The Bank is Always Right: Section 165(3) of the Bills of Exchange Act and its Curious Parliamentary History

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At the request of the banking industry, but without understanding what it was doing, the Parliament of Canada in 1966 subverted the structure of the *Bills of Exchange Act*[1] by adding[2] section 165(3). This new section provides baldly that a bank suing on a cheque credited to its customer's account is always right:

> 165. (3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

Taken literally, the subsection vindicates the bank unless, at all events, the defence set up happens to be a "real" or "absolute" defence (such as forgery), good even against a holder in due course.[3] Here, indeed, may be found some little consolation: the banks have not yet contrived to insulate themselves against these "real" defences. The subsection will therefore not protect the bank from *all* defences; its scope is not unlimited. Yet within that scope, the language of the subsection is categorical and without nuance. Taking the words at their face value, the bank is legally in the right even — to take an extreme case — if it is itself party to the fraud set up as a defence. Of course no court could permit such a construction to be put upon the subsection, though that is scarcely a matter of congratulation to those responsible for its enactment. The subsection must be read subject to the rule that no one may plead his own wrongdoing, a rule of severely limited application in the circumstances.[4] Yet even when so read, section 165(3) becomes only

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[1] R.S.C. 1952, c. 15, as it then was; now R.S.C. 1970, c. B-5.

[2] By *An Act to amend the Bills of Exchange Act*, 14-15 Eliz. II, S.C. 1966, c. 12, s. 4.

[3] *Infra*, at pp. 86-7.

[4] It could not properly extend, at all events, beyond the cases where there was bad faith or notice of defect in title. While it would cover clear cases of dishonesty and illegality, and perhaps something more, the doctrine cannot serve as a vehicle for reimposing on the banks requirements from which Parliament has excused them on a reasonable reading of section 165(3).

slightly less unreasonable. No one who reads it can say how far the courts may find it necessary to cut it down further by construction. The provision is so drafted that it cannot entirely mean what it says; its uncertainty alone condemns it.

But for section 165(3), a bank not satisfying the requirements of section 56 of the Act could not be a holder in due course:

> 56. (1) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely:
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> (a) that he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact;
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> (b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.
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> (2) In particular the title of a person who negotiates a bill is defective within the meaning of this Act when he obtained the bill, or the acceptance thereof, by fraud, duress or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

Yet section 165(3) flatly declares that, in stated circumstances, the bank is a holder in due course. What then if the bank is not a "holder"? [5] Or takes an incomplete cheque? Or one irregular on its face? What if the bank becomes holder after the cheque is overdue? Or with notice that it had previously been dishonoured? What if the bank takes the cheque in bad faith? Or without giving value? Or with notice of the defect in title of the person who negotiated it? Is the bank a holder in due course in any — or indeed all — of these circumstances, simply because section 165(3) is categorical in its terms? Do not some of the requirements of section 56 persist, notwithstanding section 165(3), and, if so, which?

The parliamentary genesis of section 165(3) may be found in an amendment moved by M. Jean Chrétien, M.P., to Bill S-14 [6] in the House of Commons Standing Committee of Finance, Trade and Economic Affairs, on March 24th, 1966.[7] The first three clauses of

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[5] "Holder" is defined in section 2 as "the payee or endorsee of a bill or note who is in possession of it, or the bearer thereof". The terms of the bill or note may make it non-negotiable: section 21(1), and, more particularly, the order may be to pay a given payee "only": section 22(1); and likewise, the terms of an endorsement may prohibit further negotiation: section 68. In any of these circumstances the bank could come into possession of a bill or note of which it was not holder. How far section 165(3) may improve its position where the instrument is a cheque is considered *infra*, at pp. 86-7.

[6] Entitled *An act to amend the Bills of Exchange Act*, 1st Sess., 27th Parl., 1966.

[7] The proceedings of the Committee are published under the title *House of Commons, First Session, Twenty-seventh Parliament, 1966, Standing Commit-*

the Bill as it then stood provided for the enactment of new sections dealing with cheques presented on Saturdays and other non-juridical days if the bank was open for business; with business days when the bank was not open for business; with holidays; and with protest. Mr. Elderkin, Inspector-General of Banks, Department of Finance, announced:

> The banks have asked for a further amendment and the Minister has agreed.[8]

The Minister of Finance who thus took responsibility for the additional clause, which was to amend the Act by adding section 165(3), was Hon. Mitchell Sharp. His Parliamentary Secretary, M. Jean Chrétien, moved it in Committee. Mr. Elderkin attributed the language of the provision to the Department of Justice:

> MR. ELDERKIN: I can say that the words are put there by the Department of Justice. This is an amendment which was drafted by the legislation section of the Department of Justice.[9]

Mr. Elderkin also explained the ostensible purpose of the new subsection:

> The relative section to which this is an addition says that a cheque is a bill of exchange drawn on a bank, payable on demand. This amendment is added in here because it is the most appropriate place to cover the situation. At the present time the general business practice is that cheques are stamped or written with an endorsement which reads: "For deposit" or "deposit only to the credit of the payee". If the bank deposits that to the credit of the payee and later finds out that the cheque is to be dishonoured — in other words, that it is N.S.F. — under the present act the endorsement, according to case law, is considered to be a restricted endorsement; the bank has acted as an agent and not as a principal and, therefore, has no recourse whatsoever against the drawer of the cheque. He has recourse only against the payee. Situations arise from time to time because of the practice today of trying to expedite business where a deposit will be made without checking to see whether or not the cheque is good.
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> The payee, quite often, will draw against the cheque and if at that time it is found, after being returned through the clearing, to be N.S.F., the recourse is only against the payee. The only purpose of this amendment is to put the bank in a position of having recourse against the drawer if they cannot claim against the payee.[10]

This explanation itself raises serious questions.

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tee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, No. 4, Thursday, March 24, 1966. They will be cited below simply as *Commons Finance Committee Proceedings.*

[8] *Commons Finance Committee Proceedings,* at p. 188.

[9] *Ibid.,* at p. 192.

[10] *Ibid.,* at p. 189.

Mr. Elderkin implies that the subsection merely overcomes the restrictive effect of endorsements for deposit. Well, that may have been the object of those who promoted it. Or it may not. That remains to be seen. It is true enough that concern with the matter, as the learned editor of *Falconbridge on Banking and Bills of Exchange* suggests,[11] does seem to have been prompted by the 1962 decision of the Alberta Supreme Court in *Imperial Bank of Canada* v. *Hays and Earl Ltd.*[12] There the plaintiff collecting bank, which held a cheque under its customer's restrictive endorsement for deposit, nevertheless credited his account before it had cleared, and allowed him to draw on his account. Later it found to its cost that the defendant drawer had a good defence against its customer, and therefore (the endorsement being restrictive) against the bank too.[13] The case is alluded to in the Commons committee debate[14] on the original motion by M. Chrétien, and later in the Senate debate[15] on the motion to agree to the Commons amendment. A similar decision was rendered by the Quebec Superior Court in *Bank of Nova Scotia* v. *Budget Motors Ltd.*[16] in 1965. In each case the restrictive endorsement was that of the bank's customer. In each case it had lain in the power of that customer to endorse absolutely; and, what is more, in each case the bank had been in a position to refuse an advance unless the instrument were so endorsed. Lastly, in each case the bank, had it obtained an absolute endorsement, would have been a holder in due course and succeeded against the drawer in that right. That an absolute endorsement was in neither case demanded by the bank; that an absolute endorsement was in neither case given by the depositing customer — these could fairly be considered, by someone assessing the drawer's position, to have been, for him, merely lucky accidents. It could, thus, with some plausibility, be felt that no injustice would be done to a drawer in such circumstances if he were deprived by operation of law of defences which he could in any case be denied by a bank sufficiently alert to its interests.

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[11] A.W. Rogers, Q.C., *op. cit.*, 7th ed., (Canada Law Book Ltd., Toronto: 1969), at p. 680, §3 and n. (w).

[12] (1962) 35 D.L.R. (2d) 136, (1962) 38 W.W.R. 169 (Alta. Sup. Ct., Riley, J.).

[13] It is not easy to see why the decision, which was merely a textbook application of plain rules, should have occasioned any special surprise.

[14] *Commons Finance Committee Proceedings*, at p. 190; Mr. Elderkin in the third paragraph from the end of the page, remarks:

> There are two case laws [sic] on it, one of which was in 1962 with regard to the Imperial Bank.

[15] *Senate Debates*, May 3, 1966; Sess. 1966-67, vol. II, at p. 400.

[16] [1966] C.S. 272 (Batshaw, J.). This decision, too, was simply a plain application of the terms of the Act.

The drawer might no doubt respond that the bank is well enough able to look after its own interests without special legislative assistance, and that there is nothing compelling the bank to advance money on uncollected effects not bearing an endorsement to its satisfaction. The bank might be expected to reply that the commercial practice of endorsing restrictively is so overwhelming as to make it impracticable to overcome it otherwise than by legislative means. The debate so carried on is necessarily inconclusive, and if nothing else were at stake the issue would not be one of great importance. But more is indeed at stake.

Mr. Elderkin's assumption, to repeat it once more, is that the subsection merely overcomes the restrictive effect of endorsements for deposit. That assumption we shall shortly put into question. But even on the hypothesis that it is well-founded, more serious issues can arise than would be suggested by the facts just considered. For in each of the two reported cases, the restrictive endorsement had been made by the depositing customer. And in each of the two cases the cheque remained in the hands of the collecting bank. Now these may indeed be the ordinary circumstances. It may be usual for the endorsement for deposit to be made by the depositing customer. And it may be usual also for the collecting bank to be the last holder. But the *Bills of Exchange Act* is not enacted merely for usual cases.

Suppose, first, that the endorsement for deposit has been imposed *by a party prior to the depositing customer*, with a view, it may be, to controlling the title to the cheque and the disposition of the proceeds thereof. Is not such a person entitled to protect his interests in this fashion? Is not this the very purpose of restrictions on negotiability? And if the depositing customer then obtains such a cheque, so drawn or so previously endorsed, and delivers it to a bank, can it lie in the mouth of the bank which acquires it to say, "Notwithstanding the precaution taken, — notwithstanding the express restriction on negotiability — we ask Parliament to give us better rights than our customer has, so that we may advance him the money on this cheque without risk to ourselves in the event that he is not in fact entitled to the amount"? Can a more insolent demand be conceived? Suppose the bank to have come to the Minister and said, "Stop registering Government of Canada bonds in the names of holders who desire it, so that we can buy the bonds without risk if they have been stolen". What response would the Minister have made then? A statute which overcomes such a *prior party's* restrictive endorsement for deposit prejudices him by making him potentially

liable to the bank in circumstances where he might otherwise have had a good defence.

Again, suppose that the cheque, by *whomever* endorsed for deposit, passes from the hands of the collecting bank into the hands of a third party, as for example another banker acting as agent of the collecting bank.[17] So long as the restrictive endorsement has its effect, it appears that every subsequent holder will be accountable for the proceeds directly to the depositing customer,[18] as for example in the case where the collecting bank has failed — an eventuality not so far-fetched as to lie outside what the Act already envisages.[19] If the restrictive endorsement has lost its effect by operation of law, the second banker may be left to account, if at all, to the collecting bank. Here the depositing customer is prejudiced. He may also be in a worse position (despite Mr. Elderkin's denial) against the bank and holders (if any) subsequent to it.[20] It may be said he

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[17] This may be of infrequent occurrence in Canada since presumably most settlements are made through the clearing houses. It might well occur in the process of collecting cheques drawn on foreign drawees but deposited for credit with a Canadian bank. It might also occur if Falconbridge is right in regarding as "common law" cheques demand drafts on bankers other than incorporated banks and savings banks carrying on business in Canada: *op. cit.*, at p. 856; contrast section 2 "bank" and section 165(1); read with *Collings* v. *City of Calgary*, (1917) 55 S.C.R. 406, [1917] 2 W.W.R. 24, 37 D.L.R. 804; aff'g 10 W.W.R. 974, 10 Alta. L.R. 102, 29 D.L.R. 697. Such instruments, if in truth cheques, would, if deposited with a bank, and credited to the customer's account, fall within section 165(3). It is possible that such instruments may be collected through third parties: the author is not familiar with the practice in these cases.

[18] Falconbridge, *op. cit.*, at p. 651:

> To whomsoever the money may be paid, it will be paid in trust for such person, and into whose hands soever the bill travels, it carries that trust on the face of it.

[19] Section 166; and see Falconbridge, *op. cit.*, at p. 388 *in fine* and p. 389. The law must be drawn to envisage this possibility, because it *is* always a possibility, particularly as regards newer institutions, and near-banks, to the extent that they are governed by the Act.

[20] It is obvious that the depositing customer would be in a worse position against *a third party* holder in due course (who would be insulated against most defences which he might wish to raise) than he would be against an immediate party (the bank) or a remote party bound by a restrictive endorsement. So far as circumstances where the customer would be in a worse position *against the bank itself* by being thrust by section 165(3) into the relationship of endorser and endorsee-holder in due course, instead of the relationship of principal and agent under a restrictive endorsement, they are admittedly not easy to construct. Perhaps a difference results from the greater warranty to which a holder in due course is entitled under section 133(b).

would have been prejudiced quite as much had he endorsed absolutely at the insistence of the collecting bank. That is perfectly true, but it is one thing to be got to agree to the result, and very much another to be subjected to a statutory régime.

Even as read by Mr. Elderkin, therefore, section 165(3) is partly unnecessary and partly objectionable on principle. It is unnecessary so far as it gives the bank by statute what it could obtain by agreement with its customer. It is objectionable so far as it wipes out the effect of endorsements for deposit imposed by parties prior to its customer.

But the provision on its face goes far beyond Mr. Elderkin's reading of it.

For whether or not the framers' *purpose* was confined to overcoming the restrictive effect of endorsements for deposit, the *language* which they finally employed was wide enough to overcome *all* impediments to the bank's status as holder in due course. The history of the provision shows this clearly. The earliest draft was the following:

> (3) Where a cheque endorsed for deposit to the credit of the payee is delivered to a bank and it credits him with the amount of the cheque, the bank acquires all the rights of a holder in due course of the cheque.

This was altered slightly to read:

> (3) Where a cheque endorsed for deposit to the credit of a person is delivered to a bank and it credits him with the amount of the cheque, the bank acquires all the rights of a holder in due course of the cheque.

These formulae might, indeed, have confined the subsection to overcoming the restrictive effect of endorsements for deposit. At any rate, they spoke only of cheques so endorsed. But the clause assumed a far wider form as it was reworded:

> (3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights of a holder in due course of the cheque.

and, with an immaterial change, as it was introduced into the Bill in the Commons committee and ultimately became law:

> (3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

No longer did the provision speak of cheques *endorsed for deposit* and delivered to a bank. Now it spoke of cheques *delivered to a bank for deposit*. Its terms made the bank holder in due course of *every* cheque so delivered and credited, whether endorsed or not. No one could, from its terms, have guessed that it had any special

application to cheques endorsed for deposit. No doubt these too would be covered, but merely as particular instances of a very comprehensive class.

The discrepancy between the very wide language of the subsection, and the narrow purpose it was said by its sponsors to serve, is emphasized by an interesting exchange between Mr. David Lewis, M.P. (N.D.P. — York South) and Mr. Elderkin:

> MR. ELDERKIN: I think the explanation is relatively simple. This custom has grown and is very general now in the banking system. When the Bank Act or the Bills of Exchange Act were written many years ago there was no such manner of treating cheques; you had to endorse your cheque, if you were going to get cash for it or it was going to be credited to your account. But, in order to facilitate particularly business this custom has grown to the extent that I think Mr. Monteith would support me when I say that people in business today will endorse their cheques in this manner simply for deposit only and the bank will give the depositor a credit for the amount in the same way as he would give him a credit if he had endorsed it without this stipulation on it. All that is being done here is putting this particular type of business transaction into the same category legally as it would if the person had endorsed a cheque.
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> MR. LEWIS: I follow that explanation entirely and have done so from the start. But, obviously, those words that are before us do not necessarily lead to that conclusion except in the total context of the banking business; there is nothing here that says: "That refers to a cheque which is endorsed for deposit only." None of the things are in these exact words. What you are saying — and I am sure you know what you are talking about — is that these words taken in the context of (a) business practice, (b) banking practice and (c) case law, lead to the conclusion you wish them to lead to. I am ready to accept that for the time being. But, I would like to make certain, for my own satisfaction, that before I vote on it that these words are not also capable, in the total context, of some other interpretation or some wider application than you assure me they are. Having appeared before the courts on several occasions I have noted that words mean certain things in some courts and then in some higher courts they will interpret the words entirely differently. I hope you will forgive me for wanting you to get some additional information.
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> MR. ELDERKIN: I can say that the words are put there by the Department of Justice. This is an amendment which was drafted by the legislation section of the Department of Justice.
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> MR. LEWIS: I am not questioning that at all. All I am arguing is for some time to study this matter, if there is not any rush. If you need it tomorrow, that is a different thing.
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> MR. ELDERKIN: Well, Mr. Lewis, there is a rush in getting the bill through. The bill with the amendments will have to go back to the Senate. There is a definite desire to get the bill through before Easter because if we do not we will still be in the same fix over the Easter holidays as we were in the past.

MR. LEWIS: In that case I will reserve my right to raise an objection if I am told I should.[21]

The bank, says section 165(3), categorically, is a holder in due course of *every* cheque delivered for deposit and credited. Thus, if any of the requirements of section 56 still bind the bank, that can only be because section 165(3) is not read literally. Indeed, taken literally, section 165(3) relieves the bank even from the necessity of being a holder. If the bank is by statute deemed a holder in due course, it is a holder *a fortiori.* What does this do to cheques originally drawn payable to payee "C only" or later endorsed payable to endorsee "D only"? What does it do to instruments marked "Not negotiable"? Has it become impossible to restrict the negotiability of cheques? Does section 165(3) say that a cheque marked "Not negotiable" is negotiable nonetheless; that "Pay C only" or "Pay D only" are wasted words, a bank being able to pay C's or D's endorsee with impunity under section 165(3)? Surely such a result is monstrous, though one can expect that sooner or later it will be advanced in argument. Counsel for a bank will say that restrictions such as "Not Negotiable", "Pay C only", "Pay D only" work by preventing persons, other than those named, from becoming holders; that this obstacle is overcome by section 165(3) which *makes* a bank a holder; that therefore in the hands of a bank there is no such thing as a non-negotiable cheque, when once it has been credited to an account. The answer to this monstrous contention is perhaps that the defence is a real or absolute defence, good even against a holder in due course; that once a cheque is rendered not negotiable, a purported endorsement, like a forged endorsement, is void, and is, in law, no endorsement at all. It is, after all, because a forged endorsement is no endorsement, or, in the words of the Act,[22] "wholly inoperative", and *not* because a forged endorsement is something *worse* than none at all, that forgery is a real defence. The purported endorsement of a non-negotiable cheque should stand on the same footing as a forged endorsement. Where, as with a forged endorsement, there is a break in the chain of valid endorsements, the Act nevertheless speaks of those who later take the instrument as "holders"[23] because they are apparently so on the face of the instrument, and as "holders in due course"[24] because, subjectively, they have satisfied the requi-

[21] *Commons Finance Committee Proceedings,* at pp. 191-2.

[22] Section 49(1).

[23] Section 129(b) and (c) contemplate that a person who takes a bill under a forged endorsement may be not merely a holder but a holder in due course. Section 133(b) contemplates the same thing.

[24] *Ibid.*

rements for that status. They are spoken of as holders and holders in due course even though it could strictly speaking be said that, as a forged endorsement is in law no endorsement, no one taking under the forged endorsement can be a holder *at all.* If, therefore, a holder in due course can be met with the defence that a necessary endorsement is missing, it would seem immaterial whether it is missing because the supposed endorsement is a forgery, or missing because the supposed endorsement was outside the power of the holder of a non-negotiable cheque.

For these reasons it is submitted that section 165(3) cannot overcome the *non-negotiability* of a cheque whether arising from a restrictive term in the original order or in the endorsement. It should be said, however, that, perhaps in reliance on that subsection, the banks appear to consider themselves holders of *unendorsed instruments* delivered to them for collection. In that respect they may be reading section 165(3) as having an effect partly similar to that of the United Kingdom statute entitled the *Cheques Act,* 1957,[25] of which section 1(1) provides:

> 1. — (1) Where a banker in good faith and in the ordinary course of business pays a cheque drawn on him which is not indorsed or is irregularly indorsed, he does not, in doing so, incur any liability by reason only of the absence of, or irregularity in, indorsement, and he is deemed to have paid it in due course.

But even if it cannot overcome absolute non-negotiability of a cheque, section 165(3) *does* seem able to overcome *irregularities* in an endorsement, and, generally, elsewhere in the instrument, so as to permit the bank to become holder in due course of an irregular cheque. So also, the bank could under section 165(3) become holder in due course of a cheque which was incomplete at the time it was taken, though it might be necessary to fill up the blanks[26] before suing. The subsection seems to overcome also the consequences of the instrument being taken overdue or with notice of dishonour. Even without the subsection, crediting the customer's account would in principle have amounted to giving value.[27]

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[25] 5 & 6 Eliz. 2, c. 36.

[26] This seems to follow from section 74(a), read with the definitions of "holder", "bill" and "note" in section 2, with section 186, with the definitions of "bill of exchange", "cheque", and "promissory note" in sections 17, 165 and 176 respectively, and with section 32.

[27] *Capital and Counties Bank* v. *Gordon; London, City and Midland Bank* v. *Gordon,* [1903] A.C. 240, 72 L.J.K.B. 451, 88 L.T. 574, 51 W.R. 671, 19 T.L.R. 402, *sub nom. London, City and Midland Bank* v. *Gordon; Capital and Counties Bank* v. *Gordon,* 8 Com. Cas. 221 (H.L.). This matter is discussed *infra,* at p. 90, n. 32.

The requirements of section 56 that a holder in due course must have taken "in good faith" and without "notice of any defect in title of the person who negotiated it", may survive against the bank despite section 165(3), on the ground that taking an instrument in reliance on that subsection would be tantamount to a fraud, if done in circumstances where there was bad faith or notice of defect. This, of course, is the justification for allowing total failure of consideration to be a defence against a holder for value taking with notice thereof.[28]

It is fair to say that section 165(3) is widely subversive of the structure of the Act and of the rights and relationships which it establishes.

The new clause, as we have already seen, was not greeted in Committee without a measure of suspicion by opposition members. Hon. Marcel Lambert, M.P. (P.C.-Edmonton West) was concerned that the bank might be entitled to recover from the drawer on dishonour even in those circumstances when it was in a position to go back against its customer. Could the bank with a recourse against its customer choose to proceed against the drawer? Indeed, could the customer insist on its doing so?

Mr. Elderkin having given by way of introduction the explanation first quoted above,[29] the following exchange took place:

> MR. LAMBERT: But, would this not have the effect of allowing the payee to resist a charge back to his account?
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> MR. ELDERKIN: No. In the first place, I think it is the practice today that when you open an account you give authority to the bank to charge back.
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> MR. LAMBERT: Yes, I know, but as the law stands now the bank is merely the agent of the payee.
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> MR. ELDERKIN: Yes.
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> MR. LAMBERT: And, therefore, in law, it could not hold the dishonoured item on its own account since it was the agent and, therefore, it had the full right to charge back because, as an agent, it had no rights. I say now that it acquires the fullest rights and is no longer the agent of the payee; it is a full person, a principal, in the chain of the transaction, and I am wondering what implications this may have.
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> MR. ELDERKIN: The implication is right because you will find that the customer always signs a document to the effect he may be charged with any N.S.F. items.
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> MR. LAMBERT: Granted.
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> MR. ELDERKIN: It makes no difference.
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> MR. LAMBERT: I am not so sure that they will interpret it that way.

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[28] See Falconbridge, *op. cit.*, at p. 620, quoting Chalmers.

[29] See *supra*, at p. 80, and n. 10.

MR. ELDERKIN: Well, they have.

MR. LAMBERT: As you proposed?

MR. ELDERKIN: This does not take anything from the drawer at all. This coincides with what the bankers say, that this does not take anything away from the banks' rights with respect to the payee; it only puts them in the position of having a right against the drawer of the cheque. But, claim must be made against the payee first.

MR. LAFLAMME: Would you just repeat what you have said regarding the rights of banks. I believe you said they had a right against the drawer if they cannot claim against the payee.

MR. ELDERKIN: Yes. It is the intent that they normally would claim against the payee first because he owes him first.

MR. LAFLAMME: But, you say he has a right and, I suppose, in due course he has the right against anyone.

MR. ELDERKIN: That is perfectly true. It is the same as an endorsement, if there was an endorsement; if the payee had endorsed his cheque and deposited it at that place the bank would be in the position, you see, of having been a principal and it would have the rights against the drawer under these circumstances as part of a transaction; but if the bank simply deposits it to the credit without an endorsement then it is only acting as an agent. There are two case laws on it, one of which was in 1962 with regard to the Imperial Bank.[30]

It is difficult to escape the conclusion that Mr. Lambert's doubts were well founded. Quite apart from section 165(3), where a bank has an accrued right to enforce a bill or note, a party liable thereon cannot insist that the bank should in preference choose to return the instrument to its customer and to charge the latter's account with the sum, even if the bank is entitled, if it pleases, to do so. The customer, at best, is simply another person liable to the bank. If the party sued by the bank has claims against the bank's customer, that party is perfectly at liberty to take appropriate legal proceedings and indeed if necessary attach the bank account, though other creditors are likely to have equal rights against any such account. But a party sued by the bank on the cheque cannot be permitted, in effect, to attach a third person's bank account by resisting payment on the instrument. This emerges clearly from the decision of the Ontario Court of Appeal in *Huron & Erie Mortgage Co.* v. *Rumig*,[31] where the plaintiff, which carried on a banking business, having credited a cheque to the account of the payee, its customer, was held entitled to succeed as holder in due course against the defendant drawer, notwithstanding defences of the nature of failure of consideration, or perhaps fraud, which the drawer would have had against the payee, *and notwithstanding that on dishonour of the cheque the*

[30] *Commons Finance Committee Proceedings*, at pp. 189-90.

[31] (1969) 10 D.L.R. (3d) 309, [1970] 2 O.R. 204.

plaintiff had not reimbursed itself out of the account of the payee. Laskin, J.A., as he then was, dissenting from the opinion of his brethren (Schroeder and Kelly, JJ.A.) thought that the plaintiff should fail, since it could have prevented the loss by debiting its customer's account. But, with respect, his conclusion cannot be supported on principle. He felt that the trust company should have followed its "ordinary banking practice" of debiting a customer's account. But that is a practice adopted by banks to safeguard their own interests. It cannot be taken for granted that they owe it to others to do so. They have made no representations that they will do so. They have held out nothing. A precaution may be adopted out of care for one's own interests, over and above what one owes to others, and persistence in such a precaution does not imply any undertaking to continue it for the benefit of others. The bank may invariably light its premises brilliantly at night to ward off burglars. That is a precaution in its own interest. If on some occasion it neglects to do so, and a pedestrian is robbed who chose the street in expectation of safety from the lighting, the bank is not liable, and it is nothing to the point for the pedestrian to prove to the point of demonstration that the robbery could never have occurred had the bank followed its customary practice. The pedestrian had no right to rely on any such practice. Laskin, J.A., with respect, is entitled to draw no conclusion from the bare existence of *a banking practice* of debiting customers' accounts with dishonoured cheques. He must argue and establish *on independent grounds* that there is a duty *to the drawer* to do so. That seems impossible when the bank is acting as a principal creditor, with a title in its own right as a holder in due course of a cheque on which two or more parties are liable, of whom the drawer is merely one. That it *is* a principal when it credits a customer's account before the cheque is cleared has been settled by the House of Lords in *Capital and Counties Bank* v. *Gordon.*[32] Nor

[32] [1903] A.C. 240; alternative citations may be found in n. 27, *supra.* See the observations of Lord Macnaghten, [1903] A.C. 240, at pp. 244-45 (with whom Lord Shand agreed), and Lord Lindley, [1903] A.C. 240, at pp. 248-49 (with whom Lord Shand, Lord Davey, and Lord Robertson agreed). At page 245, *per* Lord Macnaghten:

> It is well settled that if a banker before collection credits a customer with the face value of a cheque paid into his account the banker becomes the holder for value of the cheque. It is impossible, I think, to say that a banker is merely receiving payment for his customer and a mere agent for collection when he receives payment of a cheque of which he is the holder for value.

At page 248, *per* Lord Lindley:

> Now, when the cheque was paid to the bank, the bank received the

does the drawer stand towards the collecting bank in the position

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payment for itself rather than for Jones. It is no doubt true that if the cheque had been dishonoured, Jones would have become liable to reimburse the bank the amount advanced by it to him when it placed the amount to his credit. This he would have had to do where any cheque, crossed or not, was placed to his credit and was afterwards dishonoured. To this extent and in this sense it may be said that the bank received payment for Jones, because payment of the cheque discharged him from the liability he would have been under to repay the bank the sum placed to his credit if the cheque had not been paid. But what your Lordships have to consider is not Jones' liability to the bank if the bank never received payment of the cheque, but for whom did the bank in fact receive such payment. The amount would not be again placed to Jones' credit: it was already there. The bank in its then ignorance of the forgery could not withdraw that credit after it had received payment of the cheque. As between the bank and Jones the money paid belonged to the bank as soon as the bank received it. The bank had a right to sue for the money, and to apply it in any way the bank thought proper, provided only Jones was not treated as owing its amount.

It was said by the appellants' counsel, with some confidence, that any jury of business men would find, as a fact, that the bank received payment of these cheques for Jones, and nothing more. All I can say is that I think it very likely they would do so if left to themselves without proper directions from the judge, but that if proper directions were given them they would not be likely to go wrong. It must never be forgotten that the moment a bank places money to its customer's credit the customer is entitled to draw upon it, unless something occurs to deprive him of that right. Nothing occurred in this case to the knowledge of the bank which had any such effect. It appears to me impossible to say that under these circumstances the bank received payment of the cheques in question for their customer Jones.

The Supreme Court of Canada, in *Dominion Bank* v. *Union Bank*, (1908) 40 S.C.R. 366, arrived at the same conclusion as to the character in which the Dominion Bank had received payment of a certain cheque drawn on the Union Bank. The Government of Manitoba had issued a cheque to The Consolidated Stationery Company in the amount of $6.00. Jones, a clerk of the company, obtained possession of the cheque, misappropriated it, and fraudulently erased both the payee's name and the amount, and inserted instead the name of William Johnson and the sum of $1,000, the whole with such skill that no ordinary care could have detected the change. One of the branches of the Dominion Bank took the cheque, paid Jones $25.00, and placed the balance to his credit. After it had cleared, the Dominion Bank paid Jones a further $800 of the balance standing to his credit. The forgery was discovered when the cheque was returned to the drawer. The Union Bank successfully brought proceedings to recover the money which it had paid to Dominion Bank as having been paid on a mistake of fact. One of the defences raised by the Dominion Bank was that it had received the money purely in the character of agent for Jones, and not in its own right, so that, at any rate once it had paid over, it was not liable in an action of this nature.

of its customer's surety, having some rights as such to special treat-

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This defence failed, Dominion Bank being held to have received the sum as a principal. Davies, J., at page 373, observed:

> The character in which the Dominion Bank presented the cheque through the Clearing House to the paying bank was as the holder of the cheque, and this I think is under the authorities a determining factor.

Duff, J., as he then was, observed (at page 382):

> [F]irst, the appellants dealt with the respondents in their character of holders of the cheques *simpliciter* and not in the character of agents of their depositor...; and, secondly, the appellants were not in point of the fact intermediaries merely, but had an interest in the cheque in respect of the advance made by them to the depositor.

It will be noted that Duff, J., too, clearly holds that, quite apart from the $25.00 advance, the Dominion Bank had not acted as mere agents, at least vis-à-vis the Union Bank. And once they were found to have received the money as principals, the mere fact of paying it over did not relieve them of liability. Being principals, Dominion Bank were in a worse position than had they been mere agents. By contrast, the fact that in *Huron & Erie Mortgage Co.* v. *Rumig, supra,* the Company were principals improved their position, since, as principals, they were holders in due course, and, as such, had a good title to the cheque, a title free from the defects in the title of their depositing customer: had they on the contrary been mere agents without an interest of their own, Rumig's defences would probably have succeeded against them.

Some difficulty may be encountered in reconciling with the foregoing decisions of the House of Lords and the Supreme Court of Canada the holding on one of the points in *Gaden* v. *Newfoundland Savings Bank,* [1899] A.C. 281, 68 L.J.P.C. 57, 80 L.T. 329, 15 T.L.R. 228, a decision of the Judicial Committee of the Privy Council (Lord Watson, Lord Hobhouse, Lord Davey — who later sat in *Capital and Counties Bank* v. *Gordon* — and Sir Henry Strong). There the defendant bank was held to have acted purely as an agent in collecting a cheque drawn by plaintiff Gaden on the Commercial Bank payable to herself or order, and certified by the drawee at her request before delivery (without endorsement) to the defendant by whom it was credited to her account. The drawee failed before collection, and the controversy was as to whether the defendant was entitled to charge her account with the amount of the cheque. Their Lordships held it was; that in the absence of express agreement or intention implied from the circumstances the bank must be held to have taken the instrument as agent for collection only; and that the loss fell upon plaintiff. Sir Henry Strong, speaking for their Lordships, demanded to know (at page 286) whether it was to be inferred

> ... that the respondent, which was not a bank of discount, but whose duty and business it was merely to receive money on deposit, so far departed from its duty as well as from its general course of business, which must be presumed to have been in accordance with its duty, as to have accepted this cheque, not by way of deposit and for the purpose of obtaining the cash for it in the usual way, as the agents of the appellant, but with the intention of acquiring title to it, and thus in effect gratuit-

ment by the bank. Both drawer and customer are cumulatively liable to the bank.[33] It can recover against either or both. The law affords no basis for preferring the drawer. He is not secondarily liable as compared with the depositing customer. If either of the two is secondarily liable, it is the customer. If every holder in due course having in hand funds of some party to an instrument is bound to hold such funds to answer claims *inter se* of parties liable on such instrument, then we are in the presence of a novel extra-judicial attachment in face of which banking as we know it cannot be carried on. On principle, the position of Laskin, J.A., seems, with respect, unsupportable. The majority, with deference, was right. The drawer, quite apart from section 165(3), cannot answer a bank holding in due course by raising claims he has against that bank's customer, and this is so whatever be the state of the latter's account with the bank. The drawer's recourse is to sue (or implead) the customer, and attach his assets. He cannot attach a bank account by a telephone call or letter to the bank.

Hon. Mr. Lambert's doubts, in sum, were well founded. He was right in law.

It remains to consider the manner in which section 165(3) has been applied by the courts. There has, so far, been little jurisprudence on the subsection, — perhaps because it is considered so categorical that most cases simply applying its terms are not thought worth reporting. *Bank of Nova Scotia* v. *Archo Industries Ltd.*[34] was an action by the plaintiff bank on a cheque dishonoured in consequence of the drawers' countermand. The cheque had been drawn by the defendants Harrison in favour of the payee Archo Industries Ltd., delivered to the payee, and deposited by the payee with the endorsement "For deposit only to Archo Ind.". The bank proceeded *both* against the payee *and* against the drawers. It appears that the drawers, had they been proceeded against by the payee, would have raised defences of the nature of set-off or failure of

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ously guaranteeing its payment? Their Lordships are of opinion that there can be only one answer to this question — that which has been given by the Courts below.

One ground of distinction may rest in the fact that the defendant was a savings bank, though Sir Henry Strong appears to consider it a rule of much more general application than merely to savings banks that a cheque deposited and credited is, in the absence of agreement to the contrary, taken by the collecting bank as collecting agent only.

[33] Section 135. As between drawer and endorser, it is, *prima facie*, the former who is primarily, and the latter secondarily, liable: sections 130(*a*) and 133(*a*).

[34] (1970) 11 D.L.R. (3d) 593.

consideration. These they sought to set up against the bank. But in view of section 165(3) the Saskatchewan Queen's Bench (Tucker, J.) held the plaintiff bank to be a holder in due course, notwithstanding the restrictive endorsement. It is interesting to note that here the bank made an effort to obtain payment first from its customer. Archo was a party defendant to the action. By the time the cheque was stopped Archo Industries "had withdrawn substantially all its deposit with the plaintiff and it has not been possible for the plaintiff to recover anything from the defendant Archo Industries Ltd. in respect thereof".[35] "It was established that the plaintiff, before launching this action, had endeavoured to recover the amount from Archo Industries Ltd. and on August 14, 1967, had taken a demand note for an amount which included it."[36] Notwithstanding these efforts by the bank, the drawers pleaded that the plaintiff bank was estopped from enforcing payment against them. One of the grounds of estoppel was the bank's alleged payment of the amount of the cheque out of Archo's account despite its knowledge of the drawers' dispute with Archo and Archo's insolvent financial circumstances. This, the Court held, was not established by the evidence. The Court therefore gave this allegation no further attention. But even had the allegation been proved, it is submitted that it would have been irrelevant: the drawers' recourse was to attach the payee's account, not to resist payment demanded by one who had previously become a holder in due course. Another alleged ground of estoppel was sought in plaintiff's supposed delay in claiming against the drawers. The Court disposed of this on the ground, *inter alia*, that "the plaintiff made no representations to these defendants that there would not be a claim under the cheque".[37] The very efforts by the bank to obtain payment from Archo were said by the drawers to constitute an election by the bank to look only to its customer. Of this the learned judge said:

> In the first place, the bank at no time through its servants or agents made any representations that they would not expect these defendants to pay the money covered by the cheque or that they would look to Archo Industries Ltd. solely for payment of same. The action they took in endeavouring to collect from Archo Industries Ltd. actually constituted an affirmation of their rights arising from the deposit of the cheque and paying of the proceeds to Archo Industries Ltd. To endeavour to collect, albeit first from Archo Industries Ltd., was not, in my opinion, an election between two alternative *inconsistent* courses of conduct.

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[35] *Ibid.*, at p. 594.
[36] *Ibid.*, at p. 596.
[37] *Ibid.*, at p. 595; see also, p. 597.

> In other words, the plaintiff had one claim against two persons and in endeavouring to collect from one to the extent it did, could not be said to have made an election to rely on that one alone and waive any claim on the other.[38]

Allusion to section 165(3) is to be found in the opinion of Hyde, J. for the Quebec Court of Appeal in *Toronto-Dominion Bank* v. *Canadian Acceptance Corp.*[39] The transactions giving rise to the litigation had however occurred before the enactment of section 165(3), which, as the Court observed, could accordingly have no application. It is not clear in what connection section 165(3) was referred to, though the reference is preceded and followed by remarks as to value given by the bank. Two of the nine cheques sued on had been endorsed irregularly, and as to these the drawer's defence of fraud succeeded, as the bank was not a holder in due course. Had the events giving rise to the litigation followed the enactment of section 165(3), that subsection might conceivably have

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[38] *Ibid.*, at p. 597.

[39] (1970) 7 D.L.R. (3d) 728, at pp. 734-35. Nothing appears to turn on the reference to section 165(3) in the clear and able opinion of Mackay, J. in *Capital Associates Ltd.* v. *Royal Bank of Canada*, (1970) 15 D.L.R. (3d) 234, at p. 239. The issue there was solely as to whether the defendant bank, which happened to be both drawee and collecting bank, had or had not, in taking the cheque and crediting the plaintiff's account therewith at the same branch as that upon which it was drawn, acted as drawee and paid it (so that the drawer's countermand had come too late). This was held not to have been the case — the cheque was held not to have been paid. Nothing turned on whether defendant was agent for collection, or whether it was on the contrary holder in due course in its own right. The cheque had been endorsed for deposit to the account of the payee. The learned judge (at p. 239), citing section 165(3), refers to the collecting bank as holder in due course. His Lordship relies upon sections 133 and 134 (endorser's liability to holder) as the basis of the customer's liability to have the instrument charged back against his account if dishonoured. Of course, section 165(3) is not, ordinarily, needed to make the bank a holder in due course of an instrument which it credits to a customer's account: *Capital and Counties Bank* v. *Gordon, supra*, nn. 27 and 32. Since the cheque which was the subject of the litigation in *Capital Associates Ltd.* v. *Royal Bank* happened to have been restrictively endorsed, section 165(3) would be needed to make the bank a holder in due course thereof. But, on the facts of this case, it would not seem to matter in the least whether the bank was a holder in due course or an agent for collection. In either case, it could charge the cheque back against its customer's account, provided only that the cheque had not been paid. That, of course, was the very thing at issue. But when once the bank was held not to have taken the cheque in its character as drawee — was taken not to have paid it — it would succeed equally well against plaintiff whether it was holder in due course enforcing a warranty against an endorser, or an agent for collection charging back an uncollectable item against its principal's account. So the bank's character as holder in due course was irrelevant to the case, and so was section 165(3).

been relied on by the bank as making it a holder in due course despite the irregularity of the endorsements. It is not easy to say what answer could have been offered to this argument. Hyde, J.'s remarks [40] suggest that he might have limited section 165(3) to the situation in *Imperial Bank of Canada* v. *Hays and Earl Ltd.*[41] (the restrictive effect of endorsements for deposit) because Falconbridge [42] attributed the amendment to that case. But, with respect, such considerations, extrinsic to the subsection itself, cannot control its terms. By the time the subsection had assumed its final form, its terms were no longer confined to the restrictive effects of endorsements for deposit, as well its draftsman knew.

The history of the clause does not reflect a great deal of credit on the Canadian parliamentary process. Opposition was not pressed in Committee:

> The CHAIRMAN: Unless the committee unanimously agrees that this clause stand or unless a motion to table is approved we have no recourse but to proceed —
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> MR. LEWIS: If I may interrupt you, Mr. Chairman, I do not want to hold it up. If, on the other hand, Mr. Elderkin has not given me the full explanation of this I will object some other time.
>
> MR. ELDERKIN: Well, I tried to.
>
> MR. LEWIS: I am sure you did.
>
> Clause 4 agreed to.
>
> Title agreed to.
>
> The CHAIRMAN: Shall the bill, as amended, carry?
> Some hon. MEMBERS: Carried.
>
> The CHAIRMAN: Shall I report the bill, with amendment?
> Some hon. MEMBERS: Agreed.[43]

nor in the House of Commons Committee of the Whole:

> MR. LAMBERT: Mr. Chairman, this bill has been considered in committee and there was an amendment which received the approval of the members of the committee. On behalf of the opposition I would ask for quick passage to assist the banks so they may remain open on Easter Monday.
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> Some hon. MEMBERS: Hear, hear.[44]

But the chief responsibility clearly lay with the Government, which had misled the opposition members, and which, to speak bluntly, did not itself know what it was doing.

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[40] (1970) 7 D.L.R. (3d) 728, at p. 735.
[41] See *supra*, n. 12.
[42] See *supra*, n. 11.
[43] *Commons Finance Committee Proceedings*, at p. 192.
[44] *House of Commons Debates*, April 6, 1966; 1966, IV, at p. 3955.

The remedy is not far to seek. Section 165(3) must be summarily repealed. Its continued presence on the Canadian statute book is completely unjustified. It need not really be replaced with a new provision, but if one is wanted for the purposes for which section 165(3) was ostensibly promoted, something along the following lines should do:

> (3) Where the holder of a cheque endorses it for collection and delivers it to a bank for that purpose, the bank (but no holder subsequent to the bank) enjoys, except as against him, the rights and powers it would have had had he endorsed it specially to the bank without such a restriction; and the bank may accordingly, as against other parties or persons, be a holder for value or a holder in due course as the case may be under this Act; *but the bank before exercising the rights and powers conferred by this subsection must have recourse against the holder who delivered it for collection.*
>
> (4) In subsection (3) an endorsement for collection includes an endorsement for deposit and an endorsement for collection and deposit.
>
> (5) Nothing in subsection (3) affects the operation of any restriction imposed by a party prior to the depositing holder.

The words in emphasis, though not necessarily required as a matter of principle, would be put into the clause if it were sought to protect the drawer in the manner desired by the Hon. Mr. Lambert. In that connection, it should be borne in mind that the holder has power by an *absolute* endorsement to leave the drawer quite unprotected as against the bank, and so the protection given to the drawer by a holder who chooses to endorse restrictively is in a sense fortuitous. No mention has been made in the above formula of crediting the customer's account, because that should be left to the general law concerning value and depend upon the circumstances, as explained in *Capital and Counties Bank* v. *Gordon*.[45] The clause proposed puts the bank *at liberty* to become a holder in due course, *provided* that it gives value, which may include the crediting of the customer's account, and *provided* that it satisfies the other requirements of the Act. A slightly more elaborate formula than the above is needed if holders subsequent to the bank (e.g., other banks) are to be allowed to have the benefits of the subsection but no more.

It may be reasonable also to allow the banks to become holders for collection of cheques delivered for collection but not endorsed. There is some indication that they are at present assuming that section 165(3) makes them holders of such cheques. Tellers no longer seem to worry greatly about the endorsements of depositors. A possible formula is the following:

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[45] [1903] A.C. 240; see *supra*, nn. 27 and 32.

(6) Where the holder of a cheque delivers it to a bank for collection without endorsing it, the bank has the same rights and powers as if he had endorsed it specially to the bank for collection.

A definition subsection like (4) above would be needed to accompany (6). An adjustment in (4) would do. Subsection (6) is so drawn as to give the bank the powers it needs to collect, but no more. If draft subsection (3) is also in the Act, (6) will work in conjunction with it. Otherwise subsection (6) can stand quite satisfactorily on its own.