from Mr. Greenwood that the Smartrac Operating Loan was not at his disposal and that in view of the circumstances, the Bank was not about to lend any money to Smartrac even for purposes of reducing the FEL Operating Loan. Mr. Greenwood made it clear to Mr. Fennell that the Bank would only continue to lend to FEL as its customer, on the strength of the security package it held as well as Mr. Fennell's good character and proven business reputation.

[15] Mr. Greenwood readily acknowledged that he was well aware early on that Mr. Fennell had been using the FEL Operating Loan to fund Smartrac's development costs. The Bank took no exception to this use of the loan advances, given the amounts involved and the security held. Mr. Fennell, in his evidence, acknowledged that he had not tried to use the Smartrac line of credit prior to September of 1997. No cheques were ever written on the Smartrac account such that loan advances would be triggered to cover the overdraft under the revolving line of credit arrangement. The Bank records themselves clearly show that no loan advances were ever made or transferred to Smartrac during or after September of 1997 or, for that matter, at any time whatsoever.

[16] Finding himself unable to access the Smartrac Operating Loan, Mr. Fennell was left to reduce the FEL Operating Loan by his own financial resources which he did by making a $40,000 payment on September 9, 1997. When asked in cross-examination if he ever told Mr. Greenwood in their discussions around this time that this was at least in part Smartrac's debt that had been run up, Mr. Fennell answered that he had not because the paperwork made it obvious that that hadn't taken place and that the loan advances had been made to the FEL account. He said he did not consider himself to be in a position to argue otherwise at that time.

[17] In the course of the next annual credit review which took place in December of 1997, FEL requested an increase in the authorized credit under its Operating Loan from $25,000 to $50,000. The stated reason for the request was that FEL wished to maintain a credit arrangement with the Bank to finance its receivables from Coca-Cola as well as development costs associated with Smartrac. The Bank acceded to this request, even though FEL was at this point only a holding company with ownership of a commercial property, in light of Mr. Fennell's experience and financial capacity. The Bank also knew that FEL was trying to sell the commercial property it had formerly occupied as a distributor for Coca-Cola, over which it held a collateral mortgage.

[18] The relationship between the Bank and Mr. Fennell continued to be cordial and drifted along uneventfully until the next annual credit review was undertaken by the Bank in December of 1998. At that time, and because of some internal reorganizations within the Bank which are irrelevant to these proceedings, the administration and management of the FEL commercial account was in the process of being transferred from Mr. Greenwood to Shelley LeBrun. By this time, the amount of FEL's Operating Loan had risen to $65,000 which was $15,000 over its authorized limit. Mr. Greenwood and Ms. LeBrun recognized that something had to be done to clear up the loan account which was not only over its limit, but was absent any plan of repayment since FEL was no longer an operating company and had no revenue to service the loan. Mr. Greenwood and Ms. LeBrun settled on a recommendation that FEL be asked to sign a Demand Promissory Note in the principal amount of $65,000 with interest at the bank's prime rate plus 2%; that the loan be "termed out" for repayment but that FEL be given a four month deferment period to give it a further opportunity to sell its commercial property; and that the proceeds from that sale be used to retire the loan altogether.

[19] This recommendation went up the ladder for approval by Rod Stewart, then Manager of Independent Business and ultimately to John Zeggil who was then Manager of Commercial Services. Both agreed with the recommendation and in the result, Mr. Greenwood (who continued to be involved) contacted Mr. Fennell and asked for FEL's

agreement on the proposed change in the banking arrangements. Mr. Greenwood's testimony was that Mr. Fennell took no objection to the request and indicated that once the Promissory Note was sent to him, it would be signed on behalf of FEL and returned to the Bank. Mr. Greenwood denied having made any sort of veiled threat that the Bank's collateral mortgage security would otherwise be enforced if the request were not complied with. He also testified that it was never suggested to him by Mr. Fennell in their discussions that Smartrac ought to bear the responsibility for at least some of the loan indebtedness in FEL's name.

[20] Mr. Fennell's version of these discussions with Mr. Greenwood was that he was told that if the Promissory Note were not signed, the Bank would consider enforcing its security. He acknowledged in cross-examination, however, that Mr. Greenwood had simply explained to him what options the Bank had available to it and what its rights were. He said it was made clear to him that the Promissory Note was intended to cover FEL's indebtedness to the Bank.

[21] Mr. Fennell sometime in January , 1999 ultimately signed the Promissory Note on behalf of FEL and returned it to the Bank, albeit with the date and current level of prime rate of interest having been left blank at the time. That is to say, the Promissory Note simply specified that interest on the principal sum of $65,000 would be charged at the Bank's prime rate plus 2% per annum until paid.

[22] Mr. Fennell also acknowledged in cross-examination that there were no discussions with the Bank around the time the Promissory Note was given over whether Smartrac owed any part of the loan indebtedness and further that the intention of the Promissory Note was to give FEL more time to sell the building which was to be the source of repayment of the loan. As he put it, "I was managing my way through this note by selling the building".

[23] It was not until February of 2000 that FEL found a buyer for its commercial property. In the meantime, it had only made a few sporadic interest payments on the loan in the early months of 1999. With the collateral mortgage on the building still registered at the Registry of Deeds, an arrangement was made on the closing of the transaction to set aside in trust, funds thought to be sufficient to cover the bank loan as substitute security for that mortgage. Those funds were eventually paid into court and by virtue of an Order of this court dated June 12, 2001, increased to the level of $78,000.

POSITIONS OF THE PARTIES

[24] The Bank distills its case to the following core position. It loaned monies by way of an operating line of credit to FEL which was later converted to a Promissory Note; that it loaned those monies to FEL only; that FEL has defaulted on that loan; that even if the Promissory Note were somehow defective, the underlying debt has been clearly proven; and that the Bank records clearly show a principal indebtedness under the loan account of FEL of $64,624.07 as at June of 1999 with interest accruing thereon at the rate of prime plus 2% per annum.

[25] The lead position of the defendant is that the Promissory Note signed by FEL in January of 1999 is defective and therefore cannot be relied upon by the Bank to effect recovery. The defendant further argues that the Promissory Note was signed under duress. Beyond that, the defendant argues that the Bank is not entitled to recover the full amount of the underlying debt from FEL in any event because the Bank acted in bad faith; firstly, by not having the banking documentation reflect the true nature of the continuing relationship with FEL after it ceased to be an operating company in 1995 until the events of December, 1998 and secondly, by allowing Mr. Fennell to form the impression that the Smartrac Operating Loan was in place and available to him during the critical period of December, 1996 to September, 1997. More specifically, it is contended that the Bank should have advanced a loan directly to Smartrac on September 9, 1997 rather than requiring Mr. Fennell to reduce the FEL operating line by

$40,000 from his own financial resources. It is argued that Mr. Fennell thereby acted to his detriment by having been allowed to form the impression that the Smartrac Operating Loan would be available to him at some point in order to reduce the FEL Operating Loan which had increased by $40,000 for purposes of funding Smartrac's startup expenses, all with the knowledge of the Bank.

[26] Mr. Fennell readily acknowledges that part of the indebtedness claimed is indeed owed by FEL but that it should be limited to approximately $40,000. The explanation given for this figure is that had the Bank advanced a $40,000 loan directly to Smartrac on September 9, 1997 as Mr. Fennell says it should have done, he would only have ended up being responsible for one third of that amount as a co-principal/guarantor of Smartrac plus the $25,000 reduced balance of the FEL Operating Loan. In light of the conclusions I have reached in this case overall, however, it will not be necessary to deal with this makeshift argument.

LEGAL ANALYSIS AND CONCLUSIONS

[27] The first issue to be addressed, although not determinative of the outcome, is the validity of the Promissory Note provided by FEL to the Bank in January of 1999. I will say at the outset that there is a complete lack of evidence to support the amended plea that this Promissory Note was signed by FEL under duress. To constitute duress, there must be a coercive aspect to the impugned conduct such that there has been no true consent by the other party. Even on the basis of Mr. Fennell's own evidence summarized above, an attack on the validity of the Promissory Note on the ground of duress has not even remotely been made out.

[28] I next turn to the alleged defects on the face of the Promissory Note. The first exception to the note taken by the defendant is that although it stipulates that interest is to be charged at the Bank's prime rate plus 2% per annum until paid, the then current prime rate was not inserted in the face of the note in the space provided. Because of that omission, it is argued that the note is not for a sum certain within the meaning of the

Bills of Exchange Act and hence cannot be enforced. In support of its position, counsel for the defendant refers to the Supreme Court of Canada decision in *MacLeod Savings & Credit Union Ltd. v. Perrett* [1981] 1 S.C.R. 78.

[29] In my view, that case is entirely distinguishable from the case at bar and is of no assistance to the defendant. What is directly on point, however, are the case authorities referred to me by plaintiff's counsel which clearly establish that the stipulation of the interest rate in the manner presented here satisfies the "sum certain" requirement of the *Bills of Exchange Act*. That is because the debt is for a fixed amount of money capable of ready calculation in the present world of commerce (see, for example, *Toronto-Dominion Bank v. Cable Underground Systems Ltd. et al.* (1984) 46 O.R. (2d) 443. Accordingly, the omission on the face of the FEL Promissory Note of the current prime rate of interest then in effect is a technicality of no consequence.

[30] The second exception taken by the defendant is that the Promissory Note was not dated until after Mr. Fennell returned it to the Bank. Whether this irregularity affects the negotiability of the Promissory Note in the world of bills of exchange is a legal nicety which need not be decided for purposes of this case. The fact remains that there is ample evidence of the underlying debt owed by FEL to the Bank directly as between borrower and lender, separate and apart from the Promissory Note. The Bank records clearly establish such indebtedness and indeed, Mr. Fennell acknowledged that he agreed at the time of providing the Promissory Note that the loan would be repaid from the proceeds of the sale of the FEL commercial property.

[31] As outlined earlier, counsel for the defendant asks the court to look at the history of the administration of this loan and the conduct of the Bank after the FEL business operation was sold in 1995, in considering the Bank's entitlement to recover the debt underlying the Promissory Note. I have reviewed that history in my synopsis of the evidence given at trial and can find no merit in any of the defences which have been advanced. At the heart of the defence position is the assertion that the Bank ought to

have advanced monies directly to the Smartrac Operating Loan in September of 1997 in order to correspondingly reduce the amount of the FEL Operating Loan which, with the knowledge of the Bank, had been utilized to fund Smartrac's startup expenses. This proposition is completely untenable. Mr. Fennell could not reasonably have expected the Bank to have done that at the same time that he was informing it that Smartrac was no longer expected to be successful. Moreover, he had not provided the Bank with a supporting list of receivables which the loan was intended to finance, other than the one referred to in his May 1, 1997 letter to Mr. Greenwood which had been paid and disbursed the previous February. There may well have been a few others from the Bell Group of Companies but there is no evidence that these were ever presented to the Bank to support any advances being made under the Smartrac Operating Loan. As noted earlier, Mr. Fennell acknowledged that he well knew that the operating loan had to be supported by a sufficient level of receivables which had to be presented to the Bank. In the case of Smartrac, that foundation for a loan advance was simply never laid.

[32] I find as well that Mr. Fennell was fully aware throughout the course of his dealings that the Bank was making its loan advances to FEL as borrower and not for the account of Smartrac. This was clearly the Bank's intention as evidenced by the bank records and the testimony of Mr. Greenwood which I accept. Moreover, it is to be noted that Mr. Fennell was receiving monthly statements from the Bank in respect of both his current account and Operating Loan account for FEL. Similarly, he was receiving the monthly chequing account statements for Smartrac which confirm that no cheques were ever written that attempted to draw down an advance from the Smartrac Operating Loan account. All of this was further captured in the annual financial statements prepared by FEL's auditors which clearly showed the amount of the FEL Operating Loan owed to the Bank at year end and its investment in Smartrac.

[33] One can readily understand Mr. Fennell's chagrin at being left holding the bag, as his counsel put it, for the entire amount of the FEL indebtedness even though some $40,000 of it was incurred in order to fund the development costs of Smartrac in which he held only a one third interest. I accept that his business plan, and indeed his expectation, was to eventually draw down loan advances under the Smartrac Operating Loan to reimburse FEL for the indebtedness it had incurred under its operating loan to fund Smartrac's development costs. Unfortunately for him, the downward spiral in Smartrac's fortunes prevented that from happening, leaving FEL fully responsible for the loan advances that were made. Mr. Fennell cannot now be heard to say that some of that responsibility should be laid at the feet of the Bank. There is no evidence whatsoever that the Bank acted in bad faith in any manner in its dealings with Mr. Fennell or FEL that otherwise would attract the intervention of this court. Mr. Fennell, through his company, took a business risk in hopes of achieving substantial financial rewards from the Smartrac operation. He was willing to put FEL's credit on the line to fund Smartrac's development costs. That business venture failed and FEL must now bear the consequences.

[34] Accordingly, the Bank shall be entitled to judgment against FEL for the full principal amount of $64,624.07 together with interest which has accrued thereon at the Bank's prime rate plus 2% per annum. I will leave it to the parties to work out the appropriate interest calculation to the date of judgment and to prepare the appropriate Order to permit the funds to be paid out of court as necessary.

[35] The Bank shall also be entitled to party and party costs of this action. Where counsel have alluded to offers of settlement having been made, I will leave it to the parties in the first instance to try to reach agreement on the amount of costs to be paid. If counsel are unable to resolve the issue of costs, I will hear further submissions from them by written briefs to be filed within two weeks following the release of this decision.

J.