Law Reform Commission
of Canada

Commission de réforme du droit
du Canada

COMMERCIAL LAW

# payment by credit transfer

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Commercial law : Payment by
credit transfer.

# Law Reform Commission of Canada

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### COMMERCIAL LAW

# payment by credit transfer

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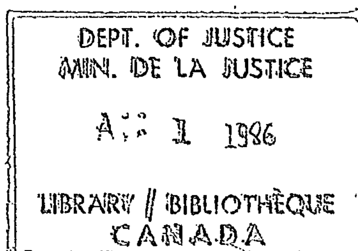

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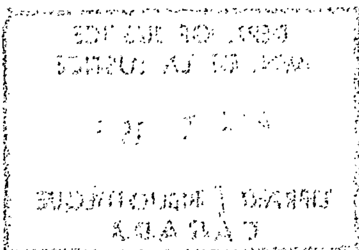

# Notice

This *Working Paper* presents the views of the Commission at this time. The Commission's final views will be presented later in its Report to the Minister of Justice and Parliament, when the Commission has taken into account comments received in the meantime from the public.

The Commission would be grateful, therefore, if all comments could be sent in writing to:

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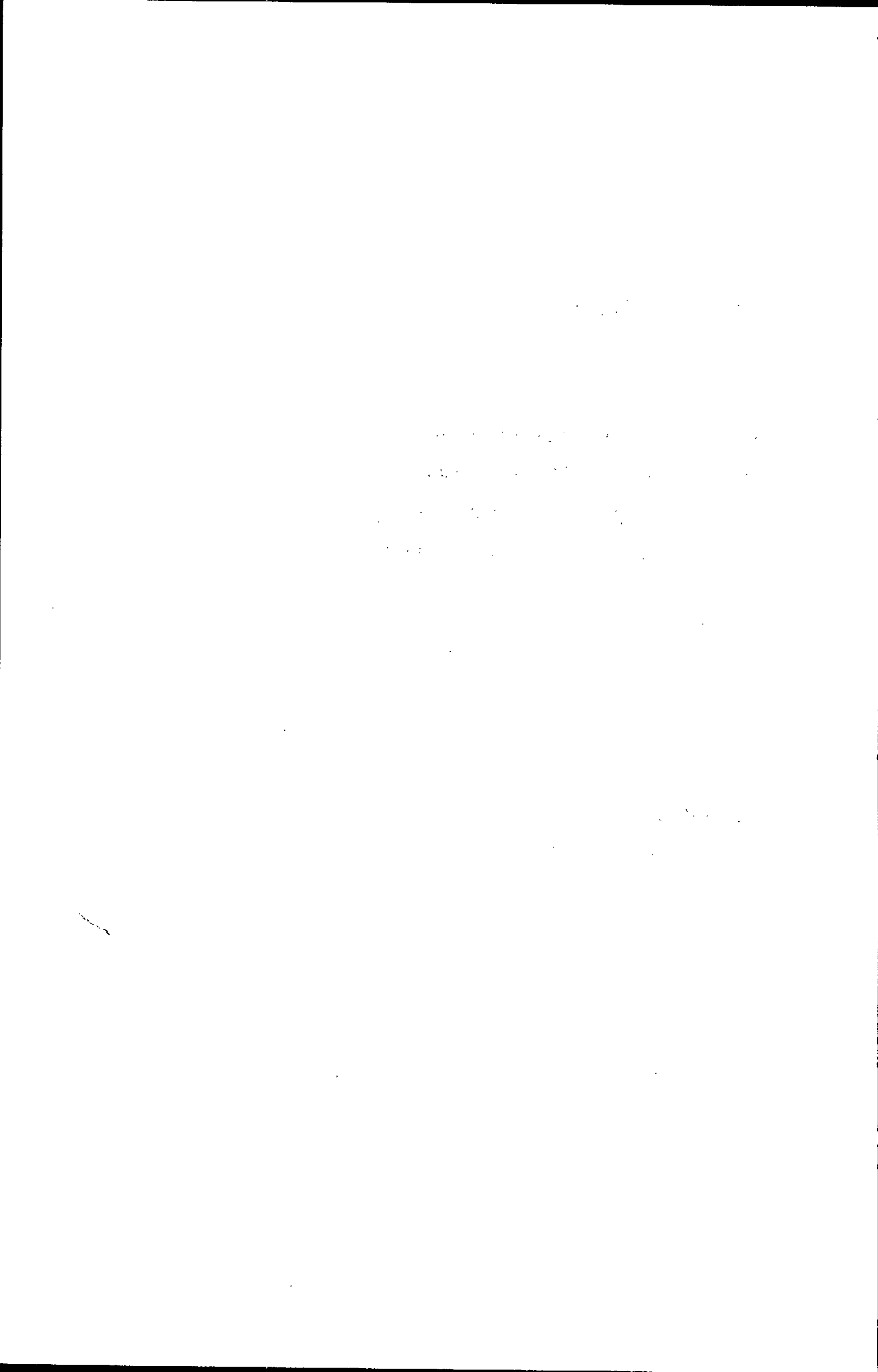

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# I.

# Introduction

This paper is about deposits to peoples' bank accounts. Today, we bank with a whole group of institutions, only some of which are legally called banks. In the interest of accuracy, the paper uses the words "deposit institution". These institutions look like banks. They have tellers, accountants and managers. They cash cheques, or pieces of paper so like a cheque that only your lawyer knows the difference. They are all participants in a set of business arrangements called the clearing system. The clearing system is how the banks get your cheques back to your bank from whomever you sent them to. Without it, you couldn't use your cheques nearly as often or as conveniently as you do.

Over the next several years, it is likely that anyone who gets payments from a large organization, whether it is governmental or commercial, will have the opportunity to get a payment by credit transfer. If getting to your bank to make deposits is inconvenient, credit transfer may be something that you're already waiting for. If enough people are even mildly enthusiastic about them, credit transfers will probably quickly become an unquestioned part of the way we go through our daily affairs. As unquestioned a part as the cheque clearing system is—and how many people know how their cheques get back to their bank?

A credit transfer isn't a cheque; but it is a new way of paying people. It may not even involve a piece of paper. Cheques are just messages about money; messages need not be in writing. When this paper speaks of a credit transfer, it means a message to pay someone by having his bank increase the balance in his bank account. The person who gets the money is called the payee; the person who sends it is the payor.

The message will probably be one of many such messages, all recorded together on a single piece of magnetic tape. Because the real savings in using credit transfer instead of cheques come from this ability to bunch them all together, credit transfers will first be used by people with a lot of payments to make at once. People like big companies paying their employees, or the government making pension or welfare payments. Later on, small companies might want to hire somebody with a computer to handle their payroll; if they did, they could take advantage of the savings from paying by credit transfer.

To be paid by credit transfer, you must have an account with a deposit institution. Not just a bank; credit unions, trust companies, the caisse populaire and others too. Who? Any place that you can open a chequing account today is potentially a place where you can be paid by credit transfer.

Do you have to take payment by credit transfer? That is a difficult question to answer. Consent is a very subtle thing; particularly if you need the money. Later on, this paper talks about consent, and policy that the government might adopt to make sure you have a right to control how you are paid.

Why call it *credit* transfer? That answer gets into the way that money moves between banks and others to cover the deposit credit that people are given and the charges made against their accounts. On a cheque, you get deposit credit before the payor is charged; the banks pay each other before the payor is charged. A cheque is one kind of *debit* transfer. A *credit* transfer wouldn't work that way. The banks would pay each other before the deposit credit was made to the payee; the payor and his bank would have to bargain out when the payor would settle up with his bank. Because of this, the risks and legal rights involved are very different from a cheque.

The Law Reform Commission is concerned that the credit transfer should have a body of legal rules and principles to govern it. These principles should give clear guidance to those who design systems, who carry forward business planning, and who deal with consumer problems. The Commission is also concerned that legal rules and principles with important social impacts be identified. Where these impacts are undesirable, proposals for meeting them must be considered. Proposals to protect the flow of payments

through the system, to adjust the rights of debtors and creditors to accommodate changes introduced by the system, and to protect the consumer are made at various points. Section VII of the paper discusses concrete legislative changes to implement these proposals. These changes are summarized by jurisdiction in Appendices II and III. Appendix IV discusses the issues raised in adapting wage attachment to payment by credit transfer. Appendix I contains a payee's form authorization consistent with the analysis set out in the paper; Appendix V is a checklist of terms for the payor's contract with his deposit institution. Appendices I and V are examples of the form that private sector action consistent with the paper's analysis might take.

This paper is admittedly technical. It is impossible to discuss the relationships involved in credit transfers, and in the payment system generally, without use of a technical vocabulary. A paper of this sort must be concerned with rights and remedies; this concern requires more precise discussion of detail than is appropriate in value-oriented research. The variety and complexity of commercial law makes such precision imperative. A useful critique of policy is inescapably technical.

The paper discusses the relationship between you and your employer, or you and the government, paying you a pension cheque or family allowance. It talks about the effect that payment has on the debt between you and the payor. It talks about your right to consent to being paid by credit transfer, instead of by cheque or in cash.

It talks about your creditors, and how your rights against them might be different. In the province in which you live, there are different rules telling how creditors can seize your wages and other debts, such as a bank account. If your wages are paid into your bank account directly, your rights are affected. A bank has rights respecting the money in your account that it does not have in respect of your other property; these rights, which are called set-off, or "compensation" in Québec, can be very important to you if you have a loan at the bank as well as an account there.

It talks about the relationships between banks and other deposit institutions that would be required to make a credit transfer system work smoothly. If something did go wrong you

should not be on the receiving end of a show in which everyone pointed their finger at the other guy and said: "He's at fault." Deciding who is at fault can be a very expensive task. This paper suggests that we identify people who are responsible for making the system work, and that that responsibility has nothing to do with fault. If the person responsible can prove someone else is at fault, then he can recover whatever loss he had to pay to the person injured by the system not working. If he can't show anyone is at fault, then he must absorb that loss himself. The people suggested to carry this responsibility are the institutions who will run the system, and in some cases, the companies and others who will use it to make payments. As a consumer, you should recognize that this responsibility is something like insurance against the system not working. Because it exists, you will find that companies and institutions charge more for the things they do for you. To keep those charges low, it may be wise to cover only the most direct kinds of loss.

If the system is a sound one, the cost of this insurance spread over the users of the system should be very low. The consequences of not having it available to an individual might be devastating. No one wants their pay, or their pension cheque, to disappear into a computer and vanish. Nor do they want to wait while a group of experts figure out where the money went. It is very important for system security that the institutions be concerned about disappearing payments; making sure they have a direct financial concern is one way of encouraging this.

The paper talks about the relationship between the institutions and companies and others who would use the system. Most of their relationships can be left to them as a matter of business. But the paper suggests at several points that an institution should be responsible for something which is not its own fault, and which clearly is the fault of the company or other payor. Where that is done, the institution should have the right to recover its losses from the payor. One section of the paper talks about the payor's responsibility to the system.

The paper has a short section trying to put the analysis into a social context at the point where you meet your bank, your employer, your government, and your creditors. What kinds of changes flow from credit transfer as a means of payment? What

sorts of demand should you put to government if you don't like those changes?

Legislation to deal with the impacts of credit transfer is then discussed. In drafting these suggestions, the Commission has tried to combine simplicity and precision. The Commission hopes that these suggestions will lend precision to the lawyer's understanding of its proposals, while the non-lawyer may still follow in general terms their content and effect.

A final warning is necessary. In preparing this paper, the general outlines of the law of creditor's remedies have been taken as given. In assessing proposals concerning use of attachment, and in particular wage attachment, this must be clearly understood. If policy is to be clearly implemented, the growth of an electronic payment system should not be the pretext for changes made for other reasons. Wage attachment, and a credit system based upon future wages as the worker's primary asset, have undesirable social features. Many legal rules exist for the purpose of ameliorating those features. The use of wage or other attachment against a solvent consumer debtor is a matter falling almost entirely within provincial jurisdiction. The general law in this area has been taken as it stands. Such an approach neither endorses nor challenges the policy adopted by provincial governments.

# II.

# Background

## A. General

A credit transfer involves replacing one person's right to a deposit at a bank or other deposit institution by another person's right to that money. If different institutions are involved, there must be an exchange of information between institutions. There is also an exchange of value between institutions, known as settlement. Normally a credit transfer would involve a payor, a payee, and one or more deposit institutions.

The transfer is a credit transfer because the payor instructs his institution to transfer funds to the payee, and to charge his account. Such instructions allow the institution to protect itself before any other parties have relied on the transfer—something which is not possible in the normal use of cheques in payment.

If an institution charges the payor's account before it gives settlement, or receives settlement before it credits the payee, the credit transfer creates credit float. Such float is analogous to a deposit for which no interest must be paid by the institution.

Information for credit transfers will probably be exchanged on magnetic tapes. This requires use of couriers, and allows a period of several days within which credit float could exist[1].

Management factors favouring use of credit transfer include volume, amount, extent of computerization of related bookkeeping, stability of the list of payees, and acceptability to the recipient. The last is particularly important in consumer and governmental payments. Because of these factors, credit transfers will at first originate with large payors. Deposit institutions or computer

service bureaux could make such services available to much smaller payors.

How will credit transfers affect the law of payment? "A has paid B" usually implies that A has discharged his debt to B. Of course, gifts and government grants do not involve the payor's debt, and pension rights are cast in a form other than debt to protect the pensioner[2]. But most personal and commercial payments are made to obtain discharge. A system of payment that does not generate legal evidence of discharge is wholly impractical.

Only a tiny fraction of payment disputes ever go to court. It is not enough to generate evidence; payment systems must have another feature. They should produce commercial records that will prevent dispute and encourage settlement. These records should automatically reach the primary parties to disputes—payor and payee—in a form in which they can be readily understood without expert aid or tracing transactions. A necessary feature of a practical system is a *genuinely* descriptive statement[3].

## B. Elements of Deposit Payment

Payment by credit transfer entails three events: information sent to a deposit institution, with proper settlement; credit by that institution to the proper account; and consent of the accountholder. Information delivery with credit is so basic that system users will never be aware of it in a properly conducted system. But the other two are the legal core of relations between individual system users and the system. "A has paid B by credit transfer" means that A has caused a deposit institution to credit B's account, and that B has consented to that credit.

Institutional settlement is important primarily when institutions fail. Settlement schedules raise questions of monetary policy, and may determine whether a payment is made, returned, or lost in an institutional insolvency.

Credit to the proper account becomes important when the institution fails to make such credit. To whom is the duty to credit

the account owed; is the duty absolute, or would negligence or other fault be required to establish its breach? Is the account a name, a number, or an identity? Wherever consumers give one answer to these questions and the operating characteristics of the system give another, the law must ultimately intervene. Through an accident of legal history, the answers to these problems for debit transfers today contain a large measure of provincial law[4].

Once a framework has been established for these problems by identifying the basic relationships involved, tentative answers to these problems can be found for the credit transfer. Rigorous use of the agency model later suggested would establish an absolute duty owed to the payee, based on receipt of funds by his institution. But this may not be as favourable to the payee as it seems, and his life might be less complicated if there were no such duty owed[5].

There are a variety of reasons for requiring the payee's consent: legal, practical, and ideological. Legally, consent to payment by the deposit obligation of a third party is necessary to establish that discharge has occurred. Where today we prove a written receipt, we will in future show completed action in reliance on a signed pre-authorization. Even when legal discharge is not an issue, the identity of the payee still is, and a signed authorization is a practical means of establishing that identity. Finally, a society that values personal liberty and competition in the market for financial services ought to refrain from forcing people into business relationships in that market.

## C. Nature and Proof of Consent: Written Agreement

Consent in law includes more than subjective agreement. But if someone is precluded from proving that he did not subjectively agree, the legal result will often be the same as though he had agreed.

From the point of view of business planning, consent should be obtained in a manner that is easily recorded, proved, and cancelled. Otherwise, the business doesn't know where it stands. In businesses the size of a major chartered bank, this rule is an axiom. Estoppel, ratification and other techniques for curing failed transactions have no proper place in planning. Similarly, proof of transactions by persons with testimonial knowledge of what happened is—with respect to individual payments—a rare event[6]. What is required is a written standing consent, good until revoked, to repeated payment by credit transfer.

## D. Role of Written Consent in Automating System

A deposit institution must be able—for debt payments—to prove the creditor consented in writing to payment by deposit. To automate the system, the creditor must have a unique numbered account—and the computer can only pay that account. It cannot ask, as payment by credit transfer is made, for the individual to confirm his identity[7]. Where debts are not being paid, there is no legal requirement for discharge. There may still be a requirement for establishing receipt to the payee's benefit. That may be either because debts were anticipated, or because the payor is accountable to others to so disburse the money. In either case, the written consent of the payee would suffice. Again, the numbered account is required to automate the system.

Written consent therefore serves three separate functions essential to the system. It establishes the unique relationship between the numbered account and the account-holder for the particular payment—essential since many people have more than one account. It establishes the consensual element for discharge. It establishes receipt to the payee's benefit where discharge is not required.

## E. Failure to Obtain Written Consent

Where signed written consent is not obtained, the payor would generally fall back on receipt to the payee's benefit—on proof that the payee had used the account. As a practical matter, both salary and welfare payments are likely to be accepted through necessity. This necessity can also be used as pressure to exact written consent when it would not be freely given. In the case of wages, such pressure is often illegal. Where it is legal, it can only be described as an abuse of economic power for the oppression of individual rights enjoyed by citizens generally. Salary or welfare could also be paid into an institution relying on the payee's need for the funds—easily withdrawn—to overcome his objection. The withdrawal, of course, would establish receipt to the payee's benefit. Again, the use of power is oppressive.

What is a realistic appraisal of the significance of consent agreements? They are a commercial necessity to prove discharge, and a very practical aid in controlling identity. They will not always be freely given, since the payor has considerable bargaining advantage. Deposit institutions, individually and collectively, have much to gain from use of credit transfers. They may place substantial cost incentives on major payors to obtain consent. The payors will also have internal savings to consider. If consent to credit transfers is to be freely given, the payee should be able to choose freely among deposit institutions, and the system should observe neutrality between them. Payor pressure on the payee to obtain consent should be forbidden[8]. To establish such rules would require both federal and provincial action[9].

## F. Factors Affecting Policy on Consent

Organized labour, poverty action groups and consumer advocates are likely to support a requirement of genuine consent. Without government support organized labour would probably still be able to protect its members.

A policy on consent requiring free choice among institutions is in the economic interest of non-banks and smaller chartered banks. But individual power to freely choose direct deposit is in the economic interest of none of the financial institutions, and non-bank support for it could be expected only on ideological grounds.

Individual payees probably value good relations with their employer or government grantor much more highly than the abstract freedom to choose either where they will "bank" or whether they will be paid by credit transfer. They may complain; but they will sign. Such conduct, coupled with consumer inertia and cross-selling by deposit institutions, would adversely affect competition in the financial sector[10].

If no governmental intervention occurred, one would expect institutions which held major corporate accounts, or received government transfers, to grow at the expense of the rest of the payment system. But if free choice among institutions is guaranteed, that is not necessarily true. Among the potential customers created by widespread use of credit transfers are many people who have no historic ties, and little reason for political sympathy, with the traditional banking community. There are many ideological and legal forms for a deposit institution, and profit from financial intermediation need not go to shareholders. The history of the credit union and coopèrative movement indicates ample reason for questioning the assumption that electronic funds transfer will inevitably produce further concentration in the financial sector.

Freedom to choose between institutions is in the interest of the non-banks and smaller chartered banks. But no deposit institution has an economic interest in individual freedom to consent to electronic credit transfer, once neutrality between institutions is assured. Even labour or poverty groups, to the extent that deposit institutions embodying their social goals are organized, can be expected to abandon the ideological point. Institutional pressure in favour of genuine consent is likely to decrease. Unless the individual right to "opt in" is firmly entrenched at an early stage, it is reasonable to predict that "consent" will soon be proposed as a right to "opt out". Students of consumer behaviour know that that is no choice at all. If an individual right to consent to the means of payment[11] is to be imbedded in the law, there will never be more potential support than exists now.

Whether or not such a right should exist is a political and ideological question, but one that cuts across party lines. It involves weighing individual freedom against institutional efficiency. Such a right will have obvious costs. Its benefits are difficult to evaluate and hard to compare with the costs. That does not suggest that society is necessarily better off if such a right does not exist. It does suggest that its existence or non-existence is too important to be left to bankers, lawyers, auditors, or economists.

## G. Summary

A written agreement evidencing consent to a credit transfer is essential to establish discharge and to connect people with numbered accounts. A formal legal requirement of consent agreements can be used to promote neutral treatment of deposit institutions. Or genuine consent to the concept of direct deposit can be required.

Each treatment raises separate issues. As a business matter, institutions might choose to accept the risks of not obtaining authorization, although this is considered unlikely. Neutral treatment is based on considerations of competition policy in the financial sector. Neutral treatment has already been endorsed by the federal government[12]. Although policy statements favouring freedom of choice are on record, meaningful sanctions to protect that freedom have not been created[13]. Ample opportunity exists to abuse the form of written consent. Legislative and operational action by both federal and provincial governments will be required to protect a right to freely choose among various means of payment.

*The Commission believes that federal commitment to genuine, informed consent to the means of payment by individual payees should be made unequivocal.* Such a commitment would have greatest effect if it were imposed in direct federal disbursals, such as interest on government obligations and social payments, on federal Crown corporations, and on employers falling within federal jurisdiction for labour purposes.

*Genuine consent requires that the policy condemn, and sanction if experience shows it necessary, all forms of pressure to obtain consent. Informed consent requires that the payor disclose the normal means of payment in the course of obtaining the consent.*

*The issue of consent is not restricted to the federal arena. The Commission draws the attention of responsible provincial authorities to the need to consider similar action in their own spheres of jurisdiction.*

# III.

# The Payor-Payee Agreement

## A. Characterization and Basic Terms

The written agreement between the payor and payee will be made to provide evidence of their consent to the use of credit transfers. Although it will be consensual, it is unlikely to be a bilateral executory contract. It is likely to be a separate document from the instrument, for example the contract of employment, governing other legal relations between the payor and payee. Of course, where the payment arises from a non-contractual relationship, such as a statutory entitlement, the agreement is necessarily separate.

The payor-payee agreement is the foundation for a series of interlocking contracts required to structure the system. Unlike the agreement, these are likely to be detailed, bilateral or multilateral, executory contracts. They are the clearing rules, which link all institutions participating in the system,[14] the payor-institution contract, settling the duties of the payor and the agency status of the institution in which his account is held, and the payee-institution account agreement. This last agreement is not seen as significantly changing, since an important goal in implementing credit transfers is to avoid disturbing the basic relationship between the payee and his deposit institution.

For this and other reasons associated with consumer protection, it must be emphasized that the model developed in the

remaining portion of this paper is restricted to credit transfers in which the payee is subject to the weakness of bargaining power and the inability to spread risk by other than explicit insurance which are characteristic of consumers. A payee hereafter means a consumer payee; a payor is most likely a large corporate or government payor[15]. At least, the payor is a business enterprise consciously choosing its means of payment to maximize its profits, and capable of obtaining expert advice from lawyers, accountants and other professionals. The consumer's life is too short, and his pocket too shallow, to seek such advice.

A payment service using this sort of credit transfer would be sold by deposit institutions to major payors, and by or through such payors to the consumer payee. This marketing strategy and the weakness of consumer bargaining power will cause the payor-payee agreement to be a simple standard-form document, produced by deposit institution draftsmen.

The agreement could take a variety of forms. The draftsman's choice would not conclusively bind a judge, for the relationships expressed are ultimately questions of fact, rather than of form[16]. Nevertheless, appropriate characterization would almost certainly be respected by the courts. Possible choices for the payor-payee relationship include creation of a power in the payor, an assignment in equity by the payee to his institution of rights against the payor[17], and a contract between them for the benefit of a third party. The choice that conforms most closely to the basic fact pattern is creation of a power by the payee[18].

The payor is authorized by the payee to make deposits to the credit of the payee at the payee's institution. The power in the payor is two-fold: he can cause the institution to become the payee's debtor[19]; he can obtain his own discharge from debt without contemporaneous manifestation of the payee's consent[20]. It is understood that the payor will use the services of other deposit institutions to make the payment. The payee's institution need not in theory be more than a passive participant—but it may undertake certain responsibilities outside this agreement in order to make the transfer work[21].

The payor will seek an authorization, rather than obtaining a contract in which he promises to pay by credit transfer[22]. Why? The payor would be unwilling to bind himself to make payments by means that he does not directly control. If he provided an express excuse for himself by use of a force majeure clause in the payor-payee agreement, the uncertainty of performance would be drawn to the payee's attention[23]. If such a clause were not included, the deposit institutions would need to guarantee levels of system performance. Such guarantees as presently exist provide for force majeure; it is unlikely that the deposit institutions would yield this protection. Yet the payor cannot claim it for himself without drawing the payee's attention to risks that interfere with marketing credit transfer services. No one likes to think of the reasons why his pay cheque might not arrive on time. So the payor has strong business reasons to cast the agreement in the form of an authorization.

Use of an authorization entails the conclusion that the agreement can be revoked on reasonable notice by the payee. But this cannot be avoided in the common law provinces by casting the agreement in the form of a contract. The payor will be unwilling to bind himself to any new performance. He is normally under a pre-existing legal or statutory duty to pay the debt or statutory benefit to be paid. A promise from the payee to do more than give reasonable notice is unenforceable[24]. Even if consideration were supplied, policy would forbid locking the payee into the agreement[25].

The payor-payee agreement would be revocable on reasonable notice. A good faith effort to estimate a time period would probably be respected by the courts[26]. Only the payor has a right to notice. The payee has no right to performance. He has given an authorization, not obtained a promise to pay by credit transfer. The payor need give no notice to cease using credit transfer, although he might do so as a matter of business courtesy. Except for the payee's institution, whose rights will be discussed later, authority is derived from the payor, and notice of revocation of that authority is transmitted through him[27]. A sample form of authorization is given in Appendix I.

## B. Risk to Payor

Reasonable notice, whether pre-estimated or determined after the fact, should protect the payor between preparation and transfer of the payment instructions. Is the payor exposed to risk after the instructions are transferred?

Between payor and payee personally, there would seem to be little risk. If the funds are credited to the payee and used by him, he would certainly be held to have ratified any unauthorized transfer, at least to the extent of accepting the payments in account. If the funds are not carried to the payee's account, or if he repudiates his interest, the payor could require the payee's deposit institution to return the payment[28].

The payee's creditors must also be considered. They have no rights in a deposit made without the authority of the payee[29]. They can seize a debt owing to the payee by the payor. It is thus necessary to decide if issue of a credit transfer in payment suspends the debt, conditionally upon the transfer being completed; and if not, when the transfer is finally paid.

If the debt is suspended, the payor is conditionally discharged, and is no longer at risk. If issue does not suspend the debt, then the payor is at risk until final payment occurs. It can be assumed that payors' institutions will not wish to honour a "stop credit" order from their customers as a matter of legal duty, and that payee's institutions will be unwilling to accept the orders of a stranger in preference to their own customer[30]. If this is so, the payor is at risk until final payment. Even if the institutions were willing to "stop", the risk of error falls on the payor, as would the onus of suit. These risks are serious discouragements to use of a credit transfer.

At common law the payor would not be conditionally discharged. *Issue* of a credit transfer would not affect the debt at all. The contrary rule for cheques and other negotiable instruments rests on two bases: the issue of a "higher" security upon which the payor is liable to the payee and subsequent holders[31], and the presumed normal intention of the parties[32]. In the credit transfer, no negotiable security is issued, and the payor is not liable to the payee upon the authority to pay[33]. The payor's institution and its successors are agent and sub-agents of the payor. Absent a clearly

proven and enforceable agreement by the payee to look only to the payor's institution for payment, the payee retains his normal rights to pursue the payor on the debt. Such an agreement would be wholly inconsistent with the payor's studied avoidance of undertaking a duty to use the credit transfer as the means of payment. The parties' normal intention must therefore be that the debt survives until final payment. At final payment, the payee's institution becomes irrevocably obligated to the payee for the funds. The payee's agreement to accept this obligation, when satisfied, extinguishes the payor's debt.

Final payment is discussed later in this paper. However, it is clear that it must occur well after the payor has released his payment instructions. Therefore the payor is put to an unacceptable risk of paying twice[34].

Statutory relief for the payor is appropriate. The provision should allow a payor who has released payment data and has no contractual right to "stop" the credit to respond to a garnishment as though the obligation seized had been discharged[35]. This is not really prejudicial to the creditor's interest. The creditor simply shifts his seizure to the payee's deposit account[36].

On the level of constitutional jurisdiction the statute must deal with competing claims to a solvent debtor's property. Comprehensive action could be provincial. Or federal action could be based on a broad view of the banking and monetary power. Since as a factual matter commercial accounts are largely held by the banks, practically useful protection could be conferred under a narrow view of banking power. This would create artificial barriers to competition, but since the persons injured would have recourse to equivalent provincial relief, failure to legislate comprehensively could not be a valid reproach to the federal government. Possible forms for such relief are given in Part I of Appendices II and III.

The result of a payor-payee agreement which creates a power to make deposits revocable on reasonable notice is fair as between payor and payee, and can be made fair as between the payor and the payee's creditors by the enactment of statutory relief against garnishment during the period that the payment is in transit. Risk to the payor can be fairly handled without undue prejudice to the rights of the payee or his creditors.

## C. Effect on the Payor's Creditors

The payor's creditors are of course interested in how he pays his bills and his deposit accounts. But the credit transfer scheme does not affect them legally. It can be expected that an institution releasing credit transfers for a payor will either charge his account, or perfect an immediate right to charge his account[37]. Either of these choices will result in the institution having priority to a claim by the payor's creditor. Had the payment been made by cheque, the collection float would delay the charge to the account. Thus, a creditor might intervene with a valid attachment in the period between issue and final payment of the cheque. Such a creditor would be paid and achieve priority[38], although a creditor who intervenes between the release of a credit transfer and its final payment would not[39].

Several comments are relevant. Most claims likely to be paid by credit transfer in the initial period are social benefits or wage claims. No creditors' remedies are available against social benefits. Wage claims are given statutory preference in the distribution of an insolvent's estate, and a creditor who is subordinated in fact to a claim to which he would be subordinate in law suffers no injury. To the extent that administration of the insolvent's estate is simplified, the result is beneficial to the creditor, since the costs and disbursements of administration are also statutorily preferred to his claim.

The preference for the payor's institution over attaching creditors operates as a guarantee of the transfer. If the payor cannot "stop" the transfer, and it is funded as soon as it is acted on by the payor's institution, the payee risks only error and institutional insolvency. Will such a superior form of money drive the cheque from use?

Commercial parties commonly use cheques for the purpose of settling an open account. In analogous uses such as payroll and salary, the normal situation involves a prior extension of credit by the payee—i.e., he is paid in arrears. Similarly, investment income is earned, credited, then paid; government grants are paid after determination of entitlement. In such a situation the creditor has already borne the risk of non-payment for a period substantially

longer than the time required to collect a cheque. It is unlikely that he has the bargaining power to do anything about the risk, or that he is seriously concerned by it[40].

Where concern, ignorance of the payor's credit standing, and bargaining power are united, the cheque is not used. Instead we find the use of drafts under a letter of credit, the consumer and business credit card, certified cheques, and cash. The superiority of the credit transfer is thus only apparent. It is unlikely that it will drive debit transfers from the field solely because of its better theoretical position in insolvency[41].

## D. Role of Payee's Institution

In an earlier part of this section, it was suggested that the payee's institution would agree—outside the payor-payee agreement—to undertake certain responsibilities in order to make a credit transfer system workable. To prevent fraud, the payor must be assured that the purported identity and account number to which he will pay are those of the payee. To restrain account manipulation, the payee's institution will want control over purported deposits to the accounts of its customers. To prevent human error and misunderstanding, the payor may prefer that the payee's institution actually verify the account number[42].

It seems likely that an authorization for credit transfer will be executed at, or confirmed by, the payee's institution. It may even be returned to the payor through banking channels, rather than by the payee. The reasons for this are security and accuracy. Other approaches—such as a very broad indemnity for errors and frauds—are possible. But such use of the payee's institution to verify the payor-payee agreement has an important side effect.

Through it the payee's institution receives a representation from the payee that the payor has authority to make deposits on his behalf. The representation creates an apparent authority in the payor. The effect of this is that such deposits are binding on the payee without further action. To make the deposit good no notice to the payee is required. This clearly establishes the institution as

debtor in respect of the funds transferred, and destroys any possible argument that it is a quasi-bailee which must give notice of attornment in order to shift its obligation from the payor to the payee. Until this representation is withdrawn, the institution can rely on any transfer which appears to comply with the powers granted the payor in the agreement. This is so even though the payee may in fact have revoked the payor's actual authority by proper notice to it.

No formal notice is required to end an apparent authority. Since the payee's institution derives its protection from authority in the payor, it can claim no formal protection. However, if the institution required the payee to execute the authorization for the payor before a branch officer, it could probably insist on some similar steps in its withdrawal. It should be emphasized that it is not form, but a concern with the force of the representation which is being served. Execution before an officer shows serious concern by the institution with the identity of the payee, and careful control of the accuracy of the account number. Its weight on revocation is not to require a formal renunciation where identity is unquestioned, but to require clear proof of a questioned identity or authority.

An authority can also be terminated by implication: by knowledge of facts necessarily revoking it, or sufficient to call the good faith of the institution into question. The law here uses nebulous formulae to draw very fine lines. But this rule would unquestionably be used against an institution which required excessive formality in learning that a payor's authority had been revoked.

What are the results for the payee's institution of the payor's apparent authority? From the time it is shown the authorization agreement by the payee until it learns of a revocation of that agreement, it can bind its customer, the payee, by action taken in reliance on the payor's apparent authority. Deposits are good when made, not when notified or ratified. On the other hand, the institution cannot hide behind a formal procedure. It therefore cannot protect itself from information conveyed by third parties whose effect is to implicitly revoke the apparent authority. It follows that the institution is exposed to a dilemma if it learns, without revocation being communicated to it by the payee, that the payee has revoked the payor's authority. It will be required to take

timely action under the clearing rules in handling the transfer, but it may be unable to learn if its information is correct.

It is naïve to attempt a prediction of how a court would balance the known information against the institution's conduct. Some facts are more suspicious than others, and some informants are entitled to more credence. If the standard of good faith against which commercial conduct is customarily weighed is used, the institution—regardless of the verbal formula employed—will be under a duty more onerous than honesty in fact, but less demanding than due care.

Two alternatives for further protecting the payee's institution exist. It could be given statutory relief by being allowed to demand formal notice[43]. It could extract a duty of formal notice from its customer as part of its normal account agreement. Neither is to be recommended. Use of the account agreement would almost certainly receive a restrictive construction, and is probably inconsistent with the basic relationship, which requires termination on reasonable notice from either party. Statutory protection would be almost certain to be restrictively construed by the courts, resulting in complication of the law without actual protection for the institution. There is also the jurisdictional problem that a statutory cure would be aimed at the deposit contract, and might therefore require holding that near banks are engaged in the business of banking to validate it as an exercise of federal power.

This analysis based on apparent authority can be applied to the payee's relationship with his institution whenever that institution is either informed by the payee of the authorization agreement or receives a copy of it. The analysis must be modified, however, if the payee's institution is simply informed by the payor or his institution that an authorized payment will be made. In that case there is no apparent authority and, if there is no actual authority, it is impossible to bind the payee by simply crediting the funds to his account. Whenever an error concerning revocation, termination, or change of banking address is made, it will be necessary to bind the payee by passage of time or use of the funds.

While the payee remains unbound, the payor also remains undischarged, and therefore exposed to the payee's creditors in the absence of statutory relief along the lines discussed.

The system could probably be operated under rules that gave the payor no apparent authority. But increased uncertainty in binding the payee might make resolution of disputed payments more difficult. Removal of the payee's institution as a control on the accuracy of account information and a check on forgery and imposture would probably introduce a greater risk of error and fraud. These risks are unquantifiable, and the savings from the simpler paperwork under such rules are obvious. There are thus strong practical pressures to operate without apparent authority. Payors would be required to bear the extra risks introduced under an indemnity, for the liability for unauthorized institutional action is clear.

## E. Effect on Payee's Relationship with his Institution

What is less clear is the effect on the payee's relationship with his institution. If the payee's direct personal access to someone who can correct errors in his account or ability to change his banking address easily is compromised, such a system cannot be tolerated. Whether total reliance on an indemnity will make the payee's institution more or less responsive within the account relationship is not clear. Perhaps no change at all will occur.

The payee can, in a set of rules designed to provide no apparent authority, directly instruct his institution. This situation where direct instructions are given should not be confused with the institution's reliance on the indemnity in the absence of instructions. Once the payee has given contrary instructions, there can be no question of actual authority continuing to exist. The possible liability of the payee to the payor is of no concern to the payee's institution; the payor's power is at an end. Action in this situation is wholly within the control of the payee's institution, and no indemnity should be permitted. Imposition of non-transferable liability should promote close obedience by the payee's institution to the instructions of the customer concerning revocations and changes of banking address.

Another reason for compelling action if the customer gives direct instructions is the law of set-off. An institution is allowed to set off a customer's demand loans against his demand balance, if it so desires, and pay only the net balance on a demand for withdrawal or a creditor's attachment[44]. This power is very important to commercial bankers. Its existence explains in part the prevalence of clauses in term or installment obligations providing for acceleration of the debt on default, insolvency, or the lender deeming himself insecure.

Such clauses have attracted adverse attention for many years, since their operation can be extremely harsh[45]. They have a proper commercial purpose; their use in consumer credit is less defensible. Some provinces have largely negated their effect by requiring that a period of notice be given to the debtor prior to invoking acceleration. If the debtor is aware of the set-off, he would not make a deposit after being given such notice. The acceleration clause would then simply be an aid in obtaining present judgment for the principal sum loaned or secured on conditional sale.

Unfortunately legislative provisions requiring notice of acceleration are commonly coupled to personal property security[46]. They fail to catch the acceleration clause of bank credit card agreements, of a real property transaction, or of an unsecured personal loan.

Requiring the institution to act on direct instructions from its customer would have several effects. It would protect the rights of consumers who were entitled to notice of intent to accelerate. It would protect those consumers who feared that their institution was about to invoke set-off, whether such consumers had a right to notice or not, by allowing them to anticipate the institution's action. It would force the institution to respect the rights of informed consumers.

An uninformed consumer would still lose his rights. To provide the uninformed consumer with meaningful protection it is necessary to extend any immunity which he had concerning the payment in the payor's hands into the deposit account. If the funds were unattachable by statute or common law because they were pension money or wages, they should remain unattachable and unavailable for set-off when converted to deposit credit by a credit transfer. Such protection requires federal and provincial action.

The common law has already extended partial protection, but the narrowness of the decision makes it unlikely that the normal consumer would be protected[47]. Statutory relief is advisable. Possible forms for such relief are given in Appendix II, Part II and Appendix III, Parts II and III.

## F. Summary

The written payor-payee agreement will probably create a limited authorization. The authorization created is permissive; the payor remains free to use other means of payment. The authorization is revocable on reasonable notice, which may be defined by the agreement. A sample form is given in Appendix I.

*Such an arrangement adequately protects participants in the transaction, apart from the payor. The payor is exposed to a risk of double payment, which is a serious deterrent to the use of credit transfers. Statutory relief from that risk would not be unjust to the other parties involved, and might promote the use of credit transfers in commercially sound situations.* Section VII discusses suggestions for such relief. Additional risks are placed on the payor if he cannot claim the benefit of apparent authority conferred by the payee.

If protection against loss of authority is not given, it is fair to predict that payors and their institutions will be required to indemnify the payee's institution in broad terms against failure of authority. *This indemnity should not be so broad as to protect an institution that disregards the express instructions of its customer.*

The law of set-off provides further reason for insistence on compliance with the direct instructions of the payee by his institution. However, such insistence can protect only the informed consumer. *To provide a full measure of protection in this highly technical area, it would be necessary to enact statutes carrying the consumer's immunities respecting wages, pensions, and like payments forward into the deposit account. Such statutes should also provide protection from attachment by general creditors of the consumer.* Section VII discusses suggestions regarding protection of these immunities by statute.

# IV.

# The Clearing System for Credit Transfers

## A. Clearing Standards and Clearing Rules

The preceding portion of this paper has characterized the agreement between the payor and payee from a legal point of view, and shown how that characterization affects the creditors of both parties. In order to support that characterization, and to provide for the exchange of information in an orderly manner, there must be clearing rules. The content of the rules may range from precise specifications for magnetic tapes to very general legal provisions. Later in the discussion, the phrase "clearing standards" is used. The parties concerned—the deposit institutions—are the only group that can intelligently write the clearing *rules*. But the rules they create must provide for a fair and equitable clearing system that is consistent with the characterization of the payor-payee agreement.

The clearing *standards* suggested are concrete criteria for evaluation of rules. In some cases, a specific rule might be approved on the basis of the standard; in others it might be more intelligent to make the standard the rule, leaving the parties free to adopt any procedure that is consistent with the standard either as agreed usage among institutions or as an internal operating procedure. Obviously, the choice of a standard for the formal rule gives the parties flexibility in handling their affairs which is not present when the formal rule is specific and arbitrary. An intermediate

position on flexibility can be reached by providing a specific rule for normal situations, but excusing non-performance in abnormal situations if the failure is reasonable in the circumstances.

The values involved in choosing an appropriate degree of flexibility in the rules are competition, certainty and efficiency in operations, and intelligent response to the unforeseen.

The terms of clearing agreements do not clearly affect bank customers as a matter of law[48]. But in practice they determine the content of the market for payment services. Apart from the obvious effects on institutional soundness of proper settlement practices and the monetary use of these transfers, commercial parties often order their affairs in a manner that cuts off the rights or remedies of users of the system[49]. Those same commercial parties then insist that this conduct is a matter of business judgment and freedom of contract, and that their internal affairs are as unalterable as the laws of the Medes and the Persians[50]. Government in its role as regulator often abets this process, through the approval of tariff terms or contracts containing the offending clauses. Relying on their inability under the pre-agreed industry practice to pass losses to the party at fault, or the availability of insurance to the user, the industry persuades government to accept imposing the loss on the user. The coup-de-grâce to the user is then administered by burying disclosure of the limited liability in fine print or disingenuous drafting[51], and marketing the product or service as though it did not involve a loss of normal rights. Government must be concerned with the fine structure of the clearing agreements in order to assure that normal rights are maintained and that the creation of credit transfers is not made the occasion for selling out consumers to the marketing convenience of banks in dealing with major payors.

## B. The Clearing Institutions

The relationship between corporate payor and individual payee has been analyzed in the preceding chapter. The payor was

shown to be the holder of a power, which he exercised through his bank and its sub-agents. The result of their action was to place funds in an individual's deposit institution credited to that individual. The act of crediting the individual's account discharged the payor and all those acting under him, and completed the transaction.

This section is concerned with the arrangements between banks and other deposit institutions which are required to carry out that transaction in a fair and efficient manner. It is built on a number of basic assumptions. It assumes that the payor is properly characterized as holder of a legal power, granted by the payee. It assumes that the arrangements between the payor and his bank are entered into for the purpose of delegating the performance of an act: payment. Obligations involved are subsidiary to that act, and for the purpose of making its performance more certain. It assumes that other members of the clearing system have no interest, apart from their own protection, in the customers or mode of doing business of another deposit institution.

It assumes three classes of participants in the payments system: clearing members, non-clearing members, and non-member correspondents[52]. Clearing members have a right to participate directly; they hold reserves at the Bank of Canada, are subject to deposit insurance or other inspection requirements, and have borrowing privileges at the Bank of Canada. The prototype for a clearing member is a chartered bank. Non-clearing members participate indirectly through the agency of a clearing member; they may hold their reserves with that member, are subject to insurance and inspection requirements, and have borrowing privileges at the Bank of Canada. Non-clearing members are situated similarly to trust companies under present law, although such companies do not enjoy borrowing privileges at the Bank of Canada. Non-member correspondents are individual credit unions or caisses populaires. They participate in the payment system only through affiliation with a central or federation which is either a clearing or a non-clearing member. Their regulation and coverage by deposit insurance or similar legislation is primarily as specified in the relevant provincial legislation[53].

## C. The Proposed Canadian Payments Association

These three classes correspond to the membership of the proposed Canadian Payments Association. If that Association is created, the two classes of members will be linked contractually through the medium of the Association. The Association bylaws will presumably provide for guarantee of a non-clearing members' obligations in the clearing by the agent clearing member[54]. The obligations of a non-member correspondent would presumably be treated within the Association as those of the member who represents the correspondent in the clearing. Whether the correspondent is formally brought into the contractual network through designation of its representative as agent, or the representative alone is made liable to the members of the Association, seems unimportant. The representative is financially stronger and more readily available than the correspondent, and will certainly provide for either recourse on the correspondent or an insurance fund from which to protect itself.

The proposed Canadian Payments Association provides a structural solution for problems of privity of contract, rule-making, and government supervision. No structural solution can assure that the members will govern themselves wisely or well; but the possibility of ad hoc government intervention if self-government fails should be a potent incentive to agreement for members of the Association.

The creation of the Canadian Payments Association is of importance in discussing standards of performance for a clearing system for credit transfers. If a bank is to be made responsible for the conduct of other institutions, it is fair to ask if that bank has any reasonable means of affecting their behaviour or ascertaining their competence. If a bank or other institution is to be made liable for the error or wrong-doing of another institution, in order to serve as a conduit for liability, it is essential to ask if the ultimate bearer of loss is financially sound.

The management, criteria for membership, and reporting requirements of the Association would allow these concerns to be met on a continuous basis. The Association provides a device through which standards can be agreed upon, legislated, and

enforced. It combines private initiative with public scrutiny in its rule-making function, and its supervision and inspection apparatus borrows existing deposit insurance arrangements.

On balance, creation of the Association would seem to enhance the confidence that financial institutions might have in the competence, credit-worthiness, and businesslike conduct of other members of the system.

The Canadian Payments Association can be viewed both as a structural device for enacting standards and rules, and as an informational medium supplementing existing institutions and inspection. By performing these roles, it would provide means of implementing standards and fostering confidence in compliance. But what sort of standards and rules should it enact to deal with credit transfers?

## D. Principles for Clearing Standards

Our law recognizes two basic sources of duty for private behaviour: contract and tort. In contract we deal with individually agreed duties; in tort with duties imposed upon people by their special status or simply by membership in society. The law of banking consists almost exclusively of rules developed by judges who claimed to analyze the "implied contract of banker and customer"[55]. Whether the contract was implied from the factual behaviour of the parties, or simply from the perceived justice of the situation, is a question which we confront with much more sophistication than the judges who developed the rules. Whether those judges discovered the actual agreement of the parties, or invented one for them, it is clear they thought that the transaction was consensual to its very root.

Our law of contract protects three basic interests in connection with consensual transactions: restitution, reliance, and expectancy[56]. If a party seeks restitution, the law attempts to place him in the position in which he was before entering the transaction. If he seeks reliance damages, he is awarded his out-of-pocket loss flowing from the transaction. If he seeks his expectancy, the

law rewards him according to a formula which speaks of the benefit of his bargain.

The promise of a banker that commonly gives rise to dispute is one for the payment of money, either because the customer seeks to withdraw a deposit or because his cheque has been wrongfully dishonoured. The rules of damages applied to these events make it plain that we have chosen to protect the restitution interest of the customer[57].

It would therefore be consistent with existing law for institutions to seek to limit their liability for non-performance of a credit transfer to restoring the funds involved. This sort of approach is implicit in the agency model which has been developed. In particular, the payee has no right to performance in such a model, and therefore no remedy for consequential dishonour. If his cheques bounce because a payroll transfer is not made, he has no legal recourse. He can, however, withdraw his authorization.

The effect of institutional attempts to limit their liability for late payment is much more complicated. The law has long recognized that there can be non-contractual liability for performing poorly in circumstances where there would be no liability for doing nothing at all. The payor's institution would normally be liable to the payor for substandard performance; the payor would be liable to the payee for his own substandard performance, and vicariously liable for that of his institution. On the view most favourable to the institutions, the transaction is one for the mutual benefit of the parties, and the standard to which they will be held is due care. Since the institutions are professionally engaged in the money transfer business, the due care is that of a prudent banker, not that of the man in the street[58].

If the courts analyze credit transfers from the agency viewpoint, the clearing rules will be important evidence of the behaviour of prudent bankers. Failure to meet the normal requirements for performance would certainly require an explanation. The clearing rules might not be treated as dispositive of the issue, since there is always a risk that business will set its level of performance below what is reasonable given the state of the art[59].

If the courts analyze credit transfers from a purely contractual viewpoint, the clearing rules are a trade usage. They can become binding on the customer if the court accepts them as

uniformly applied and reasonable, and if the customer has notice of them[60].

In the end result, there may not be too much difference in the weight and effect given the clearing rules. Both approaches require the rule to meet the test of reasonableness within a context of expert commercial activity. In both, the rules fill gaps in other agreements; they cannot override their express language. In both, evidence of uniform applications will be important. The notice requirement is too easily manipulated to produce an important difference in the analysis on the merits of a particular rule.

Late payment is only a special case of "poor performance" by the payor or the institutions. Just what constitutes "poor performance" as opposed to non-performance can't be spelled out. One reasonable line to draw would be that each credit transfer under an authorization was a separate performance. Then failure to start any particular transfer would not be actionable, but improper handling would be. If each transfer is not a separate performance, then putting the first one through raises a duty to put others through until the authorization is cancelled. This would obviously make the rules of much more importance.

In considering what appropriate standards for performance are in credit transfers, the rules for presentment and notice of dishonour governing cheques and bills should not be given great weight. The extent to which the *Bills of Exchange Act* altered the common law is not clear to this day[61]. More important, those rules were developed for debit transfers. A bank which is advancing credit against uncleared funds is under substantial business pressures to collect promptly. Both the risk of non-collection being coupled with an insolvent or fraudulent depositor and the cost of float encourage the banking system to clear and collect debit transfers promptly. The legal rules function as a seldom-used backstop for these pressures.

Credit transfers represent not a risk, but a gain, for the banks handling them. The transfer is fully funded, and can be a source of credit float. Creating pressures comparable to those encouraging the prompt handling of debit transfers may require considerable ingenuity. Yet the rules cannot be over-rigid.

It must be recognized that the clearing rules operate within the confines of the common law of contract. Unlike the Civil Code,

the common law as a matter of principle initially rejected the idea that intervening unexpected events could absolve a party from his contractual duties[62]. The early rejection has undergone substantial qualifications, but the commercial community still finds it necessary to provide by express contractual terms for such contingencies, and has borrowed the civilian concept of "force majeure" to describe such terms[63]. In weighing such clauses in the clearing rules, it must be recognized that without their presence the parties would be held to strict performance of obligations undertaken, and that this may be both unreasonable and productive of undesirable business behaviour.

Finally, the clearing rules have the function of replacing rules which our legal system would otherwise apply. Without them an incomplete or erroneous credit transfer would be governed by the law of restitution. That law lacks the degree of certainty required for intelligent commercial planning[64].

Recognizing the combination of complex private arrangements and the public interest required in drafting rules to replace the generalities of the law of restitution, government has provided for administrative approval of the clearing rules.

In summary, the general considerations from which clearing rules should be approached are:

1. that the contractual relationship they structure is based on rules that protect the customer's restitution interest;
2. that their main effect is to define inter-institutional responsibility with commercial certainty;
3. that an important commercial purpose of the rules is to maintain the speed with which credit transfers are processed (since commercial forces do not encourage speedy completion of a credit transfer, this purpose is much more important than in the present cheque clearing system);
4. that the rules must expressly provide for "reasonable" excuses for non-performance, since our general law will not supply excuses; and
5. that the rules, by defining the parties' duties, are designed to replace vague principles for loss adjustment that would otherwise be supplied by the law of restitution.

## E. Problems Requiring a Standard

Analysis of the steps involved in credit transfer and our experience with other modes of payment suggest several problems that require legal standards. These are: speedy transmittal of the payment message to the payee's institution and branch; misdirected payment involving only one institution; fraud involving several institutions; and recall or reversal of credit transfers.

### 1. Speedy transmittal

It has already been pointed out that business considerations affecting speed for credit transfers are completely different from those for cheques. Apart from customer dissatisfaction and system congestion, an amoral banker might well route his credit transfers by snail back.

On the other hand, the problem of designing an efficient courier service between data centres and branches must be recognized. In the initial period institutions may need to prepare and deliver paper vouchers for their more remote branches from data originally received on tapes. The alternative to bank courier operations is to transmit the data through the postal system. It seems unlikely that use of this alternative would be acceptable to anyone.

It seems reasonable that institutions should be required to formulate and adhere to timetables governing delivery under normal conditions, and that deviations from those timetables should require a showing of force majeure. In the presence of force majeure, institutions should be able to discharge their duty by acting with reasonable diligence. Such a clearing standard would require the industry to prepare and promulgate timetables based on data supplied by the institutions, and would impose the force majeure excuse and its accompanying duty of diligence as a binding rule. Provision for allowing the industry to force an offending institution to raise its performance level should also be available. General monitoring of industry performance could

probably be performed by the Bank of Canada in the course of its normal economic studies concerning the money supply. If credit float is kept to acceptable levels, the concern of the payor for speedy action and the banks' concern for an uncongested system should solve the problem of speedy transmittal.

There is little in this proposal from a practical viewpoint to offend the deposit institutions. They intend to handle payroll and other benefits which would need to be delivered on a firm date in order to be competitive with disbursal by cheque from the standpoint of the payee. They will necessarily operate on a timetable for normal conditions. From the legal viewpoint, the potential liability seems frightening. Disasters that can directly flow from want of money spring readily to mind; if consequential damages were available to the payee, the risk might be unacceptable.

However, the payor's institution and its transferees owe no duty to the payee. It is later suggested that even the payee's institution's duty should commence when the payee's account is credited[65]. It is doubtful whether the payor himself could be made liable for consequential damage; but if he could, his deposit institution can control its liability to him by contract[66]. Since the payee's institution will often be dealing with a well-established customer, it may advance its own funds in lieu of the transfer, on either a discretionary or guaranteed basis, and prevent damage to the payee[67].

For these reasons, a clearing standard requiring speedy transmittal and having the force of a contract among the institutions would probably not result in increased legal exposure for any institution. Breach of such a standard during an institutional insolvency might occur, but a separate provision for the status of credit transfers in insolvency is obviously required. Such a provision would override any inferences that might be drawn from the duty of speedy transmittal or its breach[68].

The main role of the clearing standard on speedy transmittal and its associated timetables would be to give some concreteness to the assurance that payment would be transmitted in a timely manner. It might be grounds for discipline within the clearing system; it is unlikely to give rise to a lawsuit inside or outside the clearing.

## 2. Misdirected payment involving only one institution

This can take a number of forms. There are over- or under-payments to the correct payee. There are payments to an incorrect payee. There are payments which are superficially correct in both amount and recipient, but which are the product of failure to act on a revocation of authority, of termination of authority, or of fraud.

### (a) *Error*

It is unlikely that an error in amount can occur after the transfer tapes are prepared. The use of control balances would require that countervailing errors occur, since if they did not, the transfer tapes would be rejected as out of balance by receiving institutions. It would be possible for such errors to occur in raw data from which transfer tapes are prepared, or in the actual process of posting the payee's account. Such errors should be very easy to trace. The latter type is clearly isolable in the payee's institution; the former involves discovering whether the payor or his institution introduced the erroneous amount into the data.

Clearing standards should protect those who rely in good faith on erroneous data. The law of restitution would allow recovery from a party who is unjustly enriched by overpayment; the effect of underpayment would be determined by the conduct of the recipient[69]. In either case, the dispute is ultimately between the payee and the party who made the error. However, for reasons of policy, the payor's institution should be required to bear these losses initially. It can extract an indemnity from the payor for his errors, and all other institutions act as its sub-agents until the payment is accurately completed. The clearing standards should therefore require the payor's institution to warrant its data as error-free concerning the amount of payments.

Similar considerations apply to errors in identifying the payee by name or bank and account number. Losses actually incurred through such error will be influenced by the extent to which data transmitted through the system permits cross-checking. Since account numbers do not commonly contain an internal check-digit,

it is likely that the account name will also be transmitted in whole or part. Such a cross-check should almost wholly eliminate error. The chance of an error in the account number producing a new number which cross-checked with an actual account name would be quite low. In principle, however, the loss should be allocated ultimately to the source of error. The payor's institution should be made the conduit to that source. The clearing standards should require the payor's institution to warrant its data as error-free concerning destination and account numbers and names of payees.

Focusing initial responsibility for error on the payor's institution should have a number of effects. It is reasonable to expect that that institution will cease to act for any payor who supplies undue amounts of bad data. This will remove such payors from the system. It is reasonable to expect that payor's institutions will bring pressure to bear on any payee's institution or intermediary which is failing to maintain proper standards of performance. Such pressure by fellow members of the industry should have an immediate and salutary effect on the institution concerned, and should be far more effective than the complaints of isolated payees to either that institution or its government regulators.

From a legal standpoint, the payor's institution warrants its own performance, and becomes vicariously liable to other institutions for the payor's errors[70]. Its warranty would bar recovery of mistaken or misrouted payments, if the receiving institution had a right to rely on that warranty[71]. Such a right would clearly exist in the case of a normal mistake in amount in a payment to the proper individual. If the mistake were of an order of magnitude, e.g. a $10,000 monthly wage, the right to rely might be called into question. If the payment data indicated on its face that it could not be properly posted to the account to which it had been put, there could be no right to rely. A payment that contained the recipient's name, but had been garbled in the bank or account number, would be an example of such a payment. If by chance the garble produced a coherent banking address, the payment would clearly be to the wrong name. The most simple sort of investigation should disclose that the payment could not have been properly posted, although discovery of the source of the payment might be impossible. Once the payor's institution sought its recovery, however, the warranty would not prevent it.

The most important effect of the warranty would be to force payors or their institutions to recover normal mistakes in amount from the payee. Since the payor is likely to be both the source of the error and in a continuing legal relationship with the payee, the most likely method of recovery is stoppage of the amount overpaid out of future payments. This represents no change from the present system. In the rare case where the payor's institution is the source of such an error, it should pursue sums which have been posted to payee's accounts outside the system. Of course, when the mistake is in the banking address and no payee exists, remedies within the system are a better answer. In that case, the receiving institution has no right to rely on the payment, and can only have posted it through negligence. But since no payee exists, the funds should still be available in the institution in which they were erroneously deposited.

Should the warranties covering amount of payment, name, bank and account number, warranties that cover negligence and innocent error but no criminal conduct, be continuing warranties? Or should they take effect when the payor's institution transfers the data? If the latter is the case, then to fully protect the institutions, it is likely that serial recourse would be provided by contract. If the warranties took effect at the time of transfer, then a similar set of warranties by intermediaries would be necessary under both the existing and proposed Canadian Payments Association organization of the clearings. If all warranties ran to subsequent parties recourse could be serial or direct.

If the warranties were continuing, then the normal pattern of recourse would be direct. Since this would make the payor's institution vicariously liable for the errors and negligence of intermediaries, it should receive an indemnity under the clearing standards against losses due to error introduced into data while under the control of another institution.

Two factors are apparent. When an intermediary is present, the two rules create different patterns of dispute. If there is any factual problem about where the error was made, the pattern of dispute and the burden of proof may alter the ultimate decision. When there is no intermediary, the indemnity mirrors the effect produced by being unable to rely on the warranty when at fault[72].

It is necessary to make an assumption about sources of erroneous data. If the greater number of errors are introduced in or prior to the payor's institution, direct recourse on a continuing warranty and the intermediary indemnity is the preferable solution. Otherwise, serial recourse on the intermediary will produce the most efficient dispute flow. It seems likely that error at the source will be the major problem. Direct recourse on the payor's institution, followed by that institution's claim on the payor under his contract with it, would produce the more efficient solution. The warranties covering amount of payment, name, and bank and account number—basically a warranty of data accuracy—should thus be continuing warranties.

(b) *Authority, revocation and termination*

The warranties of name and bank and account number just discussed were referred to as warranties of data accuracy. They are breached if the payor does not hold an authorization agreement bearing the same name and banking account data. A warranty of authority goes beyond these warranties. It is breached if the payor does not hold a genuine authorization agreement that is currently in effect. This might occur because the purported agreement is a forgery, or because a genuine agreement has been revoked or terminated.

Warranties of authority, which deal with genuineness from the viewpoint of the payee, must be distinguished from warranties of authenticity. These, which are discussed in the next section, deal with genuineness from the viewpoint of the payor. The former warranties cover situations in which the payor is deceived into making a transfer; the latter with situations in which a transfer is passed off as genuine, although it is the product of outsider crime or a material fraudulent alteration of the data.

From the institution's viewpoint, the responsibility for authority is crucial. The extent to which the payor can be said to have a substantial relationship with the payee can vary widely. An employer can certainly be charged with the knowledge of its employee's identity. But can an issuer of corporate or governmental securities properly be charged with knowledge of the identity of its share or bond holders? The problem is not one of nominee

holdings or employment under an assumed identity; it is simply whether the person acting as nominee is the nominee, whether the person signing the wage payment authorization is the person employed.

While discussing the payor-payee agreement, it was noted that two viewpoints seem to be developing on responsibility for verifying authority. Under the more conservative viewpoint, the payee's institution verifies that its customer is in fact the person executing the agreement. The verification would probably include the account number. It might be combined with operating procedures controlling the inflow of funds to customer accounts by credit transfer. A less conservative viewpoint simply accepts the warranty of the payor's institution that the payee has authorized the transfer. The burden of this liability will be passed on to the payor; his institution makes the warranty to put its own credit behind the promise.

If the more conservative viewpoint is followed, the payor's institution should be required by the clearing standards to warrant that an authorization agreement exists which purports to be signed by the payee. The payee's institution would warrant that the agreement was executed with the authority of the payee. If the less conservative viewpoint were followed, the payor's institution would warrant that the payee had given authority for the transfer. It is not necessary that the same pattern of warranties covering authority exist for all kinds of payments, so long as it is clear which pattern governs a particular class of payments. The more conservative view allows for a tighter control of accounts against certain types of manipulation, but there are alternative means of achieving this. It is probably sufficient if the clearing standards prescribe alternative means of establishing responsibility for the existence of authority, and require that institutions cooperate to the extent necessary to implement any agreed means. There are possible problems for competition policy here if different institutions cannot agree that a particular class of transfers should obviously be treated as falling under one alternative, and some desire to offer competing alternatives for the same class.

Failure to act on a revocation of authority after reasonable notice necessarily implies substandard business performance. Since revocation requires reasonable notice in order to be effective, the

standards should require the payor's institution to warrant that it has no notice of a revocation of its authority.

Termination of the payor's authority by operation of law raises different issues. There is no way that the payor or his institution can guard against the legal risks involved by any sort of prudent conduct, since termination does not depend on notice of the event which produces it. The parties most likely to profit from introduction of credit transfers are payors and their institutions, since it is they who receive major benefits of paperwork simplification or elimination. Since termination, apart from bankruptcy, is a statistically predictable event, the payor, his institution, or others can assess the risks and insure or self-insure. It is fair to arbitrarily allocate the risk of termination against them, except in the case where the payee's institution has notice of an event producing termination, and neither the payor nor his institution have such notice. In such a case, the payee's institution is clearly at fault and should be treated as the source of its loss. The clearing standards should thus require that the payor's institution warrant the non-termination of its authority unless the payee's institution has notice of such termination and neither the payor nor his institution have such notice.

Apart from the payee's knowledge of revocation or his exclusive knowledge of a termination, the losses resulting from a payment in these circumstances would fall on the payor. In many cases, the loss is only apparent. In termination of a pension on death, for example, a mistaken payment can usually be set off against a death benefit payable. The practical exposure is thus much less than would appear from pure legal analysis. Nevertheless, since the payee may be dead or incompetent or have vanished, this class of risk is a genuine one. Termination risk is unavoidable; but the risk of failing to act on a valid revocation is easily prevented. The liability imposed by these two clearing standards should not be unduly burdensome.

Should these warranties be continuing warranties? The warranty against termination has nothing to do with the conduct of any institution in the normal case, and operates purely to allocate the risk. It should therefore be treated as continuing until the transfer is completed by final payment. But the warranty against notice of revocation need not so operate. For such notice to have

effect, it must be given within a reasonable time for the payor's institution to act. Such a time will certainly have passed if the payor's institution has released its data. This warranty can accordingly be given effect at the time that the data of the payor's institution is delivered. That institution's warranty that authority has been given, or the combined warranties that a purported agreement exists and authority has been given, must be read subject to the specific provisions for revocation and termination. They are designed to carry into effect the system of continuing authority revocable on reasonable notice discussed in the section on the payor-payee relationship.

If the payee's institution verifies the identity of the payee, the warranty should be viewed as applicable to all transfers under the authorization verified. Such verification may be relied on by the payor or others as indicating the continued control by the payee of the account in question. Accordingly, there should be a clear institutional position on whether signature control over the account can be changed without notice to the payor, and if it can, upon what authority and for what purposes. The specifics of these rules should be available to payors, since they may be under a duty to control their disbursements more closely than the rules adopted would allow. Such duties of control are likely to bind government officials and those charged with disbursing investment income.

(c) *Criminal conduct*

The essence of criminal conduct involving credit transfers would be giving false information to induce or divert a credit transfer and obtain unlawful gain. Which crime was committed would depend on the specifics of the criminal act and the identity of the perpetrator. For the purpose of selecting a risk-bearer, these specifics are not necessary. An institution may be equally chargeable with losses caused by its robbery, a skilful fraud, an embezzlement or criminal breach of trust. In all these cases, it has allowed its security measures to be defeated. In obtaining the legal benefit of accounting to its customer on a debtor-creditor basis—the freedom to freely use the customer's funds which is the foundation of banking—the institution obtains also the burden of making good breaches of security out of its own funds. The institution does

not transfer the customer's funds; it causes funds to be transferred at the customer's direction and charges his account accordingly. Debtor-creditor accounting and the net settlement it allows are absolutely incompatible with a continuing legal proprietary interest of the customer in the funds in transit. The problem is *which* institution is liable for the breaches of security.

The most probable point of insertion of fraudulent information in the system is the payor. Data can be most easily corrupted at the source, before it is necessary to defeat control balances and security controls over tapes. It seems almost self-evident that the payor should bear losses caused by data which contain fraudulent instructions which he supplied to his institution. Analogy with the law of negotiable instruments is misleading. Under that law, if the payee exists, the drawee will bear some of the losses for this sort of fraud. If the payee exists, that law requires the signing officer of the drawer to be a party to the fraud if the loss is to fall on the drawer. If the signing officer is a victim of the fraud, even though it is committed by the drawer's employees, the loss falls on the drawee. The rule is outdated, and was substantially modified in the Uniform Commercial Code. Hope that the law of negotiable instruments in Canada was moving in this direction was dashed by the decision in *Concrete Column Clamps (1961) Ltd. v. Royal Bank*[73]. Since a credit transfer is not a negotiable instrument requiring endorsement, there is no formal reason for this rule to be applied.

If normal restitution principles are followed, the payor would not be allowed to plead the fraud of his own employees to obtain recovery from anyone except those who were involved in the fraud, or those who held property which was the subject of the fraud as other than bona fide purchasers for value. There seems no sound reason to depart from these principles.

However, the payor's institution may have passed transfers through the system without obtaining contemporaneous settlement for them from the payor. In this case, if the payor were insolvent and his institution were allowed to rescind its settlement, losses would be imposed on payee's institutions who had honoured the transfers for confederates of the fraudulent party.

This risk and the normal principles of restitution can be met by requiring the payor's institution to warrant that the transfer is

authentic and that its information content has not been materially altered for a fraudulent purpose. Losses thus transferred to that institution should be imposed on the payor by an indemnity provision in the contract between the payor and his institution. In any case other than payor insolvency, such treatment would result in the actual dispute being resolved between the payor and the injured parties. The risk is one against which payees' institutions are entitled to claim protection; if seriously concerned by it, the payor's institution can charge the payor's account when it makes the credit transfer.

Should the clearing standards also provide that the warranties of authenticity and non-alteration are continuing? If that were so, the payor's institution would be vicariously liable for any successful introduction of spurious transfers or alteration of genuine ones occurring after the data had left its control. If such warranties were made, they should be supplemented by an indemnity for negligence or criminal acts by the institution actually in control of the data when the act occurred.

Without such warranties, one would expect the institutions to arrive at a contractual pattern to protect themselves on interchange of data which provided for serial recourse. Each institution would promise that its data was good as of the time it was transferred. If the promise were part of the clearing rules it could be made to run to subsequent parties, allowing for direct recourse on clear facts.

By contrast, if continuing warranties were made by the payor's institution, the normal pattern would be direct recourse. The institution injured need only determine whether it was itself at fault before proceeding against the payor's institution.

Under the present and the proposed Canadian Payments Association organization of the clearing some institutions will receive transfers through an intermediary. This makes a difference in the flow of disputes produced by the two rules discussed. Under the continuing warranties, disputed transfers received through an intermediary would produce first a claim against the payor's institution, then a possible claim on the indemnity against the intermediary. Under the other rule the disputes would flow first to the intermediary, and then possibly to the payor's institution if it

was at fault. Choice of the better rule can be made under an assumption about the source of criminal conduct. If most criminal conduct concerning false or altered transfers affects the data flow at or before the payor's institution, then the continuing warranties produce a simpler normal flow of disputed transactions. If the main source of problems occurs after delivery of data into the clearing process, serial recourse under a promise that the data is good at the time of transfer is preferable. Under any commercially sound level of security, the greater number of criminal acts must occur prior to the payor's institution receiving the data. The continuing warranties are therefore preferable. This choice of rule is also desirable because the warranties covering *all* altered transfers—whether or not criminal conduct is involved—will run from the same parties. Proof that the initial data and ultimate message delivered did not correspond would be sufficient to make the payor's institution liable, unless that institution could assert the indemnity as a bar or show the data were so grossly defective when received that there could have been no right to rely.

### 3. Fraud involving several institutions

Fraud by creating spurious accounts payable often involves not only the payor's institution, but the payee's as well. Such fraud often presently results in the issue of a cheque in an assumed name. If the cheque is banked, it will be endorsed in the assumed name. If necessary, such an endorsement is clearly forgery. No one taking under it can have title to the instrument. If the endorsement is unnecessary, the depositary bank can enforce the cheque. The endorsement is unnecessary if the payee is fictitious or non-existent. Under current law, if the signing officer is a victim of the fraud and the payee exists, the endorsement is necessary. That rule has suffered vigorous attack [74].

In the preceding section, it was suggested that the present rule should not be carried over into the law of credit transfers as a general matter. Suppose, however, that the payee's institution has agreed to verify the payee's identity. Suppose it is deceived, and the payor is also deceived into issuing a credit transfer to a feigned existing person—probably by a dishonest employee in the payroll

department. On whom should the loss fall? By analogy to present law, it would fall on the payee's institution.

The policy offered in defence of the present rule is that it encourages banks to know their endorser. It does—in those cases in which the criminal feigns an existing identity. Curiously enough, in those cases where the identity is invented or plucked from the phone book at random, there is no policy requiring the bank to know its endorser, although one might think that such frauds would be more easily detected by the payee's institution than those involving feigning an existing identity.

Should the deposit institution be required to know the payee? One way to approach the question is to ask if the payor has any opportunity to verify the payee's identity. For an employer, the answer is clear. An extreme instance would have the payee execute the authorization in front of his supervisor. But other payors might have only rare or inconvenient contact with the payee.

If government or investment payments are considered, a wide range of degrees of contact appears. The mother who banks family allowance cheques through the household account, the pensioner who casually cashes his cheque at different local stores, the purchaser of a security who could receive interest through an account with the seller—all raise different issues. There is seldom any difficulty in identifying a mother who banks a family allowance cheque. For the pensioner, the issue is more difficult. Cashing his cheque may be a major part of his banking activity, and establishing a solid identity by other means may take more time and trouble than he is willing to spend. With the purchaser of securities, an issue arises concerning identity itself. Should the bank confirm that the interest is paid to the purchaser, or that the purchaser is who he purports to be?

If a verification of identity is supposed to cover only the risk that a genuine payee will be deprived of a payment by a spurious authorization, it may not be very important. It would be necessary to perpetrate a great number of such frauds on the consumer level to make any sort of significant recovery. There must be easier honest ways to make money. Casual thievery of cheques out of the mailbox takes little skill; its credit transfer equivalent is more difficult.

If verification of authority is also supposed to supplement the payor's control procedures, it is much more important. The payor is then seeking the assurance of the institutions as a system that his payments will only appear in genuine accounts traceable to real persons in their own right. If such verification were to become a normal part of the account relationship, it might become much more difficult to open an account than it presently is.

If this verification extends to all situations in which the payor's own employees have reason to know that the identity is false (because they were parties to the falsehood) the rule now applied to cheques is not only preserved but extended. Verification in these terms would cover non-existent, as well as feigned, identity. From the viewpoint of the payee's institution, there is little more opportunity to detect the one than the other—perhaps more in the case of the non-existent identity.

It is suggested that the current law regarding cheques—the so-called "fictitious payee rule"—contains an anachronism. Forgery of an endorsement or an authority to receive payment that is based on an instrument or transfer whose issue was caused by fraud is best analyzed in terms of the initial fraud. In a society that prepares its cheques in disbursing departments, close inquiry into the knowledge of the signing officer is not enough. The risk of criminal conduct by his subordinates is a legitimate and insurable risk of doing business; there is no longer need to impose it on deposit institutions generally and through them on the cheque-using public. Of course, if the signing officer perpetrates the fraud, the loss should fall on the payor.

As a general principle, where fraud on the payor is combined with fraud on the payee's institution regarding the payee's identity, the loss should fall on the payor. If that rule is unworkable in specific situations, for example, disbursal of universal statutory benefits such as family allowance or government pensions, the extra duty of verification should be expressly contracted and paid for. In the case of government securities, establishing identity between the purchaser and the payee would seem part of the legitimate duty of a sales agent—assuming that the authorization was executed at the time of sale. Establishing that identity at a later time, or verifying for tax purposes that the individual was in

fact the person he purported to be, would seem to go beyond duties presently associated with the law of payment.

As a general principle, the prevention of padding of accounts payable is the duty of the payor. Services which he seeks to obtain from the deposit institutions to attain that objective should be viewed as services contracted for outside the normal duties of the law of payments. The exact wording of the warranties of authenticity and of accuracy of name, account number and banking address must be carefully assessed to ensure that the desired lines of responsibility are drawn concerning the payee's institution's verification of its customer's identity.

## 4. Recall or reversal of credit transfers: final payment

In the discussion of the effects of credit transfer on creditors of the payor and payee, it was suggested that the payor should be conditionally discharged from his debt by issuing irrevocable instructions to make a credit transfer. The free flow of data in the system, and the valid desires for good service of the great majority of system users, should not be disturbed because the institutions are liable to third parties.

However, conditional discharge and absence of a legal right to stop a transfer for the payor do not require concluding that the payee has received final payment. Unlike the cheque, no one is out funds. The question is not who must bear the loss and sue the drawer; it is who has the right to a deposit. The consequence of allowing the *payee* to issue a valid stop order after the payor has lost such rights is simply to require his institution to return the funds represented by the transfer to the payor's institution and account.

Such a return would avoid the payor's conditional discharge and revive his debt to the payee. This has potential consequences for hindering creditors, but most of them are based on confusion and complexity in the provincial law of creditor's remedies. It is certainly possible to create a procedure which would more fully protect creditors than present law, and still keep final payment separate from recall or reversal.

Any provision for recall at the payor's request or that of his institution should be considered a matter of banking practice, rather than legal duty. The payee, the payor and their creditors are concerned in very few transactions out of all those in the system. It may well be that institutions would only recall tapes involving major losses or frauds. As operators of the system, such a choice should be in their discretion. It involves a compromise between the requests of individual customers to stop transactions and the reliance of other individual customers on the smooth flow of transactions. The business judgment of the institutions should be relied on to strike that compromise.

Final payment should be considered as an issue between the payee and his institution. Once the confusion caused by considering the payor's power to stop a transfer he has released is eliminated, the problem of final payment reduces itself to determining the point at which the payee has an irrevocable right to the credit transferred.

Any rule concerning final payment must operate in the time period between the posting of the payee's account and the time at which returns must be made. Before that period, the funds are not unequivocally appropriated to the payee. Unless rights in the nature of an assignment exist, and such rights are wholly inconsistent with the nature of the transaction[75], the payee's institution holds such funds as moneys of the payor's institution, subject to a duty to credit the payee or return. If the funds are uncredited after the time for return has lapsed, it would be in breach of its duty to its own customer to credit a proper deposit. It would also be in breach of its common-law restitutionary duty to the payor's institution, which should be made an express obligation of the clearing standards[76].

These duties should result in uncredited funds being returned. Credited funds can only be returned if they are not finally paid. There is not much reason for a legal rule which delays final payment. Such a rule would increase the exposure of institutions to legal disputes in which they have no interests other than as stakeholders. It would increase the number and complexity of interventions in normal processing. It would not be of benefit to creditors generally, although it might affect results between particular creditors. Its only normal effect on the payee would be to

increase his ability to evade his just debts. If the payee has been given the right to terminate his credit transfer authorization on reasonable notice, there is no need to delay final payment past the minimum time necessary for an institution to act intelligently on the transfer.

The institution is interested in orderly processing of accounts and reliance on completed transactions. The institution might, depending on the precise timing involved, acquire a set-off which was of value to it in bankruptcy proceedings involving the payee. The customer's only interest in setting aside the transaction is the possibility of defeating a creditor, or preferring one creditor to another.

The nature of these interests suggests that a rule which was arbitrary but easy to apply might be preferable to one requiring factual inquiry in particular cases. For example, it might be preferable to provide that the transfer was finally paid after the lapse of a certain period of time from its receipt, regardless of whether any human discretion was ever exercised, as long as the account had been posted.

Such a rule fits well with the duty of the payee's institution to credit or return. The time period for final payment could be equated to the period within which the return must be made. Up to that time, regardless of institutional conduct, the entry would be provisional. Obviously such a rule requires that the time for returns be very short—a maximum of one business day seems an appropriate compromise between tradition, the need to allow opportunity for discretion, the efficiencies of electronic equipment, and the problem of providing courier service.

Such a rule would eliminate inquiry into the significance of "Paid" stamps and account posting routines, variations of institutional practice regarding which report goes to what officer when, and what he does with it, and the somewhat fictitious search of employee's memories for particulars of processing of an individual item. It would end the necessity of educating individual judges in the intricacies of processing routine by calling a parade of bank operations personnel as expert witnesses; surely the most expensive form of education ever devised, and the least rewarding, since the chance that that judge would ever again hear such a case is

miniscule, and if he did, the law would require him to erase his knowledge and hear the witnesses again.

The main disadvantage of such a rule is straightforward. It would on occasion arbitrarily award large sums of money. The difference between a set-off and an unsecured claim in bankruptcy, or between attachment of a full account and an empty one, is sometimes an incentive to litigate or negotiate under present factually oriented rules. An arbitrary rule would largely remove the possibility of a negotiated settlement in which losses are shared between the parties for large claims.

Another disadvantage of such a rule is that institutions are allowed to prefer themselves in a conflict of interest with their customer. The rule itself only authorizes return; it does not compel it. The institution can often reasonably contest the authority and authenticity of instructions.

A third disadvantage is that the customer may demand that a return be made with insufficient time to act. To this extent the certainty of an arbitrary rule is illusory. It authorizes action in circumstances where inaction can benefit the institution or affect the rights of third parties. At least the issue of whether the institution attempted to comply in good faith with its customer's instruction should be open.

Even with these disadvantages in mind, an arbitrary rule seems preferable. If such a rule allowed factual inquiry in only those cases where the institution's position had been improved by increasing its set-off, it would still be an improvement over the present situation. There would seem to be little reason for an institution to treat cases in which it held no set-off on any basis other than executing a standard operating procedure. An arbitrary rule would probably be of help in designing that procedure.

The clearing standards should require the payee's institution to credit the payee or return the transfer within a fixed time period. This period should be a maximum of one business day. Whether a force majeure excuse, accompanied by a duty of reasonable diligence, is acceptable requires careful thought. A failing institution would desire to receive credit transfers, but not post them to its customer's credit. A vicious fraud on payors could occur under the cloak of reported computer malfunctions. On the other hand, the spectre of insolvency can transform a short period

of computer malfunction into severe inconvenience or worse for large numbers of people if that spectre leads to an arbitrary rule for returns. Perhaps the power to excuse delay should be in the control of the regulator with insolvency responsibilities for the institution, or delegated by those regulators to the board managing the regional clearing.

The suggested rule of law establishing when final payment occurs is not a clearing standard. It does have important impact on the standards. Like the suggested rule making a credit transfer conditional payment of an obligation when irrevocably released by the payor, it is an essential part of the structure of a credit transfer system. Unlike the former rule, it clearly pertains to the relationship between the deposit institution and its customer. In the constitutional sense, it is law concerned with banking, and a clearly legitimate matter of federal legislative jurisdiction.

## F. Summary

A number of clearing standards are required in order to establish an efficient credit transfer clearing. These standards have an impact beyond the interests of the institutions themselves. Care must be taken not to make these standards over-specific.

Standards can take the form of promises about conduct. The standard respecting performance on the agreed timetables is of this sort. Standards may also be in the form of warranties: statements that a fact exists accompanied by legal responsibility for its non-existence. The standards dealing with accuracy, authority and authenticity are of this sort. Implied in the latter form of statement is the rule that legal responsibility is not incurred if the person to whom the warranty is made actually knows that the fact warranted does not exist or has been stripped of the right to rely upon its existence by his own conduct.

*The institutions should be required to promulgate timetables governing handling under normal conditions. A standard defining force majeure excuses for deviation from the timetable, and establishing the duty of reasonable diligence when force majeure*

*is invoked, should be prescribed.* The timetables, when not manifestly unreasonable, should be left to institutional judgment.

*The payor's institution should be required to warrant the accuracy of its data, in particular the amount and banking address of a credit transfer.* If names are transmitted in the transfer message, they should also be warranted accurate. This warranty should cover errors introduced after the data is released by the institution.

*The payor's institution should warrant its authority to make the transfer.* Different underlying factual situations may make it desirable for the payee's institution to assume part of this burden. If this is done, the obligation under the warranty of *authority* should be clearly restricted to cases in which only that warranty is breached, and not the warranty of authenticity as well. The warranty of authority requires as complement a warranty that no notice of revocation exists at the time data is released, and a warranty against termination by operation of law. The general effect of these warranties is to protect reliance on the system of continuing authority revocable on reasonable notice, and to allocate the risk of termination in an equitable manner.

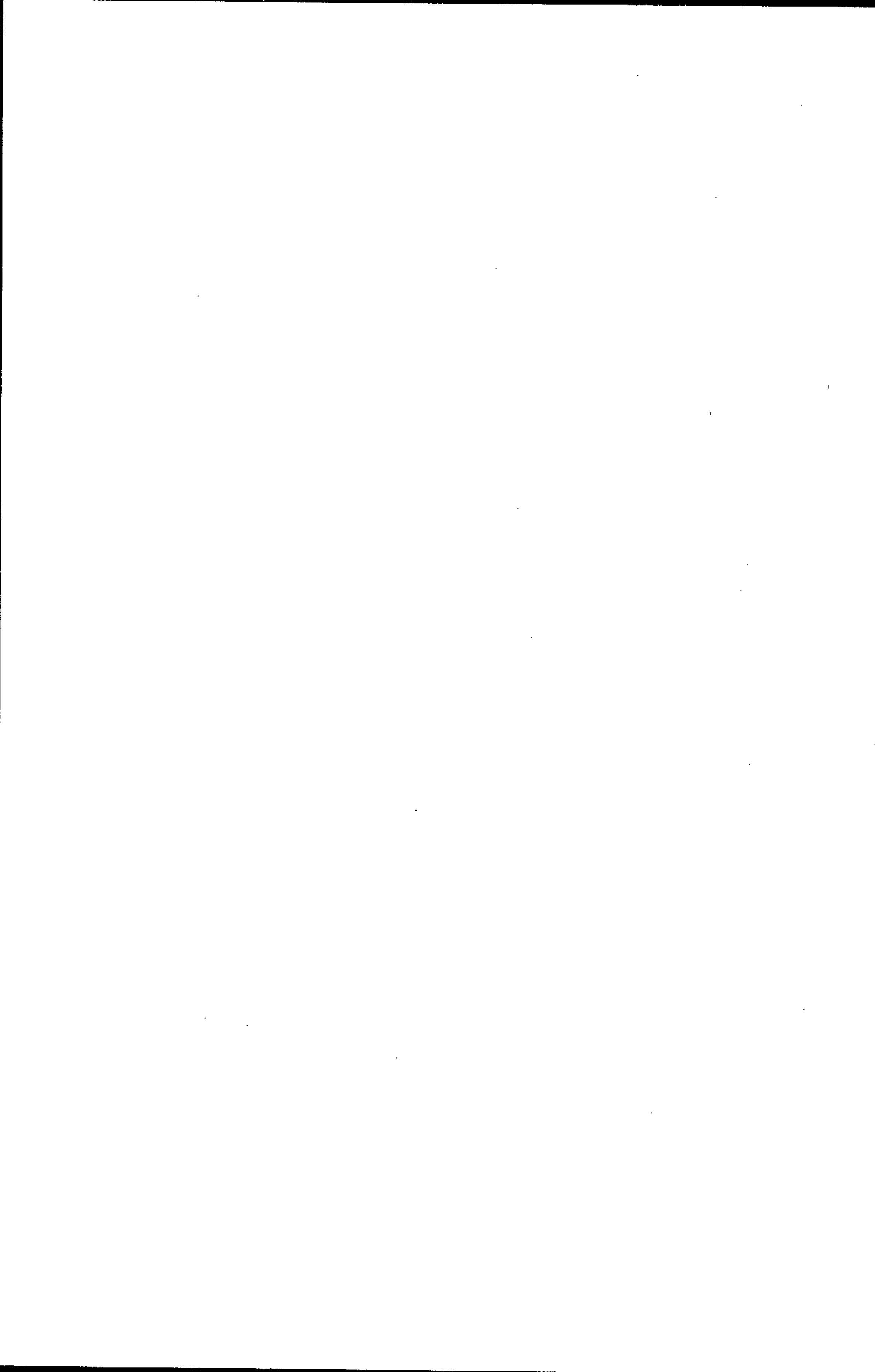
*The payor's institution should make a continuing warranty, covering conduct after data is released, that the data is authentic and has not been materially altered for a fraudulent purpose.* Such a warranty produces changes in the risks now associated with payment, particularly when combined as suggested above with the warranty of authority. These changes should be accepted as the general rule. Allocation of the risks discussed to the payee's institution should be a special case, specially contracted and paid for.

The standards summarized above cover the need to assure speedy transmittal of messages that are accurate, authorized and authentic. Their effect is to create a system of direct recourse for losses on the payor's institution in all cases of non-compliance with the standard except that of speedy transmittal. In that relatively clear case, the recourse is against the party holding the data when it went outside the time limits for action established by the standard.

*Where fault can be shown, the payor's institution should be entitled to indemnity from other participants in the clearing.* No

institution would be able to take recourse on the warranties if its conduct or knowledge were such that it had no right to rely on the information warranted. The operation of the warranties would effectively bar recourse by the payor's institution at common law in those cases where it had breached a warranty. In such cases, it would be forced to pursue the payee himself outside the clearing system, or to throw the loss onto the payor if it were justified in so doing.

*The payor's institution should have no legal right to recall payments. The payee's institution should be required by the clearing standards to credit or return a transfer within not more than one business day of receipt at the branch of account.* The desirability of a force majeure excuse here must be carefully weighed in light of the risks raised on insolvency. A rule for final payment based on the lapse of the time for return is an essential supplement to the clearing standards and the credit transfer system.



# V.

# The Agreement between the Payor and his Deposit Institution

Several factors distinguish the agreement between the payor and his deposit institution from the other agreements studied in this paper. Unlike the clearing rules, this agreement is bilateral. Unlike the payor-payee agreement, it will probably contain a bargained-for mix of services. While the agreement will have some standard terms, it may well have a fairly wide range of options. Since it is in this agreement that the institutions can compete for major customers on the basis of services offered, it seems reasonable to expect a fairly diverse set of offerings. In the initial stages, a major customer might even be able to negotiate for a custom-designed plan. Finally, although the agreement will certainly provide for termination, it will be a bilateral executory contract with legally enforceable, continuing duties on both sides.

The expected diversity of plans makes it difficult to discuss this contract. But the terms of the contract which are required to integrate it into the payment system can be discussed. Such terms are primarily concerned with passing on duties and liabilities that were placed on the payor's institution by the clearing standards, but that from a business viewpoint are properly borne by the payor. A second group of terms concerns duties that might be borne by either the payor or his institution, but that must be borne unequivocally by one of them if the system is to function effectively from a legal viewpoint.

## A. Risk-shifting Terms

In the preceding chapter, a series of warranties were required from the payor's institution for the protection of other participants in the clearing system. These warranties were designed to force the payor's institution to seek its legal remedies for error or fraud outside the payment system in the normal case. The terms suggested in this section are designed to divide the remedies of the payor's institutions into two groups: those based on the payor's fault, for which the remedy is under the terms discussed in this section; and those based on error or fault elsewhere in the system, for which the remedy is under the clearing standard indemnity or in restitution from the individual receiving the payment.

The warranties made by the payor's institution were in most cases continuing—the institution was asked to assume the initial burden of loss in cases where it could not possibly be at fault. By contrast, the payor's warranties are to be made at the time that he delivers data or authorizes its preparation by the institution. The warranties against revocation and termination require a slightly different treatment. These involve situations in which action by the payor may be required to prevent loss; they should accordingly be made at the last point in time at which the payor's institution could be expected to respond to such action.

The warranties of accuracy cover the amount of payment, the account number and banking address, and the name if transmitted. If some other form of internal control against errors introduced in data transmission is adopted, it should be covered as well. This information is fixed when the payment message is prepared; warranting its accuracy at that time causes no problem for the payor. To give the payor's institution greater protection, the data should be warranted at the time of delivery to the payor's institution. If the payor's institution not only transmits the payments, but also prepares the data as a service for the payor, the scope of these warranties must be altered. The risk of introducing errors into the data during preparation is something which can be bargained for. The resulting provision is part of the definition of the service of preparing payments for transfer.

For example, if an institution prepared payrolls in addition to transferring the payments involved, both the time and the content of the payor's warranties would be different from those discussed. The institution is entitled to have the data supplied by the payor warranted accurate, but in this case the data may be hours of work, rates of pay, tax dependency information, and so on. Whether the warranty takes effect when data is delivered by the payor or when the institution releases data to the system determines who will bear the risk for errors made in preparing the data for release. Since the payor's institution in this case is computing the sums to be paid, it should bear the risk of these errors. The payor must thus warrant the data from which pay is computed, rather than the net pay to be transferred.

The warranties of authority, of no notice of revocation, and against termination require payor action to be effective. The payor must maintain a file of current authorizations; he must give notice to the institution when a current authorization is revoked; and he must give notice when he has knowledge of a termination. If the institution prepares the payments, as well as transferring them, it might take over the duty of maintaining the current authorizations file. Normally the payor would maintain this file, and would give notice of revocation to the institution after receiving it from the payee.

The entire burden of the warranties of authority and against notice of revocation should normally rest on the payor. They should be effective as of the time payments are released by the payor's institution. The warranty against termination is designed to give protection in any situation except that in which the payee's institution knows, and the payor and his institution do not know, of the termination. The burden of this warranty, up to the time payments are released by the payor's institution, should be borne by the payor. After that time, action cannot affect the risk. Since the precise risk is closely related to the kind of payments being made, it should be borne by the payor. His ability to spread risk is not as great as that of the institution, but his ability to control the risk by design of the terms governing his relationship with the payee is much greater.

The warranties of authenticity and against material alteration for fraudulent purpose cover risks that the payor should not bear

entirely. The payor should warrant that his data is authentic when delivered to his institution. Once it is delivered, its security should be the responsibility of that institution and the other members of the clearing system that handle it. The warranty against material alteration is perhaps redundant at this stage, although it highlights the necessity for all of the data to be authentic. Authenticity means more than that an authorized officer of the payor has released the payments; it means that the payments are in fact due, owing or payable in light of the underlying transactions that give rise to them. Thus this warranty is breached by a padding of accounts payable, regardless of the state of mind or knowledge of the officer releasing the payments.

These warranties are borne only in part by the payor because they are continuing warranties on the part of the payor's institution. After that institution takes delivery of the data, it should bear the burden of these warranties until the data is again transferred. Each subsequent transferee should then bear the burden for the period of time it controls the data. However, initial responsibility remains with the payor's institution; only the ultimate burden of the risk shifts through the operation of the indemnity discussed in the section on the clearing standards.

## B. Other Terms

Apart from handling risk, four areas require treatment. First, the payor must agree to terms regarding times for delivery of data, format, and security which are acceptable to his institution. If these do not correspond to the standards generally in use within the system, the payor should expect to pay for whatever services are necessary to meet system standards. Conversely, a payor who can supply data in acceptable format should be able to use the system by payment of service charges that correspond to the actual services rendered. He should not be required to pay for services he doesn't want or need.

Second, the payor or the institution must maintain files of current authorizations for legal purposes. To be prudent, such a

file should be maintained for the period the authorization is in effect, and revoked authorizations should be held for the period of the local statute of limitations on a written contract. Keeping these files accurate and current is likely to be a difficult and time-consuming task. The agreement should cover who has responsibility for that task, and provide that the other party can obtain copies of the filed authorization, or if necessary, the original.

Third, the payor should agree not to revoke the institution's power to act for him, either expressly or by notice to others, respecting any payment that has been released by the institution. This promise is designed to lock the payor into the system; but only respecting such payments. Its justification is simple. Normal rules of agency law would allow the payor to make such a revocation. If it is made, the institutions handling the payment suffer disturbance of their normal operations and are exposed to the risk of loss. These institutions have a legitimate reliance interest in being free from such interference. The ability to destroy their agency powers cannot be removed; but by promising not to destroy them, the payor makes himself liable for all damage directly caused by such an act. This should be a sufficient deterrent.

The payor's institution need not worry about claims by the payor based on its acting without authority, since the suggested promise would create an offsetting liability. Its only concern would be a possible claim by the payor's trustee in bankruptcy or creditor. Its answer to that claim is again the offsetting contractual liability of the payor. It need not worry about the payor's solvency since it already has the funds. No proprietary claims are in issue, since the institution is only accountable as debtor and creditor to its "banking" customers.

Since the payor also agrees not to revoke any individual payment after its release by the institution, the transfer is irrevocable on such release. It is thus possible to recognize the credit transfer as conditional payment, as was earlier suggested in the chapter dealing with the payor-payee relationship.

Finally, the payor should agree to be bound by the clearing standards and practices adopted by the institutions, as they exist from time to time. Such agreement would aid in making the detailed structure of the system binding on the payor. The control

against over-reaching by the institutions is the requirement for approval of clearing standards by government. The practices must be consistent with the standards to be enforceable.

The contract between the payor and his deposit institution will also cover many items not directly related to the operation of the system. Among these are the necessity, if any, to maintain a demand account with the institution and the times and manner in which the payor is to make funds available to cover the payments made. The institution must define its responsibility to the payor for delays, including those of the other members of the system which are unexcused under the clearing standards. The respective responsibility for re-creating data which is rejected by institutions to which it is cleared must be settled. A deadline for "stopping" a credit transfer, if earlier than the release of the payments by the payor's institution, must be set. Related deadlines, covering changes or corrections to data which do not amount to a request to stop the payment, must be agreed. Action to be taken by the payor and the institution if a payment is returned should be defined. If the institution intends to prepare the payments, as well as transmit them, the exact scope of the services it will render and the charges for them must be agreed. The charges for the basic function of transmitting payments need to be agreed, and the contract should provide for its termination by the parties on reasonable notice.

## C. Summary

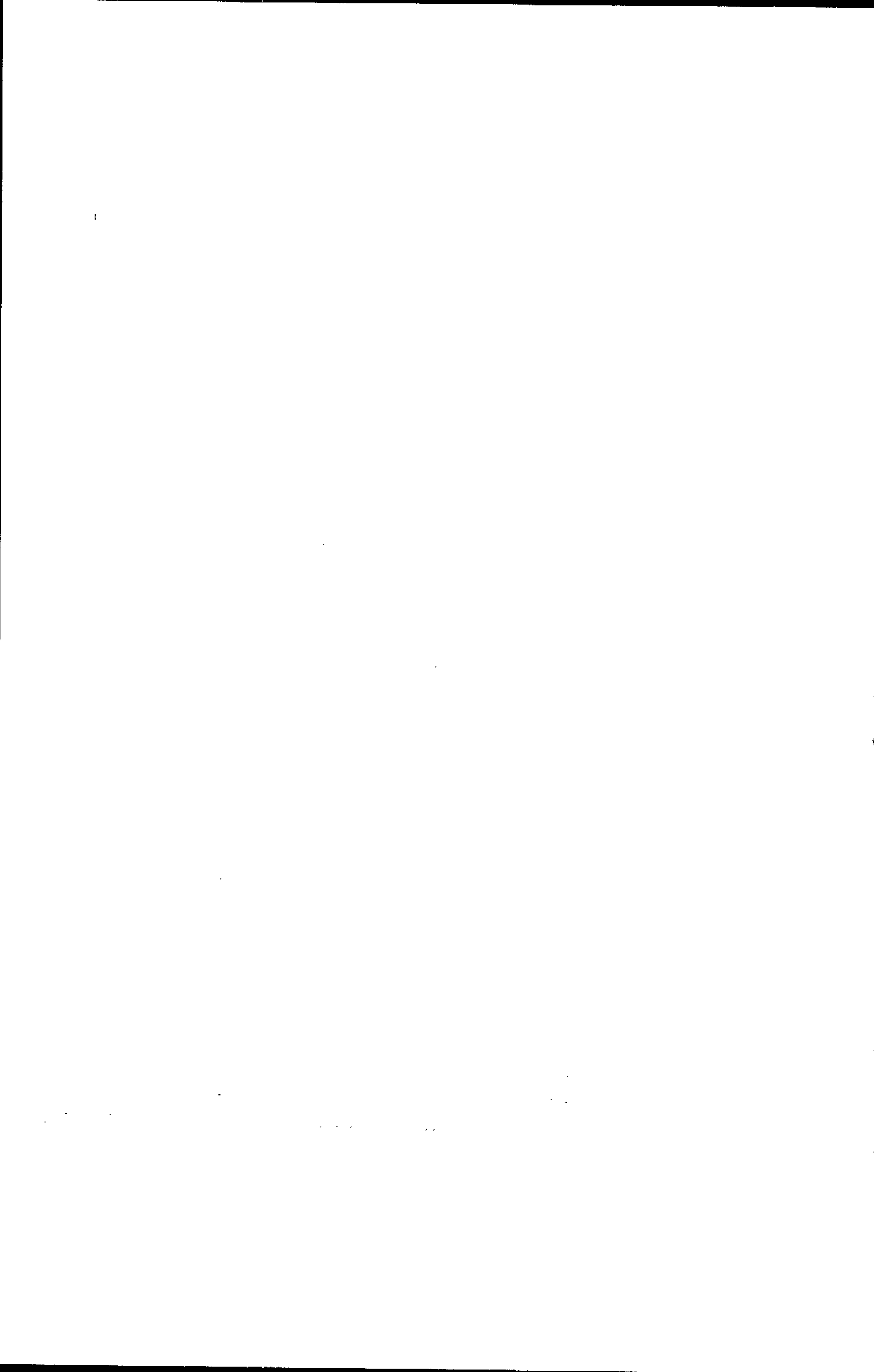
The contract between the payor and his institution is likely to be a detailed commercial agreement, containing executory duties on both sides. Since this is the vehicle on which most institutional competition for customers is expected to take place, only the terms essential to system operation can be described in any detail.

*A major group of those terms concerns the adjustment between the institution and the payor of the catalogue of risks imposed on the institution as an initial matter. These risks were imposed on the institution for the protection of other institutional members of the system and their customers. Most of these risks*

*relate to the operations of the payor in large part; even where the risk is one that affects all participants in the payment, the practical risk is likely to come from the payor if acceptable levels of system security are maintained.* Since the payor is by hypothesis a large business or governmental entity, it is capable of spreading these risks through insurance or self-insurance. If the payor is a small business contracting for preparation as well as transmittal of payment by the institution, it would be reasonable to expect the institution to assume the risks associated with such preparation and charge accordingly.

Other terms, not relating to risk, are required to make the system run smoothly. Among the most important are those governing record-keeping concerning authorizations and timetables for data delivery. *Payees and other institutions rely on the smooth flow of data through the system. This reliance interest must be protected. A term controlling the right of the payor to stop payment or terminate the power of his institution to act for him is thus essential.* It is also prudent to bind the payor to accept the clearing standards and practices as they exist from time to time.

*Finally, the contract must deal with the particular business relations of the two parties. These terms are of no concern to the other parties or government, so long as they are consistent with the general policies expressed in the clearing standards and conform to current competition policy.* A check-list summarizing important terms of this contract is contained in Appendix V.



# VI.

# The Social Impact of Credit Transfer

The primary impact of credit transfers will fall initially on two groups; employees of large organizations, public or private, and recipients of broadly-based social benefits. Since employees are the simpler group, they will be discussed first.

From the viewpoint of the salaried employee, there would likely be little impact. His pay is constant; he is likely to be a good credit risk, so that advances against a delayed payment are not a major problem. If the recommendations concerning freedom of choice discussed earlier are adopted, he may have more actual freedom under the new system than he does today. If he is not presently being paid by a paper-based direct deposit, he will find the credit transfer eliminates the periodic trip to the bank to deposit his cheque. He can thus spread his banking trips to off-peak times; perhaps if his institution installs cash dispensers or electronic teller equipment, his banking trips will be almost totally independent of "banker's hours".

This would appear to be a major convenience to this group. If it is not paired with substantial disadvantages caused by inadequate descriptive statements, a net benefit and consumer acceptance could be expected.

For the wage-earner, the picture is more complex. His pay may vary substantially depending on overtime or lay-offs. He may not be as good a credit risk. These factors make it less likely that advances against a delayed payment would be available to him as a matter of course. System reliability is therefore much more important to him. He may not have an established connection with an

institution; perhaps he may not want one. For cultural reasons, he may conceal his actual net pay from his family, and be unwilling to have it recorded on statements that arrive by mail. He may be a poor credit risk, in fear of wage attachment, and hence totally unwilling to jeopardize his wage immunity by using the credit transfer system. He probably does not realize that use of the system would jeopardize that immunity. If he is dealing with a hard creditor, an attachment may precipitate financial disaster.

Obviously, most wage-earners do not fit this picture entirely. The real problem is whether enough of them will be affected by one or more of these factors to create a folklore concerning the disadvantages of credit transfers. The role of organized labour in reacting to credit transfer of payroll is crucial, since it could refute such folklore far more readily than deposit institution advertising.

Credit transfer of payroll has a potential for increasing the use of chequing accounts by wage-earners. It poses a threat to persons living on the margin of insolvency, but this could be met by proper changes in provincial law governing wage attachment. Suggestions are made in Section VII of this paper. If credit transfer authorizations are revocable on reasonable notice, they would be unlikely to affect the manner in which chequing accounts are opened, closed, or maintained.

Credit transfer of payroll may affect the position of the deposit institution as a consumer creditor. The major deposit to the account would now occur automatically, and consumer inertia is on the side of the institution. Its practical position on set-offs improves marginally, since it need no longer wait for the consumer to deposit his funds. But no gains are made against an attachment properly served on the employer. If the conditional payment concept is recognized, and if credit transfers are integrated with the employment contract in such a manner that the funds become payable under the contract on the effective date of the deposit, the set-off would gain priority over an attachment served on the employer. Use of a new form of attachment, to be served on both the employer and the payee's deposit institution and capable of capturing the payment in transit, could eliminate this problem. Such a remedy is discussed in Appendix IV. This remedy could be given statutory priority over the set-off to the extent that the wages were attachable in the hands of the employer. It would not

cure the problem raised by loss of the wage immunity against the institution, caused by its powers to invoke the set-off rather than an attachment. To cure that problem, the immunity must be carried forward into the account by statute or an extension of the common law[77]. Suggestions are made in Section VII to accomplish these changes. Consideration of social impacts should not unduly prejudice the use of credit transfer of payroll. The most serious potential impacts are met by these adjustments in the law of creditor's remedies.

Social impacts from the credit transfer of social benefits are much more complex. Each group of potential recipients has different characteristics. A universal benefit will reach many people for whom it is not an essential of life; a benefit based on a test of need must obviously arrive reliably. Benefits may also be based on qualifications—such as age or inability to function effectively in society—that are directly related to coping with problems or changes caused by a new technology. It is probably unwise to generalize about the impact of credit transfers. A group that receives a social payment is pre-selected for certain factors; the impact of credit transfers on such a group must be carefully considered with respect to these factors. Introduction of a program on a pilot project basis, and careful extrapolation of the results, are obvious precautions.

The secondary impact of credit transfers is part of the general effect of computerized business operations. Unlike a cheque, a credit transfer cannot be made payable to bearer or cash. Even if it goes to a nominee, it must carry sufficient information for the nominee to identify the intended beneficiary. This is not strictly speaking a blow to privacy. Very few cheques to third parties are issued in bearer form. But such cheques are not presently machine readable. It is true that the information is available from the cheque, and it is also true that the cheque is microfilmed during the clearing process by the institutions. But the microfilm is not machine readable.

Privacy is protected by the cost and difficulty involved in retrieving the films from storage. It would be practically impossible to machine sort or monitor the flow of payments to or from an individual or corporation anywhere other than at that person's deposit institution branch or the data centre servicing that branch.

If the payments are in electronic form and machine readable, entirely different factors of cost and difficulty apply.

Threats to privacy could once be met by imposing strict duties of confidentiality on the bank—duties that could be complied with by careful control of personnel at the branch. The threat to privacy is much more diffuse under a system using machine readable payments messages. Just how diffuse it is depends on the flow of information through the system. Factors such as encryption of messages, the adequacy of descriptive billing, and the direction of data flow are all involved. If messages are encrypted or scrambled, only those with the proper key can read them. Most private snooping would thus be restricted to its present methods. Choice of directions of data flow which allowed individuals to confine sensitive information to their own institution might complicate the task of the snooper. Various options for suppressing descriptive elements of the statement might be offered, giving the customer the choice of keeping some information within his institution.

Solutions to privacy problems involve such detailed analysis of the needs and desires of the users of the system that they may never be made. Those desiring privacy would simply refuse to consent to credit transfer on the terms generally offered. This possibility underscores the importance of requiring genuine consent to the use of electronic credit transfers.

No matter what solutions are advanced for the protection of data against outside threats, the threat from the institution and those who have legal power to compel disclosure remains. The institutions will avoid unacceptable use of the data they hold from the point of view of economic self-interest. Nothing could be more fatal to their customer relations than the revelation that they had used confidential data to advance their commercial interests in a non-privileged situation.

The primary threat to confidentiality and privacy must therefore be considered that posed by government. The activities of the intelligence community, the police, and tax authorities will be considerably aided by access to the sorts of information passing through and accumulated by an electronic payments system. Considering credit transfers on tape specifically, the information provided would aid in tracing institutional relationships to link organized criminals, follow funds in tax evasions, and trace funds in

covert operations. Use of traceable means of payment would display a certain naïveté on the part of the evil-doer, but for government to deny itself any use of such information would make easy criminal conduct that might otherwise be difficult and time-consuming.

Although the time lag involved in credit transfers makes them of little value for operational intelligence information, they would be a useful source of information for strategic purposes and for convicting the evil-doer. Against those considerations must be balanced the need to allow selective searches through the personal affairs of millions of people in order to obtain such intelligence. The problems posed by a wiretap, even of a public telephone, are miniscule compared to those raised by searching payments system traffic. If such searches are to take place, and it is obvious that they will if the data exists, the structures for their control must be worthy of the highest respect of a free society. If they are not, that society will not long remain free in any meaningful sense of that word.

This paper has not addressed the issues involved in privacy and confidentiality in depth. Those issues are heavily dependent on the exact content of the message. Government is already in possession of the likely content of transfers based on social benefits; payroll information is more readily available from the employer. Areas of major interest from the privacy viewpoint, such as payments by individuals and business to business transfers, fall outside of the scope of this study.

Since the information typically available from credit transfers from large payors to individuals is already available from the payor—often in machine-readable form—it is not likely that the particular forms of credit transfer discussed in this paper will adversely affect individual privacy. Since the *new* information gained by the payor is only the banking address of the payee, no serious threat to confidentiality should emerge from these transfers. However, particular proposals must be evaluated in full detail to properly assess their impact on privacy and confidentiality.

The impact on the labour market is not clear, although anyone familiar with the processing of cheques through the clearing system will not mourn the jobs replaced. The endless repetition at high speed and total accuracy required to proof-encode cheques,

and the necessity to process peak loads in the late evening, make the work dreary and the turnover of personnel high. Predictions differ as to whether jobs will be eliminated or growth will simply occur in other areas without loss of existing jobs. Here as well, credit transfers are simply a small part of the total impact of automated information handling.

Unlike many other forms of electronic funds transfer, the capital requirements for a credit transfer system are very low. Much of the necessary equipment and capacity has already been installed for other reasons, and the credit transfer represents an attempt to utilize this equipment to its full capabilities.

On balance, the social impacts of credit transfer seem acceptable. The worst legal effects can be blocked by technical adjustments to the law. While other consequences may be more subtle, the operation of a credit transfer system can be commenced by increments and its successes or failures evaluated through experience. Massive commitments of funds and hardware are not involved, and the decisions to be made are reversible ones.

# VII.

# The Legislative Basis for Credit Transfer

Two major legislative changes are required to successfully accommodate existing legal rules to a large-scale credit transfer system. First, legislation must provide a solution to the risk of double payment imposed on the payor by present rules—a solution which conditionally discharges the payor until final payment occurs. Second, legislation must remove the social impact on the debtor-creditor relationship of the technical changes in the mode of payment—changes in timing and in the form of payment which would otherwise nullify important debtor rights.

## A. Legislative Relief for the Payor

### 1. When does payment occur?

At common law, the mere instruction of an agent to pay a debt on behalf of the principal—even if the principal advances funds to the agent for that purpose—is not a discharge for the principal. The rule is of great benefit to creditors, since it leaves the risk of the agent's failure or wrongdoing on the principal. In the transactions discussed in this paper, the creditors are the consumers.

However, the agents to which payment is given in a credit transfer are not potential fly-by-nights. They are federally or provincially inspected and insured deposit institutions. Their

irrevocable acceptance of instructions to pay some other person is worth something.

Assuming that proper rules governing settlement and priority for payments in transit are in place, there is justification for treating the irrevocable issue of a credit transfer as a conditional discharge. A cheque is so treated, and it is a far less secure means of payment than such a credit transfer would be.

## 2. Jurisdiction over relief for the payor

Who has the jurisdiction to enact a statute giving such a credit transfer the effect of a conditional discharge of the payor's obligation? The law of debtor and creditor is essentially a provincial matter; the law of banking and of bills of exchange a federal one.

Once proper settlement practices are established, payment by credit transfer is remarkably similar in legal effect to payment in bank notes issued by the payee's institution. In the times in which such notes were allowed to circulate as currency, they represented the institution's obligation to pay their value in legal tender. The deposit obligation is also a duty to pay legal tender. In substance, the transaction is one which was assigned at Confederation to the federal government.

In form, the transaction does not involve either a bill of exchange or paper money. It need not involve a chartered bank as either payor's or payee's institution, although in many cases one or both of the institutions will be a chartered bank. The scope of the constitutional "banking" power respecting the provincially chartered near-banks remains a politically charged issue.

## 3. Suggested relief for the payor

In view of this complex jurisdictional position two suggestions are given for reaching the desired result, which is to make the irrevocable issue of a credit transfer a conditional discharge of the payor's obligation for the purpose of protecting the payor from the risk of attachment and possible double payment.

(a) *Suggested federal solution*

There is no logical point in the existing federal statutes for insertion of this provision. If comprehensive successor legislation to the *Bills of Exchange Act* were enacted, covering all forms of payment made through the deposit institutions and the payment system, that legislation would cover this point, and many others as well. But the present *Bills of Exchange Act* is not a logical place to expect this sort of provision, which has nothing to do formally with either bills of exchange or promissory notes. The controls on the issue of bank notes found in the *Bank Act* and *Bank of Canada Act* deal with a related legal problem, but lack clear connection to the specifics of the reform. The *Currency and Exchange Act*, in its domestic impact, deals primarily with legal tender; it is unlikely that anyone would ever consult it in search of a provision like the one proposed. In view of the disastrous state of the index to the Revised Statutes, the question of finding a logical home for a provision such as this cannot be taken lightly.

Until the changes in the payment system have matured to the point where comprehensive successor legislation to the *Bills of Exchange Act* is appropriate, the most reasonable point to insert such a provision would be in either the proposed *Borrowers and Depositors Protection Act* or the proposed *Canadian Payments Association Act*[78]. The first Act affects the business operations of all institutions which would be involved in issuing credit transfers, and declares rights of their consumer customers. There is a reasonable probability that it would be consulted by the average lawyer grappling with this sort of a problem. The second Act will provide the regulatory structure for arriving at rules governing the exchanges of payments between institutions. The proposed provision has a very significant impact on such exchanges. The *Canadian Payments Association Act* might therefore become a useful home for the miscellaneous remedial provisions of substantive law which are required pending the creation of comprehensive successor legislation to the *Bills of Exchange Act*. If it were so used, lawyers would soon learn of its relevance to payment related problems.

The *suggested statutory text* follows:

**Credit transfer as conditional payment**

(1) Subject to this section, a payor is conditionally discharged from a debt owed to the person to whom a payment is addressed, if

(*a*) the payor has given instructions to a deposit institution to make the payment on his behalf;

(*b*) the instructions are duly authorized by the payee;

(*c*) the payor has no contractual right to revoke the instructions; and

(*d*) the instructions have been released to the payor's deposit institution.

**Final payment**

(2) Entry of an irrevocable credit to the account of the payee by a deposit institution acting on instructions authorized by the payee discharges the payor.

**Failure to complete transfer**

(3) The conditional discharge given by this section is without effect, if

(*a*) the time allowed for credit to the payee by the standards and rules of the Canadian Payments Association has elapsed, and the payee has not received irrevocable credit;

(*b*) any deposit institution has acted on

(i) an order or

(ii) information

given by the payor or his institution to block or recall the payment;

(*c*) any deposit institution other than the payee's institution has suspended normal payments or the conduct of its business without settling for the payment; or

(*d*) the instructions have been refused by the payor's deposit institution for lack of funds or credit to execute them.

*Comment*:

Subsection (1) creates the conditional discharge, and sets out the requirements for obtaining it. These requirements are normally within the payor's knowledge, allowing him to answer the writ of attachment. A defect in the payee's authorization would vitiate any discharge; the requirement leaves the payor no worse off than before. Subsection (2) provides for final payment in the normal case; the effect of returns is discussed in the text in the part dealing with clearing standards. Subsection (3) destroys the conditional discharge in cases in which the payment has not become final. This subsection shifts the risk of institutional failure to the payee at the time that his institution receives settlement. It protects the payee against undue delay, the failure of institutions other than his own, the failure of the payor, and exercise by the institutions of their power to block transfers. The protection is the immediate revival of the right of action against the payor on the underlying obligation.

(b) *Suggested provincial solution*

A province can deal with the problem by the simple expedient of barring the creditor's remedy. While the federal solution requires a careful formulation of the rights of the payor and payee, the provincial solution is merely to remove the creditor's access to those rights.

A province need not concern itself with final payment, since the extinction of the obligation between payor and payee destroys the substance upon which the provincial remedy operates.

The provincial solution must be inserted into each statute providing for attachment. The local *Consumer Protection Act* is not a logical home for the provision, since it impacts on those making payments to consumers. Such payors may have no other legal involvement with consumers at all.

Statutes providing for attachment now contain provision for the garnishee defendant to dispute the existence of a debt owing to the principal debtor, or to assert such set-offs or other rights as he may have if a debt does exist. Efficient administration of justice would be best served by allowing the garnishee defendant to answer the writ "not indebted, by reason of credit transfer" and cast the burden of proceeding further on the principal creditor. If the garnishee defendant is required to schedule an appearance, and credit transfers become a common means of payment for wages, the lower courts will be required to hear evidence on a substantial proportion of garnishments. This is a waste of time unless the principal creditor is able to prove that the payment was not ultimately completed. In the normal case, the payment would be completed.

The appropriate provision would be inserted in the portion of the statute which defines claims which are capable of being attached. It might read as follows:

*Note:*

In the suggested statute, the three parties to an attachment have been described as follows:

the person who is creditor of the obligation seized is called the "principal debtor"; this refers to his status vis-à-vis the judgment debt or other right in respect of which the attachment serves as remedy; in the normal nomenclature of this paper he is the payee;

the person who is debtor of the obligation seized is called the "person indebted or liable" in respect of the obligation, and the "garnishee defendant" in respect of his procedural rights; in the normal nomenclature of this paper he is the payor;

the person bringing the principal action and seeking the attachment as remedy is the "plaintiff"; in the normal nomenclature of this paper he is a creditor of the payee.

**Attachment barred; credit transfers**

(1) No debt, obligation or liability shall be attached under this Act, if

(*a*) the person indebted or liable thereon has given instructions to a deposit institution to make a payment on his behalf;

(*b*) the instructions are duly authorized by the principal debtor;

(*c*) the person indebted or liable has no contractual right to revoke such instructions; and

(*d*) the instructions have been released to the deposit institution of the person indebted or liable.

**Procedure**

(2) The garnishee defendant may claim the benefit of this section by endorsing "not indebted/paid credit transfer" or like language upon the writ and returning it as provided in this Act.

**Dispute**

(3) If the plaintiff by affidavit on information and belief of the deponent shows

(*a*) the time allowed for credit to the principal debtor by the standards and rules of the Canadian Payments Association has elapsed, and the principal debtor has not received irrevocable credit;

(*b*) any deposit institution has acted on

(i) an order or

(ii) information

given by the person indebted or liable or his institution to block or recall the payment;

(*c*) any deposit institution other than the principal debtor's institution has suspended normal payments or the conduct of its business without settling for the payment; or

(*d*) the instructions have been refused by the deposit institution of the person indebted or liable for lack of funds or credit to execute them;

the writ shall reissue, and the garnishee defendant shall answer to the facts alleged concerning non-payment, together with such defences or set-offs as he may otherwise have.

## B. Legislative Relief for Consumer Debtors

### 1. Creditors' remedies and consumer accounts

Funds deposited in account with a bank or other deposit institution can be reached generally by creditors using a writ of attachment or by the institution itself under a claim of set-off. The latter claim frequently flows from an instalment obligation which the debtor has allowed to go to default. The institution then invokes the acceleration clause, and sets off the principal amount. The collection of delinquent bank credit card accounts often proceeds in this manner.

Two factors would increase difficulties resulting from the use of such creditors' remedies in a society where credit transfers were an important means of payment. The first is that the consumer's funds flow to his account automatically under a continuing authorization. No act by the consumer is required, and therefore consumer inertia favours the creditor in finding moneys in the account. The second is that the present immunities respecting wages (partial) and pension or welfare payments (total) do not reliably trace into the consumer account. Although the leading case found that the immunities passed into the account, it did so on a narrow factual analysis of the account's operation which does not describe the operation of the normal consumer account[79].

### 2. Jurisdictional aspects: scope of legislation

To grant relief in this situation is a somewhat complicated matter. Use of set-off by a bank is clearly a matter regulable by the federal government, and probably only by the federal government. The matter lies at the core of commercial banking. Use of a set-off by provincially regulated institutions simply involves their exercise of a power available between two mutual debtors under the local law of contract. It is perhaps arguable that a province could alter the general law of set-off, and thus deprive the banks of its use absent a federal authorization in the *Bank Act*. But since such an alteration would almost certainly be restricted to consumer accounts in deposit institutions, it seems probable that the governing law is that stated in the Québec *Vacant Property Act*

*Case*[80]. In dealing with the escheat of unclaimed deposits in all deposit institutions, the Act involved so clearly impacted primarily on banks that it was held beyond the power of a provincial legislature.

Use of a writ of attachment is by contrast so clearly a provincial matter, absent insolvency, that federal regulation going beyond the fixing of the situs of accounts[81] or the creation or waiver of immunities for persons within the federal jurisdiction[82] would be only arguably valid, even if restricted to accounts in the chartered banks.

A workable legislative package would thus seem to include:

(i) federal legislation covering the use of set-off on the consumer payments account by a chartered bank and federally chartered near-banks doing a consumer business, incorporating provincial immunities by reference, as well as federal immunities;

(ii) provincial legislation covering the use of attachment against any consumer payments account in a deposit institution; and incorporating by reference immunities existing under federal law prior to deposit of the funds, as well as provincial immunities; and

(iii) provincial legislation governing the use of set-off by the provincially chartered institutions, following the same principles as the federal legislation in (i) above.

Such a package would not give rise to competitive advantage between the various institutions, would give the consumer the same substantive protection wherever he kept his account, and would meet the problem with lost immunities caused by the replacement of cheques with credit transfers.

## 3. Federal legislation governing the use of set-off on consumer accounts by chartered banks and federally chartered near-banks doing a consumer business

This legislation generally prohibits set-offs of the consumer account against liabilities. It then specifically authorizes a set-off

to the extent the account contains funds that would not have been immune from creditors, or that would once have been immune, but have rested in the account over thirty days. If the debtor can accumulate savings in his current account, he can presumably pay his creditors without undue hardship.

BANK ACT, new section **95.1**:

**Consumer set-offs prohibited**

(1) No bank shall set off an account or other liability of a customer against the amount on deposit in a *consumer account*, except as allowed in subsection (2).

**Exception**

(2) A bank may exercise rights of set-off available to it apart from this section to the extent that the amount on deposit in a *consumer account* exceeds the total of all *exempt funds* deposited to that account within the 30 days preceding exercise of the set-off.

**Definitions**

(3) In this section

"*consumer account*" means an account maintained with a bank by one or more natural persons, against which withdrawals or third party payments are customarily honoured on demand, and which is used for the primary purpose of paying normal living expenses of the account-holder or his dependents or obligations arising therefrom; and

"*exempt funds*" means any amount paid or payable to a natural person which would be exempt from attachment while in the hands of the payor; where part of an amount would be so exempt, means that part; and includes all such amounts, whether the source of the exemption arises from federal or provincial law, statute, prerogative, or case-law.

The following subsection should be enacted only in the event that the provinces cannot be persuaded to modify the operation of

writs of attachment and an adverse social impact on consumers or bank operations appears as a result of this.

**Attachments barred**

(4) Amounts on deposit in a *consumer account* are exempt from attachment to the extent of *exempt funds* deposited in the account in the 30 days preceding service of the writ; and no bank shall be liable for any act or omission in which the bank has relied in good faith on this exemption.

It should also be noted that the federal government has various extra-judicial remedies in the nature of an attachment. Section 224 of the *Income Tax Act* is an example. Use of these remedies should be governed by directives designed to achieve the same social ends as are involved in limiting the rights of general creditors.

Finally, it should be recognized that the problem of set-off also exists in the operation of any federally chartered near-bank which enters the payment transfer business. The above suggested reforms should thus also be incorporated in federal trust and mortgage loan legislation, with the appropriate institution inserted in place of "bank".

## 4. Provincial legislation governing attachment (garnishment) of deposit institution accounts

The legislative framework governing attachment varies between the provinces. In some cases several statutes must be consulted in order to locate all sources of the remedy applicable to deposit accounts, and the exemptions related to various classes of debtors.

There is thus no single formula which can meet the needs of all provinces in coping with the effects of credit transfer on debtors under local law. Nor is terminology necessarily uniform in describing the funds to be seized or the third party in whose hands they are seized.

The key principle supported in this study has been that of carrying exemptions presently good against a creditor into the deposit account along with the payment, and keeping those exemptions good in that account against both general creditors and the deposit institution itself. The preceding suggested legislation described a device for keeping the exemption good against banks, and a second choice device for keeping the exemption good against general creditors in accounts held by banks. The following suggestion if enacted by a province would apply to all general creditors, thus making the second choice option unnecessary.

The suggested statutory language would probably be best included in a province's *Consumer Protection Act*, although it must be examined for consistency with the various statutes governing attachment in the particular province.

**Attachment of deposit accounts; restriction**

(1) A writ of attachment (under the______Act(s)) does not operate to seize a *consumer account*, except as set out in this section.

**Exception**

(2) A creditor may seize by attachment the debt owed by a deposit institution to its customer or member, which is represented by the balance in a *consumer account*, to the extent that the debt exceeds the total of all *exempt funds* deposited to that account within the 30 days preceding service of the attachment.

**Definitions**

(3) In this section

"*consumer account*" means an account maintained with a deposit institution, including a chartered bank or other federally incorporated entity, by one or more natural persons, against which withdrawals or third party payments are customarily honoured on demand, and which is used for the primary purpose of paying the

normal living expenses of the account-holder or his dependents, or obligations arising therefrom; and

"*exempt funds*" means any amount paid or payable to a natural person which would be exempt from attachment while in the hands of the payor; where part of an amount would be so exempt, means that part; and includes all such amounts, whether the source of the exemption arises from federal or provincial law, statute, prerogative, or case-law.

*Comment:*

In subsection (1) the parenthesis should list all Acts of the province providing for "normal" attachment of debts. Acts such as the *Absconding Debtors Act*, (B.C., N.B., Ont., Sask.), which create an extraordinary general seizure of the debtor's property (also termed an attachment) should not be included in this list.

## 5. Provincial legislation governing set-offs exercised by provincially chartered institutions

The relationship between a deposit institution and its customer or member in respect of the account is that of debtor and creditor. The appropriate common law action for recovery of the funds deposited is money had and received. In such an action, as a matter of contract law, the defendant is entitled to plead any matter arising out of the course of the same transaction in respect of which the claim is made[83].

The province has clear jurisdiction to modify such law in respect of a provincially chartered institution, although a modification in respect of banks is probably beyond provincial power. Thus the provinces must deal, for institutions under their control, with the same problem dealt with by the federal government respecting banks.

In most provinces, the appropriate statute for dealing with the problem would be the *Consumer Protection Act*. Like the suggestion concerning attachment, the rule is restricted to consumer

accounts. The alternative would be to amend the chartering legislation for each class of deposit institution. This is somewhat cumbersome, and conceals the fact that all classes of institution are receiving the same treatment.

**Consumer set-off prohibited**

(1) No deposit institution subject to the jurisdiction of this Province shall set off an account or other liability of a customer or member against the amount on deposit in a *consumer account*, except as allowed in subsection (2).

**Exception**

(2) A deposit institution may exercise rights of set-off available to it apart from this section to the extent that the balance on deposit in a *consumer account* exceeds the total of all *exempt funds* deposited to that account within the 30 days preceding exercise of the set-off.

**Definitions**

(3) In this section

"*consumer account*" means an account maintained with a deposit institution subject to the jurisdiction of this Province by one or more natural persons, against which withdrawals or third party payments are customarily honoured on demand, and which is used for the primary purpose of paying the normal living expenses of the account-holder or his dependents, or obligations arising therefrom; and

"*exempt funds*" means any amount paid or payable to a natural person which would be exempt from attachment while in the hands of the payor; where part of an amount would be so exempt, means that part; and includes all such amounts, whether the source of the exemption arises from federal or provincial law, statute, prerogative, or case-law.

## C. Summary

The legislation contained in this section offers two possible solutions to the problem of protecting the payor from paying twice. It also supplies a three-fold program for the purpose of reducing the impact of payment by credit transfer on debtor-creditor relationships. *Successful implementation of these suggestions cannot rest on the federal government alone. Action by both levels of government is needed.*

# VIII.

# Conclusion

*There should be an explicit and unequivocal federal policy commitment to the principle of genuine, informed individual consent to the means of payment.* The commitment should reach direct federal activity, federal Crown corporations, and the federal labour relations jurisdiction. The commitment should be monitored, and sanctioning legislation enacted if abuses appear. (pp. 13-14) Provincial consideration of these issues should be promoted through liaison with the responsible provincial bodies.

*Issue of irrevocable instructions to a deposit institution to make a credit transfer to a payee should be treated as a conditional discharge of an obligation owed to that payee.* Negotiations with the provinces should take place to achieve the necessary changes in provincial law governing the attachment of debts. In default of such changes, partial solutions could be imposed unilaterally by the federal government under the banking power. Federal action on a unilateral basis should await proved abuse, since it might have anti-competitive effects on the deposit institutions. (p. 19)

*No statutory relief should be given to the payee's institution against the consequences of failure of the payor's authority.* The payee's institution can gain sufficient protection from the doctrine of apparent authority, and from the warranties of the payor's institution. Statutory relief would be jurisdictionally difficult and likely to receive a restrictive construction. (p. 23)

*Statutory relief against the operation of set-off should be given the consumer in those cases where the funds owing by the bank or other deposit institution bear a close connection to funds in which the consumer has protected rights, such as a total or*

*partial immunity from creditor's remedies.* Examples of such funds are pension payments, welfare, and wages. Suggested statutory provisions are discussed in Section VII. (pp. 25-26)

*The clearing standards approved by government should contain provisions dealing with the duty of institutions to transmit credit transfers speedily, and requiring the payor's institution to warrant data accuracy, the payee's authorization, and data authenticity.* These warranties should give direct recourse on the payor's institution, with an indemnity for that institution by the party at fault. (pp. 35-46) The role of the payee's institution in verifying customer identity should not lead to loss of the benefit of the warranty of authenticity in cases in which successful fraud has led to breach of both warranties. The primary responsibility for stopping such frauds should lie on the payor and his institution. The fraud is successful only because the payor's controls over disbursing have been outwitted. The payor should therefore bear the loss. (pp. 43-46)

If payors require the verification of facts regarding the payee by his deposit institution, for example verification that the payee is the purchaser of a security or verification of his identity, such a service could be made available. But it involves risks and service in addition to those involved in simply verifying an account number and that no change in control has occurred. Such risks and services would justify an additional fee on the part of the institution performing them. It may nevertheless be desirable to build the capacity to give these services into the clearing standards as an option. (pp. 46-49)

*Recall of a credit transfer after the payor's institution has released its tapes should be considered a matter of banking practice, within the complete and uncontrolled discretion of the deposit institutions involved.* Their customers will speedily curb abuse of such power. The decision to recall a transaction that is in the clearing process is one best taken by those who know the process in detail. (p. 50)

*The common law duty of the payee's institution to make restitution of funds transferred to it for a customer, which have been held past the time for returns but remain uncredited to the customer, should be an express obligation contained in the clearing standards.* (p. 52)

*An arbitrary rule concerning final payment, allowing factual inquiry into intervention in the processing sequence only in those cases in which a conflict of interest existed between the institution and its customer, should be adopted. The exact time period allowed for return should be set after consultation with the industry, but should not be in excess of one business day after receipt by the branch of account.* (p. 52) Ability to relax this rule for force majeure should be considered, but is acceptable only if it can be properly combined with protection for users of the system in the event of an institution's failure. (p. 53)

*The greater part of the burden of risk placed on the payor's institution by the clearing standards should be ultimately borne by the payor.* The principal exceptions to this principle are breaches of the warranties of accuracy, authority or authenticity caused by fault of the payor's institution or a subsequent institution. (pp. 58-60)

*The payor should be locked-in to his agreement with his institution in respect of payments in transit. Such a lock-in is necessary to protect the legitimate reliance interests of both the institutions and users of the system.* In addition, the payor should be contractually bound to the clearing standards as trade usage. (p. 61)

The principle of a basic payments transfer service, with additional bookkeeping services superadded on a fee-for-service basis, should be accepted in arriving at the pricing of credit transfers. (p. 60)

*Changes in the law of attachment and of set-off mentioned above are an essential part of social adjustment to a consumer credit transfer.* The Commission's present intent is to recommend such changes to the responsible authorities. (pp. 65-67)

Any use of credit transfer to deliver social benefits should be based on a careful initial evaluation involving field officers responsible for eligibility determinations and intake. *Introduction of such programs on a pilot project basis is an obvious precaution.* Provision of stand-by arrangements should be seriously considered if eligibility for the benefit is based on criteria involving need or age, or if it is recognized that substantial numbers of people would

suffer serious inconvenience through delay or non-receipt of the payment. (p. 67)

*Privacy and confidentiality impacts of a credit transfer system handling payroll and social benefits do not seem serious. Impact is however almost totally dependent on the message content and direction of data flow, and thus on the particular details of a proposal.*

Government monitoring of the proposals in this area should continue. All parties interested in developing payment techniques should be aware of the dangers of committing excessive data to the message transmitted, and the need to balance confidentiality with a meaningful descriptive statement. (pp. 67-69)

*Implementation of a comprehensive program to meet the social impacts of credit transfers cannot rest with the federal government alone. Provincial action will be needed.* (p. 85)

# Endnotes

1. See Canadian Bankers' Association, *Standards and Procedures for the Initial Implementation of the Interbank Credit Clearing System*, Section 3, Rule 12, (8 June, 1976).
2. Initially, this was a matter of private contract. However, the result is now mandated for a substantial proportion of employers by:
   *Pension Benefits Standards Act*, R.S.C. 1970, c. P-8, s. 10(1)(*b*); *Pension Benefits Act*, (Alta.) R.S. 1970, c. 272, s. 16(1)(*b*), 18; (Ont.) R.S. 1970, c. 342, s. 21(1)(*b*), 24; (Sask.) Stat. 1967, c. 67, s. 16(1)(*b*), 18; *Supplementary Pension Plans Act* (Que.) S.Q. 1965, c. 25, s. 31.
   Also relevant are the incentives contained in the *Income Tax Act*, Stat. Can. 1970-71-72, c. 63, s. 146(2)(*c*) (RRSP's) and Department of National Revenue, Taxation Information Circular 72-13RS (1 Dec. 1975) (employee's pension plans) s. 12.
   To receive favourable tax treatment, plan rights and interests must be non-assignable and inalienable. The result is to destroy characterization as debt, and to defeat creditors.
   In the government sector, the same result obtains by virtue of the prerogative or explicit legislative provision. See, *e.g.*, *Canada Pension Plan Act*, R.S.C. 1970, c. C-5, s. 64.
3. How much description is required? The payor must be able to make a satisfactory reconciliation between his instructions to his deposit institution and the institution's action on those instructions. Requiring an abbreviated report from the institution can have unpleasant consequences. If any portion of the data necessary to specify the payee unequivocally is omitted, the transfer can be diverted in respect of the omission. The payor would seem to need the trace number, the amount, and the account number and banking address of the payee as an absolute minimum. Other data related to his own bookkeeping operations might be very useful.
   The payee's information needs are more difficult to specify. Since the data must be passed through the entire clearing system, there are problems of privacy and confidentiality raised by any source data apart from the trace

number. On the other hand, a statement consisting of amounts, credit dates, and trace numbers unsupported by other particulars is useless. It guarantees that the institutions will have hundreds of tracing questions asked of them that would be directed to the payor in the normal course of affairs.

Either the payor, the nature of the payment (*e.g.* wages, dividend) or both seem desirable information for the payee. In some cases the payor's reference for the payment would be useful. There may be problems in putting this information on the statement. Perhaps a worthwhile compromise would be to carry the information through to the payee's institution's records, but to supply only a trace number on the statement. Then the payee's institution could answer many questions without initiating a trace procedure, but the data would not be available to anyone who was able to obtain the payee's bank statement by fair means or foul. Or perhaps the payee could be offered the choice of having certain information masked out on his statement as a marketing feature.

4. See *e.g. Norwich Five Ins. Society v. Banque Canadienne Nationale,* [1934] S.C.R. 596 (1934) 4 D.L.R. 223.

5. Why? Because the only reason for his institution to refuse to credit him with a transfer would be an error in the information received—probably in the account number. If he has *not* been paid in this case, his rights against the payor are still alive. If he has been paid, then the payor must be let off the hook.

   Since whether or not the payee's institution received value creditable to his account is likely to be the main source of these disputes, the payee would perhaps be better off with a clear remedy against the payor. The payor would then be entitled to call back the disputed transfer, as would the institutions that processed it, insofar as they had satisfied their duties under the clearing standards. An institution which had not satisfied its duties would be unable to shift its loss, and would have to content itself with its remedies against persons unjustly enriched. Giving the payee a right against his institution puts resolution of a difficult factual question on him, rather than on the institutions.

6. See *Capital Associates Ltd. v. Royal Bank* (1970), 15 D.L.R. (3d) 234, 236-238, *appeal dismissed* (1973), 36 D.L.R. (3d) 579.

7. Some electronic techniques of payment can incorporate identity checks at the time of payment; but credit transfer cannot. The payee does not initiate the transfer.

8. The neutrality requirement is already express policy; requirements of free choice and no pressure may be implicit in the statement that the consumer's freedom to switch institutions should be preserved. See Departments of Finance and Communications, *Towards an Electronic Payments System*, 7, 24 (Information Canada, 1975).

9. In their proprietary and legislative jurisdictions, both levels of government are involved. Both make social payments; both have primary jurisdictional responsibility in important sectors of labour-management relations. Either, by failure to act, would leave substantial groups unprotected. Whether a prohibition of pressure in the way payment of wages is made is enforceable in the employment context is questionable, but it should at least shift the balance towards the employee and prevent overt abuses.

10. The extent to which services such as chequing, credit accommodation and cheque negotiation at other branches are separate as distinct from a commingled service of "consumer banking" is the entry-point to the cross-selling problem. If "consumer banking" is the relevant concept, and various electronic services are inseparable parts of it in the modern market, there is no cross-selling and tying is an analytic impossibility. Not abuse of market power, but factual market structure, produces the anti-competitive result.

    In view of the massive advertising effort of financial institutions to sell this "package" concept of consumer banking, the usefulness of the tying concept is questionable—it may lead to a focus on effects, rather than causes.

    Tying is now a matter reviewable before the Restrictive Trade Practices Commission under s. 31.4 of the *Combines Investigation Act*, R.S.C. 1970, c. C-23 as amended S.C. 1974-75-76, c. 76, s. 12. The use of tying to secure loan transactions or where technologically reasonable is specially protected, s. 31.4(4), *id.*

    The elliptical drafting of *Bank Act* s. 102.1 and 138 (enacted and modified as part of the 1975 Combines Investigation amendments) appears to establish that tying accomplished in pursuit of an agreement among banks (or any other Combines offence or reviewable matter as accomplished) is wholly outside the *Combines Investigation Act.* The other construction—that the closing words of s. 102.1 refer *solely* to the items listed in s. 138—is less defensible, since the doctrine of statutory authority would immunize such an agreement in any event. That doctrine, however, would not oust the *jurisdiction* of the Commission and the Director.

    The *White Paper on the Revision of Canadian Banking Legislation* (Aug. 1976) proposes integration of these provisions with the *Combines Investigation Act.* Such integration would eliminate the above problem. The Minister of Finance would retain authority to authorize mergers of threatened banks, and consultative authority for all bank mergers. In addition, he could authorize inter-bank agreements for reasons of monetary or financial policy. See Bill C-13 (3d sess.; 30th Parl.: 1977), s. 6 and Dept. of Consumer and Corporate Affairs, *Proposals for a new competition policy for Canada: second stage*, 31-36 (1977).

11. The content of such a right must be carefully assessed. It is probably sufficient to require consent to use of cheques or means of payment by direct deposit generally, provided the consent is revocable on notice. Fairness would require disclosure that the payment would normally be electronically transmitted, if that is the case. Many technocrats resist such disclosure, stating that consent will be withheld through irrational consumer fears. Consent to each specific means of transmission would hobble the growth of the system and its ability to react to emergencies. But a "we know what's best for you" attitude concerning disclosure does not consort well with placing any risk whatever on system users. If the system is a black box to its users, then the participants must assume *full* insurance liability for its successful function.

12. See note 8 *supra.*

13. Ibid.

14. The proposed Canadian Payments Association would afford a device for binding all participants in the payment system except credit union locals to a set of rules and obligations. Since local credit unions and caisses populaires would access the system through a central or federation, that body would be

required to either act as agent for the locals in agreeing to the rules, or to insure their performance at the agreed standards. The latter is more in keeping with the relative financial power and bargaining roles of the institutions, and would not preclude agreed recourse by the central on its local.

For the structure of the Canadian Payments Association see Department of Finance, *White Paper on the Revision of Canadian Banking Legislation* (August 1976).

15. Credit transfers can flow from individuals to large organizations. European giro systems contain a well-known example.

    Many corporations today collect bills through the use of deposit institution branches on a local or national scale. However, the agency characterization and allocation of risk are different. A payee which invites its customers to pay through a bank branch is constituting that bank its agent for receiving payment.

    A payee who consents to payment at his own branch and institution is involved in a different transaction.

    At issue are the effective time of payment, the risk of non-receipt through error, and the risk of insolvency. In many European giros the last risk is moot, since the same institution holds both accounts and is in any event a governmental organ. All three risks raise questions of the user's sophistication, ability to spread risk and financial strength relative to the transaction which can appropriately receive a different answer as between individuals and large organizations.

16. /*B. & M Readers' Service, Ltd. v. Anglo Canadian Publishers, Ltd.*, [1950] O.R. 159 (C.A.) (agency); *Wm. Brandt's Sons & Co. v. Dunlop Rubber Co., Ltd.*, [1905] A.C. 454, 462 (H.L.) (equitable assignment); compare *Bell v. London and North Western Ry.*, (1852), 15 Beavan 548, 51 E.R. 651 (Ch.) with *Re Kent and Essex Sawmills Ltd.*, [1947] 1 Ch. 177, [1946] 2 All E.R. 638. The non-formal elements of the test for existence of a contract would probably be satisfied by the parties' conduct; but two important formal elements are lacking: a non-illusory promise by the payor and consideration moving from the payee.

17. An assignment is a common law technique for transferring the benefit of a legal duty from one person to another. Today, because of legislation derived from the English *Judicature Act*, 1873, most assignments can be described as statutory. Such an assignment has certain procedural and substantive requirements, and results in the advantage that joinder of the assignor is not necessary to enforce rights under it, or to give a good discharge.

    A transaction which fails to fall within the statute may nevertheless be enforceable as an assignment in equity. The courts of equity, whose jurisdiction continues to be exercised by our superior courts, never respected the common law rules forbidding the assignment of choses in action.

    The relationship of the parties in a credit transfer permits a formal arrangement of the transaction as an equitable assignment. Since *future* rights are involved, the transaction cannot be a statutory assignment; it is merely a contract to assign which may be enforceable in equity. But difficulties about consideration raise a problem. The normal use of equitable assignment to create security in receivables could have undesirable effects in applying the characterization to a consumer transaction. Finally, the characterization

would project the rights of the payee's institution forward through time to the instant at which the payee's rights to the funds would have been perfected, creating chaos in the relationships with creditors. Deposit institutions cannot be presently accountable to third parties in respect of undelivered payments for unknown sums.

18. Assignment is rejected on the following grounds. The existence of a debt owed to the institution by the payee-assignor is purely fortuitous in the instant case; it is clearly the most important factor in the characterization of simple instructions to pay a third party as equitable assignments. Did the alleged assignor intend to pass a property interest? Yes, because otherwise the creditor-assignee would not have made the loan or given time. See *Brandt's* case, *supra* note 16. In the employer-employee situation, it is both a monstrous distortion of the employee's intention and in many cases contrary to public policy (civil servants) to find an assignment. The public policy point can be taken in respect of all pension benefits. See note 2, *supra*.

    Assignment gives the payee's institution an interest in debts in the payor's hands and in non-debt payments as they leave the payor's hands—an interest in payments in transit through the clearings. Such an interest might be found in all cases, or only when the payee was indebted to his institution. The result for all cases would seriously derange the law of creditor's remedies; if the rules were restricted to cases where the payee was in a net overdraft position it would create chaos for payors and their payment agents. Finally, it seems likely that the *form* of the authorization would satisfy the requirements of signature, unconditionality and notice to the debtor—thus qualifying as a statutory assignment of sums presently due. Can it be seriously asserted that the parties intend to authorize direct suit to collect by the receiving institution?

    The third party beneficiary contract must also be rejected. There are serious formal difficulties, discussed in text *infra* and in note 16. Even if these are surmounted, under presently accepted law none of the groups whose interests must be adjusted could claim legal rights under the contract. The characterization is sterile under both the present law and American law in respect of third party beneficiaries. See *Restatement, Contracts* (1931), 133, 147.

    By contrast, creation of a power to pay is a generally acceptable characterization. It has been applied by the courts to analogous situations. See *Bell v. London and North Western Ry., supra* note 16, *Ex parte Hall*, [1878] 10 Ch. D. 615, and *Coulls v. Bagot's Executor and Trustee Co., Ltd.*, [1974] A.L.R. 385. Such a power provides protection for executed transactions, but is revocable prospectively. Its use in this context can be combined with the doctrine of promissory estoppel to do away with over-reaching by institutional parties, while protecting their reliance interest.

19. Under normal circumstances, the payor could not make a third party the payee's debtor without an independent communication from the third party to the payee acknowledging the existence of the indebtedness. See *Griffin v. Weatherby* (1868), L.R. 3 Q.B. 753. The requirement of a fund in the third parties hands, *Liversidge v. Broadbent* (1859), 4 H. & N. 603, 157 E.R. 978, is clearly present at the end of the credit transfer. There is some doubt that the requirement still holds. *Shamia v. Joory*, [1958] Q.B. 448.

    The need for such communication was substantially reduced by recognition of the statutory assignment. By assigning to the payee (rather than instruct-

ing the third party) the payor could make payment. The onus of communicating with the third party shifted to the payee—if he omitted to give notice of assignment, he remained at risk of further dealings by the payor with the debt. But from the viewpoint of the present transaction, an assignment by the payor would introduce serious difficulty. Outside of "on-us" transactions, the payor must become the customer of multiple deposit institutions in order to perform the assignment. The institutions are notified after the fact, if at all, by the payee customers; they must treat as irrevocable in practice instructions which are not irrevocable in law.

Nor does the payee become bound by such an assignment. Unlike the assignment by the payee discussed in text, which the payee originates and which would bind him after notice to the payor, the present assignment binds the payor after notice to the institution. Both acknowledgment and a payor's assignment must accordingly be rejected as models for the transaction.

20. The payor's discharge should not be confused with the immediate charge to account relied on in *Liversidge v. Broadbent, supra,* to support the third party's new duty to the payee.

    It is the authorized creation of the third party's duty which justifies the payor's discharge. The authorization agreement can be viewed as a standing agreement to accept deposits under the power therein conferred in lieu of payment by more orthodox means, thereby discharging the payor.

    Cf. *Civil Code* art. 1173.

21. In some cases the payor is the logical source of an approach to the payee to enter these agreements—for example, direct deposit of payroll or pensions. In the payroll case, return of an executed agreement could conveniently occur directly to the payor or through the payee's deposit institution. In the pension or welfare case, the choice is probably between return through the mails and through a deposit institution. In the case of interest payments on government bonds, the most reasonable approach is through the salesmen of the bonds—commonly deposit institutions.

    There are various approaches taken by institutions to the practical problem of verifying identity and account number to be credited, and the parallel legal problem of forged authorization agreements. One approach places all such problems in the payor's area of responsibility, covering the risks of error and forgery for participants and customers by the warranty of the originating institution. Subsequent parties are protected and liability passed to the originating institution by a chain of indemnity rights. The originating institution has recourse on the payor, unless the institution is itself at fault. But for subsequent parties, it is the originating institution's liability which makes the system acceptable.

    A second approach requires the return of authorization agreements through the receiving institution. That institution verifies its customer's identity and account number, and incurs the corresponding liability for forgery of a customer's authorization and erroneous account number data.

    A final variant merely supplies the authorization to the receiving institution. The institution then incurs the forgery risk, based on its opportunity for examination of its customer's signature.

22. At least one strong legal reason is the line of authority which would use the agreement to promote the relationship from mandate to equitable assign-

ment. See *Brind. v. Hampshire* (1836), 1 M. & W. 365, 150 E.R. 475 (Exch.); *Crowfoot v. Gurney* (1832), 9 Bing. 372, 131 E.R. 655 (C.P.)

23. Uncertainty would decrease marketability. The enthusiasm of computer specialists for such systems is not shared by marketing men, or the public generally. The typical force majeure list of excuses for non-performance, or a promise phrased in terms of a reasonable effort to make the payment, would probably be equally suspect to the consumer.

24. *Vanbergen v. St. Edmunds Properties, Ltd.* [1933] 2 K.B. 223 (C.A.): *Central London Property Trust Ltd. v. High Trees House, Ltd.*, [1947] 1 K.B. 130: *Conwest Exploration v. Letain*, [1964] S.C.R. 20; *Tool Metal Co. v. Tungsten Electric Co.*, [1955] 2 All E.R. 657 (H.L.); *C.P.R. v. The King*, [1931] A.C. 414, 432 (P.C.).

25. See the discussion of the role of institutional neutrality and consent *supra* in the text at 10-12, and note 8.

    The inadvisability of locking the payee into an agreement must not be confused with the use of a lock-in clause against the payor in respect of partially executed tranfers to protect the reliance interests of the institutions and their customers. See p. 61, *infra*.

26. See the *Tool Metal* and *C.P.R.* cases, *supra* note 24.

27. This follows from the payee's authorization to the payor to make deposits to the payee's credit, using the services of the deposit institutions as a group. All institutions, except the payee's, act as delegates of the payor. Insofar as it acts under its customer account agreements or its knowledge of the payor-payee agreement as communicated by the payee, the payee's institution has an independent status.

28. It is suggested in text at pp. 37-53 that this right to call upon the payee's institution, or other recipient of value, in the event of failure of authority or certain other events should be modified by the terms of the payor-institution contract and the clearing rules. The proposed modifications would place liability without fault on the payor's institution for all errors save for identity and bad payor data. The payor's institution would have recourse against the recipient of value for restitution and against a party at fault for damages. In view of the nature of the payor-payee agreement, damages other than interest on the mispayment and costs of a mistaken defence against the payor are unlikely.

    If the payee's institution does not receive a copy of the authorization, the identity risk must also be assumed by the payor's institution. That institution would of course provide for recourse on the payor.

29. *Colonial Bank v. Exchange Bank of Yarmouth* (1885), 11 App. Cas. 84 (P.C.) Strictly speaking, the case establishes that the recipient bank, which had a valid set-off against the payee, could not hold the funds. But the rationale—that an agent bank which remits to the wrong recipient by mistake and without authority retains an interest sufficient to bring money had and received in its own behalf—is as valid against an attaching creditor as against set-off. If the recipient is indebted to the remitting bank, it can hardly be indebted to the payee in respect of the same funds.

    See also *Royal Securities Corp. v. Montreal Trust Co.* (1966), 59 D.L.R. (2d) 666, [1967] 1 O.R. 137 (H.C.J.) (dictum) (analogous claim in detinue for cancelled note allowed; declaration cancellation invalid).

30. For all institutions but the payor's and payee's, the problem of processing the other, valid orders in the system is sufficient answer to an asserted power to 'stop credit'. This is a valid answer by the payor's institution once the payor's transfers have been mixed with the rest of its business. Until that time there is every business motivation for the payor's institution to honour its customer's request, and no duty to the payee to allow the transfer to go forward. There should therefore be no need when the payor is an important customer such as government or a large company to impose a legal right to stop payment: if it is commercially convenient to satisfy its customer, the payor's institution will do so; if not, the cost of the stop payment right would be imposed on other users of the system.

    In dealing with the payee's institution there are several problems. The cheque collection process is probably not relevant. A bank which had reason to believe its customer had void or voidable title to an instrument would probably refuse to take the instrument. If the bank had no such knowledge, it would have the clear protection of s. 165(3), *Bills of Exchange Act*, in extending credit to its customer against deposit of the cheque.

    The credit transfer system does not permit a bank to wash its hands of the transaction. Value has already been confided to the system and the proper claimant must be determined. If that is to be done factually, the payee's bank must be at liberty to act on accurate information. We could go further, and allow it to 'stop' on the payor's instruction without liability, or even compel it to do so. We could go not so far, and make the transfer irrevocable on release by the payor.

    One constraint on choice is the time of final payment. After final payment, a 'stop' is a chargeback. Also, some consideration must be given to the effect on the payor's discharge against both payee and creditors if the chargeback is permitted. But the proposition need not be reversible: there is no reason to treat 'unstoppable' transactions as finally paid. See the discussion in text at 49-50, *infra.*

31. *Belshaw v. Bush* (1851), 11 C.B. 208, 138 E.R. 444 (C.P.): cf. *Re Defries & Sons, Ltd.*, [1909] 2 Ch. 423 and *Royal Securities, supra* note 29 (if higher security exists, cheque cannot operate as payment, conditional or otherwise).

32. *Griffiths v. Owens* (1844), 13 M. & W. 58, 153 E.R. 24 (Ex.).

33. Normally the "payor" of a cheque is said to be the drawee bank. But in the terminology used in this paper the payor is the person from whom value moves. In the case of a cheque, it is the customer whose account the drawee charges. That customer is the drawer of the cheque.

    The drawer of the cheque is liable on the instrument to the payee and subsequent parties. From a formal standpoint the liability is conditioned on timely presentment; but the circumstances in which non-performance of the condition will discharge the drawer-payor are quite limited. *Bills of Exchange Act*, s. 85, 91-92, 166 and authorities cited note 61, *infra.*

    In the credit transfer, the payor does not agree to pay—he simply has power to do so through the credit transfer scheme.

34. Why does the mere release of payment instructions create an unacceptable risk of paying twice? The payor's institution does not want to be left holding the bag. Although it may be unlikely the institution would mount a tape after the payor had requested its recall, the institution will almost certainly

take the contractual position that the payor loses the right to control his instructions by releasing them for action. In addition, the institution will either charge the payor's account or perfect a set-off against it prior to release of its own data to the clearing system. See note 37, *infra*. By releasing its own data, it incurs settlement responsibility on the effective dates of the transactions. If it cannot charge the payor's funds, it will of necessity pay with its own.

The net result is that the payment instruction puts the payor at risk when it is handed over, unless the underlying debt is immune from garnishment. If the debt is seized, recall of the payment is at the payor's risk.

35. It is suggested that it is best to bar the remedy, rather than change the underlying legal relationships. If the debt is actually paid at the point when data is released, the authorization agreement becomes an equitable assignment coupled with an executory accord—in which satisfaction is achieved by the payor's (irrevocable) instruction of his deposit institution. Now it is the payor's institution which is drawn into a customer relation with a total stranger. While the institution may not object to holding a non-chequable deposit which it will speedily transfer anyhow, the payee may have entirely reasonable objections to the credit standing or accessibility of the payor's institution.

    Such statutory relief is not purely a question of provincial law. The same analysis which applies to garnishment applies to such powers as those exercised extra-judicially by the Minister of National Revenue under the *Income Tax Act*, s. 224. S.C. 1970-71-72 c. 63 *as amended.*

36. This is perhaps a Panglossian view of the situation. Given the state of the cases concerning attachment, and their confusion of a legal remedy with voluntary conveyance of the creditor's interest, the race between competing creditors can still result in an unequal distribution outside bankruptcy. And not all insolvents are subjected to bankruptcy.

    Nevertheless, the suggestion is fair to creditors as a class. It decreases the exposure of payors. It does not immunize the assets involved, which are available both before and after their transit through the credit clearing system. Nor should it be beyond the wit of a legislature to fashion a remedy which by proper service could seize the debt in the payor's hands and if not, as it came to rest in the payee's institution.

    Attachment is not presently such a remedy, since the timing of service is material. See *Canadian Bank of Commerce v. Dabrowski* (1954), 13 W.W.R. (N.S.) 442, *noted* (1954), 32 *Can. Bar Rev.* 1141. But once the technical problems are appreciated, an arbitrary technical solution can be constructed. Whether the complications involved make such a solution worthwhile is an open question. See Appendix IV, *infra*.

37. An immediate charge is simplest, and gains an immediate credit float for the institution. Perfection of a right to charge provides only protection against creditors.

    On accounts where bargaining genuinely occurs between customer and institution, the customer could be expected to bargain for the right to charge. The actual charge would be made on a schedule based on settlement and estimated transit time—leaving the customer with the benefit of the credit float. In event of a creditor attaching the accounts, the institution would simply report the net between the account balance and the transfers in the

deferred charge account, since it has a valid set-off in respect of that account.

On the typical consumer or small commercial account, an immediate charge would probably be made. This would both gain credit float, and save the bookkeeping costs associated with deferred accounting for each customer.

38. A cheque is not an assignment. *Bills of Exchange Act*, s. 127. Thus its holder has no rights against the drawee. Strictly speaking, he has an expectation that the drawee will pay; for the drawee is not liable on the cheque even after its presentment. However, in the normal case the drawee will honour the cheque if there are funds available.

    Here, however, the creditor's attachment has blocked the account, and the bank will not normally pay.

39. As mentioned *supra* note 37, the institution will either charge the account or perfect a set-off when it acts on the payor's data. Apart from the relatively short period between the payor's release of data and institutional action, the creditor comes too late. The transfer has been settled for by the payor or the institution has rights derived from it superior to the payor's—and hence the creditor's—right to the account balance.

    There is an alternative to the set-off. The institution could in theory simply make the transfers on credit by advancing its own funds, and renounce any set-off in respect of the advances. This would never occur without legal compulsion of the institution, but it would, absent an express agreement for a deferred charge and set-off, be the legal position against government if it chose to originate transfers from an existing deposit balance, as opposed to covering them with a series of drafts, and obtained a deferred charge through its superior bargaining power.

40. See *Royal Securities*, note 29 *supra*, for an interesting illustration of the remarkable casualness with which business on occasion treats the insolvency risk.

41. Credit transfer is used with the restriction to payments from large payors to small payees mentioned earlier. Ultimately, this may become something similar to the Uniform Commercial Code concept of a sophisticated actor embodied in the definition of a "merchant" (UCC 2-104 and Comments).

    Of course, a payor need not be a large business. In a giro, or a system of remission through the agency of a bank, the payor is often unsophisticated. These methods of payment compete with the cheque and bank credit card. Market power could probably be abused to force the substitution of these means for the cheque in some uses.

    Whether abuse is present would seem to require inquiry into the reasonableness of the requirement of a particular means of payment by a payee, and the actual existence of market power. If the corner grocer takes only cash payment, it may be either a reasonable precaution in his market or without competitive effect. If the telephone company were to accept only "telephone payments" on giro deposits in payment of their bills, both unreasonableness and power would seem clearly present. A wide range of conduct lies between.

    The analysis offered in this paper assumes that a credit transfer, as restricted in the text, is properly and factually differentiated from both giro and agent for remission type credits. See note 15.

42. See note 21, *supra*.

43. Similar considerations are responsible for *Bank Act*, s. 95-96 and the much broader relief afforded by Uniform Commercial Code 3-603.

44. See Falconbridge, *Banking and Bills of Exchange* 196 (7th ed. 1969).

45. See *Harmon v. Gray-Campbell, Ltd.*, [1925] 1 W.W.R. 1134, [1925] 2 D.L.R. 904 (Sask. C.A.): *General Motors Acceptance Corp. v. Hiebert* (1955), 15 W.W.R. 703 (B.C.S.C.) (Wilson, J.); *Mayer v. Abrams* (1965) 51 W.W.R. 154, 51 D.L.R. (2d) 128, *aff'd per cur.* (1966) 56 W.W.R. 128, 55 D.L.R. (2d) 194 (B.C.C.A.)

46. *E.g. Conditional Sales Act* S.B.C. 1961, c. 9 s. 14(9) *as amended* S.B.C. 1974 c. 19, s. 6; but see *Consumer Protection Act*, R.S.M. 1970 c. C-200, s. 33.

47. See *Holy Spirit Credit Union Society v. Kwiatowsky* (1969), 68 W.W.R. 684 (Man. Q.B.)

48. The basic position is that contracts do not bind persons other than the parties.

    Rule 2(b), disclaiming any legal effect for the clearing house rules (quoted Falconbridge, *Banking and Bills of Exchange* 384 (7th ed. 1969), no longer appears in the current rules. See Canadian Bankers' Association, *By-Law 24: Bank Clearing Associations* (approved by Treasury Board 11/IX/75). On its true construction, Rule 2(b) meant not what it appeared to say, but rather that clearing house presentation was not to be used as a pretext to obtain payment of a disputed item. *Bank of British North America v. Standard Bank* (1917), 35 D.L.R. 761, 38 O.L.R. 570 (C.A.) (drawee bank receiving an instrument through the clearing house is agent of collecting bank for purpose of presentment on itself, and owes duties of good faith and diligence; generally cited for *dictum* interpreting Rule 2 that purpose of clearing rules is to place banks on same footing as if they had dealt directly).

    The leading Canadian case is *Sterling Bank v. Laughlin* (1912), 1 D.L.R. 383, 3 O.W.N. 643, 21 O.W.R. 221. (Div. Ct.) The defendant had endorsed and discounted a draft with the plaintiff bank. The draft was presented through the clearing house at Toronto; but the drawee, having acquired the draft and stamped it as its property, failed to make settlement. Boyd, C., carefully stated the effect of the clearing house presentment:

    > There is no evidence that she is or was aware of or is to be bound by the dealings sanctioned as between the banks by their voluntary association in the clearing house system. That is a matter not binding per se on the public unless it can be assumed or proved that the party sought to be charged has been dealing with the bank subject to the usages of the clearing house. No such evidence was given in this case... [; instead the evidence showed that the plaintiff bank had accepted payment in the form of the drawee's credit, working a novation and discharging the defendant endorser.] *Id.*, at 384.

    In short, the rules of the clearing house if uniformly adhered to can be proven as trade usage; they bind persons who can be charged with notice of them insofar as they are reasonable. Cf. *Royal Securities Corp. v. Montreal Trust Co.* (1966), 59 D.L.R. (2d) 666, 707-09, [1967] 1 O.R. 137 (H.C.J.) Reference to the customer agreement will normally reveal that the customer has agreed to be bound by clearing house rules in effect from time to time.

49. See, *e.g.*, Eddy, *The Canadian Payment System and the Computer: Issues for Law Reform*, 59-62 (Law Refórm Commission of Canada, 1974) (bank credit cards).
50. Daniel 6:8-15.
51. See *Montreal Trust Co. v. Canadian Pacific Airlines Ltd.* (1977), 12 N.R. 409 (S.C.C.); *Arrow Transfer Co. v. Royal Bank*, [1973] 3 W.W.R. 241, 265, 19 D.L.R. (3d) 420, 444 (B.C.C.A.) (Nemetz J. dissenting), *aff'd* (1972), 27 D.L.R. (3d) 81, 97, [1972] 4 W.W.R. 70, 87 (S.C.C.) (Laskin J. dissenting).
52. These classes are modelled on the membership requirements of the proposed Canadian Payments Association. See *White Paper on Canadian Banking Legislation*, 17-18 (August 1976). Non-member correspondents are not specifically discussed in the white paper. They are the residual class created by allowing the credit unions and caisses populaires to participate in the Association by means of their centrals and federations. Since each such credit union or caisse is an independent legal entity, their liability under clearing rules cast in the form of Association by-laws could not be established by such a procedure.

    Given the relative strength of the individual credit union or caisse and the centrals or federations, it seems likely that the real protection for other system participants is the warranty of performance given by the central or federation. Whether that body attempts to bind its members to the Association, or simply takes recourse against them under its own rules would seem to be a matter of indifference to the Association members.

    It is probable that the members would be liable under the reasoning of the *Royal Securities* case, note 29 *supra*, in any event, since they are commercial parties customarily dealing through the clearing house.
53. Provincial centrals can qualify for federal inspection and lender of last resort assistance from the Canada Deposit Insurance Corporation. See *Cooperative Credit Associations Act*, R.S.C. 1970, c. C-29, s. 43-67, 80, 87-88 as amended S.C. 1973-74, c. 37, s. 19-33, 36-41.

    The Québec Deposit Insurance Board insures the depositors of caisses populaires in that province, and is itself entitled to CDIC loan assistance. *Canada Deposit Insurance Corporation Act*, R.S.C. 1970, c. C-3, s. 33.
54. Cf. *By-laws of the Canadian Bankers' Association*, Art. 24, Rule 11 (approved Treasury Board, 11/IX/75): "A member appointed as a clearing bank [by a non-bank financial intermediary] shall be liable for the transactions [of such institution] in the same manner as for its own transactions. . .".
55. *Joachimson v. Swiss Bank Corp.* [1921] 3 K.B. 110; *Foley v. Hill* (1848), 2 H.L. Cas. 28, 9 E.R. 1002; see Paget, *Law of Banking* 55-60 (7th ed. 1966); Falconbridge, *Banking and Bills of Exchange* 275-86 (7th ed. 1969); Nicholls, "The Legal Nature of Bank Deposits in the Province of Quebec" (1935), 13 *Can. Bar Rev.* 635. See generally *Re Bergethaler Waisenamt* [1949] 1 D.L.R. 769, 775-76 (Man.C.A.); *Bank of Nova Scotia v. Royal Bank*, [1975] 5 W.W.R. 610, 626-27 (Alta. App. Div.).
56. See Milner, *Contract* 1-62 (1963); Fuller and Perdue, "The Reliance Interest in Contract Damages" (1936), 46 *Yale L.J.* 52, 373.
57. *Bills of Exchange Act*, R.S.C. 1970, c. B-5, s. 134 sets damages for dishonour of a bill of exchange at its face amount, interest from presentment

or maturity, and the expenses of noting and protest. If one views the bill as an alternative to cash payment by the drawee, it is clear that all the elements are restitutionary.

Damages for dishonour of a cheque must be specially proven unless a business drawer is involved; in the case of the business drawer damage is presumed. The injury amounts to defamation of credit, since the funds involved remain on deposit if the cheque is not honoured. *Gibbons v. Westminster Bank*, [1939] 2 K.B. 882, [1939] 3 All E.R. 577; *Fleming v. Bank of New Zealand*, [1900] A.C. 557 (P.C.): but see Uniform Commercial Code 4-402 (1972 ed.)

An over-the-counter withdrawal would not normally involve third parties, and the business customer may well stand on the same footing as the consumer. The latter is entitled only to interest as damages. *Henderson v. Bank of Hamilton* (1894), 25 O.R. 641 (Ch. Div.) (chequable savings). The funds themselves either remain on deposit or are recovered in the action.

In the holder's action for conversion of a cheque or bill, damages are measured by the face value of the instrument. *Lloyd's Bank v. Chartered Bank of India, Australia & China*, [1929] 1 K.B. 40, 57, 75 (C.A.). Ignoring bills traded at a speculative discount, the recovery is again restitutionary.

The payments aspect of banking is thus legally founded on strict protection of the depositor's restitutionary interest. Application of the contract test of remoteness of injury to *Gibbons'* case, *supra*, makes it unlikely that a consumer would normally recover anything beyond nominal damages.

58. See Linden, "Tort Law as Ombudsman", (1973) 51 *Can. Bar Rev.* 151, 160.
59. *Cavanaugh v. Ulster Weaving Co. Ltd.* [1960] A.C. 145 (H.L.): *King v. Stolberg* (1968), 70 D.L.R. (2d) 473, 65 W.W.R. 725 (B.C.S.C.).
60. See note 48 *supra*. Cf. *Bills of Exchange Act*, s. 166 (2).
61. Compare Falconbridge, *Banking and Bills of Exchange* 387, relying on *Bank of British North America v. Haslip* (1914), 19 D.L.R. 576, 30 O.L.R. 299, *aff'd* 20 D.L.R. 922, 31 O.L.R. 442 with Paget, *Law of Banking* 199-201, 436; see *Canadian Encyclopedic Digest (Ont.) 3d*, "Bills of Exchange", s. 277-78.
62. *Paradine v. Jane* (1647), Aleyn 26 (tenant evicted from leasehold during Civil War by Royalist forces); but see *Taylor v. Caldwell* (1863), 3 B.&S. 826, 122. E.R. 309 (contract to use hall discharged by destruction of hall; "impossibility"): *Krell v. Henry*, [1903] 2 K.B. 740 (hiring of flat to view parade frustrated by delay of Coronation of Edward VII); *Jackson v. Union Marine Ins. Co. Ltd.* (1874), L.R. 10 C.P. 125 (vessel unavailable through grounding and ensuing repair work; voyage charter frustrated).

    The relaxation of the rule is by no means total. See *Tsakiroglou & Co. Ltd. v. Noblee Thorl G.m.b.H.*, [1962] A.C. 93, [1961] 2 All E.R. 179 (H.L.) (contract for Sudanese groundnuts c.i.f. Hamburg not frustrated by closure Suez Canal); *The Eugenia*, [1964] 2 Q.B. 226, [1964] 1 All E.R. 161 (C.A.) (time charter on Black Sea—India route not frustrated by closure Suez Canal); *Davis Contractors Ltd. v. Fareham U.D.C.*, [1956] A.C. 696, [1956] 2 All E.R. 145 (H.L.).

    The *Civil Code of Québec*, s. 1072 provides:

    > Le débiteur n'est pas tenu de payer les dommages-intérêts lorsque l'inexécution de l'obligation est causée par cas fortuit ou force majeure,

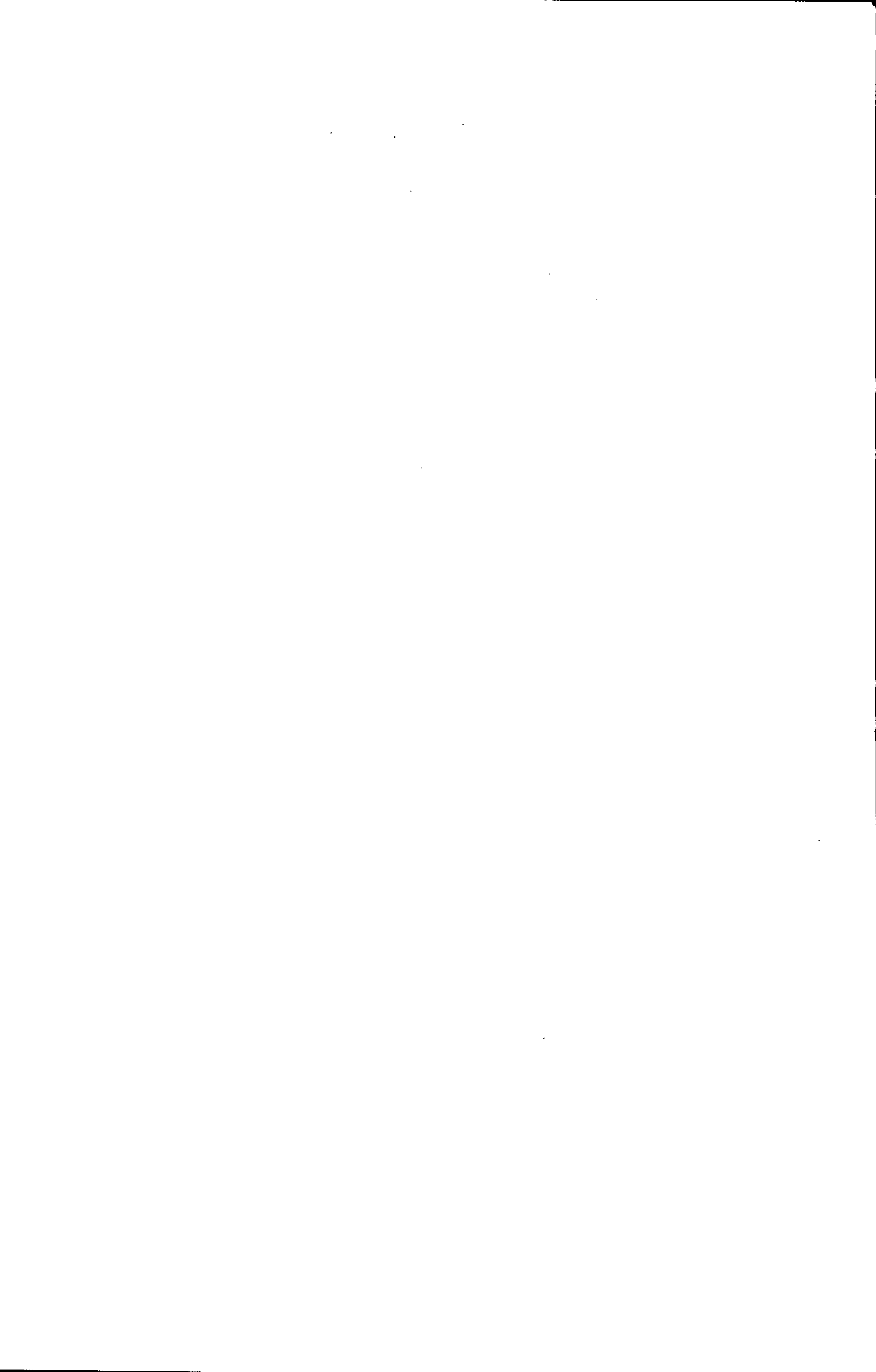
sans aucune faute de sa part, moins qu'il ne s'y soit obligé spécialement par le contrat.

Compare *Peter Kiewit Sons' Co. of Canada Ltd. v. Eakins Const. Ltd.*, [1960] S.C.R. 361, 22 D.L.R. (2d) 465 with *Swanson Const. Co. Ltd. v. Manitoba* (1963), 37 D.L.R. (2d) 615, 43 W.W.R. 385 (Man. Q.B); *Industrial Overload Ltd. v. McWatters* (1972), 24 D.L.R. (3d) 231 (Sask. Q.B.).

63. *Achille Laura v. Total Societa Italiana per Azioni*, [1969] 2 Lloyds Rep. 65 (construing the 'Suez Canal closure clause' resulting from the 1956 War and decisions cited *supra*); *Eastern Air Lines v. McDonnell Douglas Corp.* (1976), 532 F. 2d 957, 19 UCC Rep. 353 (CA 5); *Eastern Air Lines v. Gulf Oil Corp.* (1975), 19 UCC Rep. 721 (SD Fla.); see Uniform Commercial Code 2-615 and Comments (1972 ed.).
64. See Paget, *Law of Banking* 343-68 (7th ed. 1966).
65. See page 50, *infra*, and note 5, *supra*.
66. See pages 57-60, *supra*. The payor's liability would seem to sound in misfeasance, rather than non-feasance. The institutional liability rests on the extent to which the duties undertaken are delegable by the payor and the extent to which the payor purports to control institutional performance. How the liability for late or misdirected payment will be resolved from the payee's viewpoint remains a question upon which the courts will undoubtedly have the last word.
67. The willingness to so cover its customer's account would obviously be a competitive factor of some significance to consumers.
68. Cf. Canadian Bankers' Association, *By-laws*, art. 24, rule 17 (11/IX/75).
69. If the payee has used the funds, he will have ratified the transaction and it will amount to at least an acceptance on account. However, if the payee rejects the underpayment on learning of it, it would appear to have no binding effect at all.

    Mispayment or overpayment might be unrecoverable occasionally through the fault of the payor, and reliance by the payee. But in the normal case, the payment should be recoverable; the payee can hardly claim justifiable reliance. See *Kelly v. Solari* (1841), 9 M. & W. 54, 152 E.R. 24 (Exchequer); *Royal Bank v. R.*, [1931] 2 D.L.R. 685 (Man. K.B.)
70. See text *infra* at pages 58-60.
71. Good faith is an overriding duty in the performance of every contract. To claim to rely on a warranty when one has actual knowledge that the contrary state of facts exists is not action in good faith.
72. The indemnity contemplated is one against damage suffered as a result of fault by negligence or non-compliance with the clearing standards of the intermediary or payee's institution.
73. (1976), 8 N.R. 451 (S.C.C.) The case discusses the rule at length, with valuable dissents by Laskin C.J. and Spence J. The potential of the present rule for fragmenting litigation in the case of serious frauds, and its weakness from the point of view of insurance principles in those cases in which the drawee takes its recourse on prior parties, must be weighed against the virtue of a "know your customer" rule.
74. *Id.*

75. See note 18, *supra.*
76. The difficulties in applying the standards of the common law argue strongly for expressly dealing with the more common types of problems likely to arise. See generally Paget, *Law of Banking* 343-68 (7th ed. 1966).
77. The leading case is *Holy Spirit Credit Union Society v. Kwiatowsky* (1969), 68 W.W.R. 684 (Man. Q.B.). The case carried the immunity into the account, but on the rationale that the account-holder had made it a practice to withdraw the funds in a lump sum after each deposit. This is of little help to the typical consumer.
78. Bill C-16 (2d sess., 30th Parl. 1976); not yet introduced, but see *White Paper on Revision of Canadian Banking Legislation, supra* note 14.
79. *Holy Spirit Credit Union Society v. Kwiatowsky, supra* note 77.
80. [1947] A.C. 33, [1947] 1 D.L.R. 81.
81. Cf. *Bank Act* R.S.C. 1970, c. B-1, s. 96(4).
82. *E.g.* the prerogative immunity of federal civil servants; *Canada Shipping Act* R.S.C. 1970, c. S-9 s. 205 (merchant seamen).
83. See *Re Sutcliffe & Sons Ltd.*, [1933] O.R. 120 (C.A.), following Lord Mansfield in *Dale v. Sollet* (1767), 4 Burr. 2133, 98 E.R. 112 *Civil Code*, arts. 1187-88.



# Appendix I

## Sample Form of Authorization for Credit Transfers

(Large Organization to Consumer Payee)

*(Numbers in parentheses coincide with explanatory notes on following pages)*
*(Starred items to be completed if used, prior to Payee receiving form)*

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### Authorization for Credit Transfer

| To: | | and | |
|---|---|---|---|
| | Payor's Name * | | Payor's Institution (2)* |
| | Address * | | Branch * |
| | " * | | Address * |
| | Payor's reference (1)* | | " * |

I hereby authorize ____*____, hereafter called PAYOR, to transfer funds to my account at the institution, branch, and number indicated below. I agree to accept final payment of those funds to my credit as authorized in discharge on account of any obligation owed me by the PAYOR. The PAYOR is authorized to use the services of any member or affiliate of the Canadian Payments Association in carrying out this authorization, and I agree to be bound by the standards, rules and practices of that Association as they may exist from time to time. I AGREE TO GIVE WRITTEN NOTICE OF REVOCATION OF THIS AUTHORIZATION TO ____(3)*____; AND TO BE BOUND BY THIS AUTHORIZATION UNTIL PAYOR HAS HAD REASONABLE TIME TO ACT ON THAT NOTICE. PAYOR or his institution may terminate this agreement by sending ten (10) days' notice to me at the address below. (4)

| | |
|---|---|
| Payee's Name (5)* | |
| Address (5)* | /s/ ____________ Payee |
| " | |
| Payee's Institution | Identification Number (5)* |
| Branch | |
| Transit Number (7) | |
| Payee's account number (7) | Date: Witness: (6) |
| Account Name (8) | |

VERIFICATION — (note 9)

To: PAYOR and PAYOR'S INSTITUTION

We verify that our customer, and above signing payee, (__) holds signature authority over, (10) or (__) is the holder or co-holder as indicated by the account name above of rights in, (11) the indicated account. We undertake to inform you of any change in these facts while this authorization is in effect.

Institution Signing Officer

Date Title

Institution & Branch

# Notes to Appendix I

(1) "Payor's reference" would be a number or code inserted for the benefit of the payor's institution in associating particular authorizations with payor customers. A given corporate account might produce hundreds of authorizations which must be cross-referenced between machine memory and file storage of the authorization document.

(2) In some cases, there may be no Payor's institution disclosed to the payee. On investment instruments sold through deposit institutions, there would be no need for such disclosure, since the obligor would prepare his own payment messages and the selling agent would verify identity and account number. For government instruments, there would not necessarily be a fixed "payor's institution" for the life of the investment, since the government rotates its business among the chartered banks. The Payor's Institution is shown here to facilitate the giving of notice. See note 3.

(3) It is assumed that at some stage of development, institutions will be willing to act as the payor's agent in preparing payroll or other disbursals for credit transfer. In such a case, notice might be given directly to the institution. If the Payor prepares his own data, notice would of course be directed to him. This blank gives the Payor the ability to direct where notice is given, and would be filled in before the forms were distributed to Payees for completion.

(4) This ten day notice period is not legally binding. It is a matter of courtesy only. As was pointed out in text, this agreement is only an authorization. It creates no right to a performance. It should be remembered that failure to give such notice would produce consumer outrage, and quickly scuttle acceptance of credit transfer by consumers. Termination without notice would thus be restricted to emergency situations. It is believed that use of such powers can be safely entrusted to the commercial good faith of the deposit institutions. The availability of such a power is essential to the protection of the system and its users from criminality and major insolvencies.

(5) These are important to the Payor's internal control procedures. The number is the *Payor's* reference number for internal identification of the Payee—for example, a payroll number, a registered share certificate, or a governmental claim number. The Payee's name need be completed prior to distribution only if this number is also completed. Obviously, the payor must not complete name and number in an inconsistent manner. The address is pre-printed to take care of the "John Smith" problem—employees with identical names. In the investment situation these items would be completed by the selling agent and issuer of the security during or after the payee's purchase application.

(6) The witness is not legally necessary. But it is desirable that the form be completed under the guidance of someone who can take elementary steps to be sure that the banking address data is accurate. If verification is used, the verifying officer could witness.

(7) This information must be obtained by a properly instructed person. The payee cannot be relied upon to complete the part of the form without aid, nor should he be told to "just give us one of your personalized cheques

attached to the form". The payee must clearly understand that the payment will be made into the account whose number is given, and none other. If he has a choice between personal chequing, cheque/savings, or a savings only account, this should be clarified.

Although a personalized cheque can be used to obtain the transit and account number data, if the payee gives a cheque on the correct account, it will not necessarily reveal the existence of co-holders of the account. That information is *accurately* available only from the payee's institution. The payee's cheque may be misleading, and the payee himself may not answer truthfully. If the existence of co-holders is a material factor in the payor's decision to accept the authorization, there is no substitute for verification.

**(8)** The account name is especially important if the optional verification feature is not used. Obviously some privacy considerations are involved here. Consideration should be given to use of limited disclosure by a verifying institution, *e.g.* payee OR spouse, payee OR other, payee AND other, payee IN TRUST. The need for this information varies with the kind of payment made. Certain classes of payor would incur serious risks of paying twice if they do not obtain this information; for others, it is a useful tool in reducing fraud.

**(9)** As mentioned in text, verification is likely to be used for only some transactions. Credit transfer of investment income, particularly if arranged by the selling agent, is likely to involve this feature.

**(10)** The verifying institution marks the appropriate choice. The signature authority box would cover use of powers of attorney or legal successions to control made on information satisfactory to the verifying institution, *e.g.* executors and administrators. See *Bank Act*, s. 97.

**(11)** The holder/co-holder box must be used in conjunction with the account name. There is no intent here to cause an institution to look to the execution of the terms of any trust or other duty from which it is excused by its chartering legislation. See, *e.g. Bank Act*, s. 96. The role of this verification, and the undertaking which follows, is to ensure that the payor has knowledge of any co-holder's existence, and will be informed of any change in the control of the account. Whether payment into a joint account is considered an acceptable disbursal of the funds by the payor is likely to depend on the nature of the payment; joint spouse accounts may well differ from other joint accounts in this regard.

# Appendix II

## Summary of Federal Legislative Changes

*Words italicized in the draft are specially defined in the legislation*

### I. Federal legislation concerning conditional discharge and final payment

Amendments to the proposed *Borrowers and Depositors Protection Act* or proposed *Canadian Payments Association Act*:

**Credit transfer as conditional payment**

(1) Subject to this section, a payor is conditionally discharged from a debt owed to the person to whom a payment is addressed, if

(*a*) the payor has given instructions to a deposit institution to make the payment on his behalf;

(*b*) the instructions are duly authorized by the payee;

(*c*) the payor has no contractual right to revoke the instructions; and

(*d*) the instructions have been released to the payor's deposit institution.

**Final payment**

(2) Entry of an irrevocable credit to the account of the payee by a deposit institution acting on instructions authorized by the payee discharges the payor.

**Failure to complete transfer**

(3) The conditional discharge given by this section is without effect, if

(*a*) the time allowed for credit to the payee by the standards and rules of the Canadian Payments Association has elapsed, and the payee has not received irrevocable credit;

(*b*) any deposit institution has acted on

(i) an order or

(ii) information

given by the payor or his institution to block or recall the payment;

(*c*) any deposit institution other than the payee's institution has suspended normal payments or the conduct of its business without settling for the payment; or

(*d*) the instructions have been refused by the payor's deposit institution for lack of funds or credit to execute them.

## II. Federal legislation covering the use of set-off on the consumer payments account by a chartered bank and federally chartered near-banks doing a consumer business, incorporating provincial immunities by reference, as well as federal immunities

Amendment to the *Bank Act*, new section **95.1**:

**Consumer set-offs prohibited**

(1) No bank shall set off an account or other liability of a customer against the amount on deposit in a *consumer account*, except as allowed in subsection (2).

**Exception**

(2) A bank may exercise rights of set-off available to it apart from this section to the extent that the amount on deposit in a *consumer account* exceeds the total of all *exempt funds* deposited to that account within the 30 days preceding exercise of the set-off.

**Definitions**

(3) In this section

"*consumer account*" means an account maintained with a bank by one or more natural persons, against which withdrawals or third party payments are customarily honoured on demand, and which is used for the primary purpose of paying normal living expenses of the account-holder or his dependents or obligations arising therefrom; and

"*exempt funds*" means any amount paid or payable to a natural person which would be exempt from attachment while in the hands of the payor; where part of an amount would be so exempt, means that part; and includes all such amounts, whether the source of the exemption arises from federal or provincial law, statute, prerogative, or case-law.

The following subsection should be enacted only in the event that the provinces cannot be persuaded to modify the operation of writs of attachment and an adverse social impact on consumers or bank operations appears as a result of this.

**Attachments barred**

> (4) Amounts on deposit in a *consumer account* are exempt from attachment to the extent of *exempt funds* deposited in the account in the 30 days preceding service of the writ; and no bank shall be liable for any act or omission in which the bank has relied in good faith on this exemption.

It should also be noted that the federal government has various extra-judicial remedies in the nature of an attachment. Section 224 of the *Income Tax Act* is an example. Use of these remedies should be governed by directives designed to achieve the same social ends as are involved in limiting the rights of general creditors.

Finally, it should be recognized that the problem of set-off exists in the operation of any federally chartered near-bank which enters the payment transfer business. The above suggested reforms should thus also be incorporated in federal trust and mortgage loan legislation, with the appropriate institution inserted in place of "bank".

# Appendix III

## Summary of Suggested Provincial Legislative Changes

*Words italicized in the draft are specially defined in the suggested legislation*

### I. Provincial legislation barring attachment

Amendment to the *Attachment of Debts Act* and other statutes creating a remedy of attachment for the normal enforcement of judgment debts or other orders and for seizure of sums owed the defendant pending litigation of a liquidated claim:

*Note*:

In the following amendment, the three parties to an attachment have been described as follows:

the person who is creditor of the obligation seized is called the "principal debtor"; this refers to his status vis-à-vis the judgment debt or other right in respect of which the attachment serves as remedy; in the normal nomenclature of this paper he is the payee;

the person who is debtor of the obligation seized is called the "person indebted or liable" in respect of the obligation, and the "garnishee defendant" in respect of his

procedural rights; in the normal nomenclature of this paper he is the payor;

the person bringing the principal action and seeking the attachment as remedy is the "plaintiff"; in the normal nomenclature of this paper he is a creditor of the payee.

The appropriate provision would be inserted in the portion of the statute which defines claims which are capable of being attached. It might read as follows:

**Attachment barred; credit transfers**

(1) No debt, obligation or liability shall be attached under this Act, if

(*a*) the person indebted or liable thereon has given instructions to a deposit institution to make a payment on his behalf;

(*b*) the instructions are duly authorized by the principal debtor;

(*c*) the person indebted or liable has no contractual right to revoke such instructions; and

(*d*) the instructions have been released to the deposit institution of the person indebted or liable.

**Procedure**

(2) The garnishee defendant may claim the benefit of this section by endorsing "not indebted/paid credit transfer" or like language upon the writ and returning it as provided in this Act.

**Dispute**

(3) If the plaintiff by affidavit on information and belief of the deponent shows

(*a*) the time allowed for credit to the principal debtor by the standards and rules of the Canadian Payments Association has elapsed, and the principal debtor has not received irrevocable credit;

(*b*) any deposit institution has acted on

(i) an order or

(ii) information

given by the person indebted or liable or his institution to block or recall the payment;

(*c*) any deposit institution other than the principal debtor's institution has suspended normal payments or the conduct of its business without settling for the payment; or

(*d*) the instructions have been refused by the deposit institution of the person indebted or liable for lack of funds or credit to execute them;

the writ shall reissue, and the garnishee defendant shall answer to the facts alleged concerning non-payment, together with such defences or set-offs as he may otherwise have.

## II. Provincial Legislation covering the use of attachment against any consumer payments account in a deposit institution, and incorporating by reference immunities existing under federal law prior to deposit of the funds, as well as provincial immunities

Amendment to the *Consumer Protection Act*:

**Attachment of deposit accounts; restriction**

(1) A writ of attachment under the______Act(s) does not operate to seize a *consumer account*, except as set out in this section.

**Exception**

(2) A creditor may seize by attachment the debt owed by a deposit institution to its customer or member, which is represented by the balance in a *consumer account*, to the extent that the debt exceeds the total of

all *exempt funds* deposited to that account within the 30 days preceding service of the attachment.

**Definitions**

(3) in this section

"*consumer account*" means an account maintained with a deposit institution, including a chartered bank or other federally incorporated entity, by one or more natural persons, against which withdrawals or third party payments are customarily honoured on demand, and which is used for the primary purpose of paying the normal living expenses of the account-holder or his dependents, or obligations arising therefrom; and

"*exempt funds*" means any amount paid or payable to a natural person which would be exempt from attachment while in the hands of the payor; where part of an amount would be so exempt, means that part; and includes all such amounts, whether the source of the exemption arises from federal or provincial law, statute, prerogative, or case-law.

*Comment:*

In subsection (1) the parenthesis should list all Acts of the province providing for "normal" attachment of debts. Acts such as the *Absconding Debtors Act* (B.C., N.B., Ont., Sask.), which create an extraordinary general seizure of the debtor's property (also termed an attachment) should not be included in this list.

## III. Provincial legislation governing the use of set-off by provincially chartered institutions in their consumer business, incorporating federal immunities by reference, as well as provincial immunities

Amendment to the *Consumer Protection Act*:

**Consumer set-off prohibited**

(1) No deposit institution subject to the jurisdiction of this Province shall set off an account or other liability of a customer or member against the amount on deposit in a *consumer account*, except as allowed in subsection 2.

**Exception**

(2) A deposit institution may exercise rights of set-off available to it apart from this section to the extent that the balance on deposit in a *consumer account* exceeds the total of all *exempt funds* deposited to that account within 30 days preceding exercise of the set-off.

**Definitions**

(3) In this section

"*consumer account*" means an account maintained with a deposit institution subject to the jurisdiction of this Province by one or more natural persons, against which withdrawals or third party payments are customarily honoured on demand, and which is used for the primary purpose of paying the normal living expenses of the accountholder or his dependents, or obligations arising therefrom; and

"*exempt funds*" means any amount paid or payable to a natural person which would be exempt from attachment while in the hands of the payor; where part of an amount would be so exempt, means that part; and includes all such amounts, whether the source of the exemption arises from federal or provincial law, statute, prerogative, or case-law.

# Appendix IV

## A New Form of Attachment?

In the body of this paper, it was suggested that problems raised by the timing of credit transfers might be met through use of a new form of attachment. A recurrent problem in the use of attachment is that the garnishee defendant—the person in whose hands the debt is to be seized—may not be technically indebted to the principal debtor—the person called the payee in the paper. This may be true even though there are normal payments made between them and there would be a clear right for the principal debtor to obtain a payment if it were not made. These technicalities flow from the precise legal meanings of terms such as debt and due, owing or accruing due, which are customarily part of the definition of the sorts of claim which can be attached.

For example, the anticipation of a debt would cause no attachable claim to exist. In most provinces, the attachment provisions for wages allow wages or salary to be seized if they would be due or payable within 7 days after the affidavits in support of the writ are sworn. This is an effort to avoid the problem raised by contracts which require an entire performance over a period greater than the pay period. Under such a contract, no debt comes into being until the payday, and the employer often could pay before the writ had any opportunity to operate. This was viewed as an injustice to creditors.

The problem raised by credit transfers is slightly different. It is likely that most wage payments will be pre-paid and pre-positioned in the system, for credit to the payee on the morning of his payday. Under the unmodified definition of debt discussed above, and the conditional discharge concept proposed in this paper, it

would be impossible to attach such a wage payment in the employer's hands. Under the usual modification allowing seizure of debts due or payable within 7 days after the affidavits are sworn, a decision on the precise effect of the conditional discharge would be required. Probably the debt would be unattachable; if not, it would be available in the employer's hands if the transit time through the system were less than 7 days. Since the current legislative judgment is that unavailability of the wage payment is unfair to creditors, some correction of this effect seems in order.

The problem is complicated because the payment changes from a debt or potential debt in the employer's hands to a debt in the deposit institution's hands. Depending on provincial practice, it may or may not be available in the institution's hands if deposited into a joint account.

A province which desired to create such a remedy would need to resolve the following questions:

1. By what procedure is the deposit institution to be notified of the writ against the employer?
2. Does notice to the deposit institution bind the balance of the account then in its hands, as well as the arriving payment? Does it reach intervening deposits?
3. Does use of the new remedy give priority over a creditor who serves a normal attachment against the institution in the period between service on the employer and service on the institution? between service on the employer and final credit to the payee's account?
4. What is the effect of such a remedy on instructions by the payee to close his account or return a payment, if final credit has not been given?
5. What is the effect on a joint account?

In view of the complexity of such a scheme and the number of parties whose rights are potentially involved, it might be simpler to provide, after the recommendations concerning exemptions are implemented, that an employer paying by credit transfer could be required to endorse the employee's account number and location on the writ, and return it within 2 days. The creditor could then serve the institution on payday. Such a scheme has some loop-

holes, but is considerably less cumbersome than creation of a new remedy involving duplicate service, relation back of the attachment, and the rights of intervening parties.

The costs imposed on employers and deposit institutions by either attempt to adjust attachment of wages to payment by credit transfer, combined with the high cost and low recovery associated with use of the remedy, afford ample reason for a serious consideration of abandoning the remedy in favour of a more socially efficient form of collection of debts.

# Appendix V

## A Checklist for the Payor-Payor's Institution Contract: Credit Transfers

I. Duration and formal matters

(*a*) Effective date;

(*b*) Banking resolution or other authority of payor, giving officers with signing authority for data release;

(*c*) Termination clause.

II. Basic duties

(*a*) Format in which payor will supply data;

(*b*) Data processing duties of payor's institution, if any;

(*c*) Duties to provide security;

(*d*) Time-tables for data delivery;

(*e*) Time-tables for data release by institution; duty to pay promptly;

(*f*) Record-keeping duties concerning authorizations, current and expired—*cf.* local statute of limitations;

(*g*) Who will be given as party to notify of revocations on payee's authorization—duties to supply information on revocations flowing from this designation;

(*h*) Action to be taken on payor data which cannot be processed—deadlines;

(*i*) How transfers will be paid for—duty to maintain a demand balance with institution—rights to charge or set-off transfers—credit arrangements, if any;

(*j*) Last time at which data can be modified—when transfers are irrevocable by payor;

(*k*) Duty of institution to reverse transfers not finally paid and re-credit payor.

III. System protective duties and excuses

(*a*) Force majeure clause modifying duty to pay promptly;

(*b*) 'lock-in' clause for partially executed payments—*cf.* text at 61;

(*c*) Agreement to be bound by the clearing standards and rules of the Canadian Payments Association as they exist from time to time.

IV. Risk-allocating terms

(*a*) Payor's warranty covering data accuracy—*cf.* text at 37-39—effective on data delivery;

(*b*) Payor's warranties of authority and no notice of revocation, and against termination—*cf.* text at 40-42—continuing, but subject to revocation of the authority on reasonable notice;

(*c*) Payor's warranty of authenticity and against fraudulent material alteration—*cf.* text at 44-49—effective when data delivered.

V. Non-standard terms

(*a*) Prices; charges for special services rendered;

(*b*) Special duties—*cf.* II (*a*), (*b*), (*d*), and (*f*), *supra.*