TAB 12

CANADIAN PAYMENTS ASSOCIATION

ASSOCIATION CANADIENNE DES PAIEMENTS

RULE F4

AUTOMATED FUNDS TRANSFER SYSTEM SETTLEMENT PROCEDURES

Rule F4 - Automated Funds Transfer System Settlement Procedures

Implementation and Revisions

Implemented

January 22, 1996

Amendments Pre-November 2003

July 15, 1996, April 23, 2001 and June 4, 2001.

Amendments Post-November 2003

1. Amendments to reflect consistency with the new CPA Payment Items and ACSS By-law, approved by the Board November 27, 2003, effective January 27, 2004.

2. Sections 2, 4(a), and (b). Approved by the Board March 29, 2004, effective May 31, 2004.

3. Section 3(a), approved by the Board June 29, 2004, effective January 5, 2005.

4. Amendment to correct settlement procedure for AFT transactions, approved by the Board February 21, 2008, effective April 21, 2008.

Rule F4 - Automated Funds Transfer System Settlement Procedures

Introduction

1. This Rule outlines procedures applicable to the Settlement of obligations arising from the Exchange and Clearing of AFT transactions.

Scope

2. The procedures outlined in this Rule are applicable to AFT Transactions as defined in the Rules and CPA Standard 005.

   All times specified in this Rule are based on Ottawa Time.

Settlement

3. (a) Each Direct Clearer shall maintain a recapitulation of Debit and Credit Transactions, by AFT File, and by due date for all AFT Transactions Exchanged for a period of one year.

   (b) No Settlement shall be made for obligations arising from any AFT Transactions contained in a rejected AFT File.

   (c) Settlement must be effected for obligations arising from the Exchange and Clearing of Rejected Transactions.

   (d) The Settlement date shall be the Business Day following the due date or the Business Day following the date of Exchange for AFT Transactions delivered on or after the due date.

   (e) Where applicable, the rules and regulations of the Regional Clearing Association for the handling of Cheque Clearing Logs and settling of balances shall apply.

ACSS Entries

4. (a) Each Processing Direct Clearer shall initiate, in the National Electronic Settlement Region and using stream identifier "C", a debit entry against each of the other Direct Clearers from which it has received Credit Transactions (i.e., "C", "F" and "I" Logical Record Types) for Settlement in accordance with subsection 3(d). Each debit entry shall specify the total number and value of AFT Transactions received from the Direct Clearer being debited. Such debit entry shall be made by 5:00 a.m. on the settlement date, except where the settlement date is a Business Day following a Regional or Civic Holiday, in which case entries may be made up to 9:30 a.m. on that day.

   (b) Each Originating Direct Clearer shall initiate, in the National Electronic Settlement Region and using stream identifier "D", a debit entry against each of the other Direct Clearers from which it has delivered Debit Transactions (i.e., "D", "E" and "J" Logical Record Types). Each debit entry shall specify the total number and value of AFT Transactions delivered to each Direct Clearer being debited. Such debit entry shall be made by 5:00 a.m. on the settlement date, except where the settlement date is a Business Day following a Regional or Civic Holiday, in which case entries may be made up to 9:30 a.m. on that day.

TAB 13

BANK OF CANADA
BANQUE DU CANADA

Canada's Major Payments Systems

Large Value Transfer System (LVTS)

Designed and operated by the Canadian Payments Association (http://www.bankofcanada.ca/core-functions/financial-system/oversight-designated-clearing-settlement-systems/canadas-major-payments-systems/the-lvts/) (CPA), the LVTS was launched on 4 February 1999. The LVTS is a real-time, electronic wire transfer system that processes large-value, time-critical payments quickly and continuously throughout the day. It provides participants and their customers with the certainty that, once a payment message has passed the system's risk-control tests, the transaction will settle on the books of the Bank of Canada on the same day, regardless of what happens to any of the participants subsequently.
The LVTS plays a particularly important role in the settlement of Canadian-dollar payment obligations arising from securities and foreign exchange transactions. The LVTS has been designated under the Payment Clearing and Settlement Act, and, thus is subject to Bank of Canada oversight. For a discussion of the Bank of Canada's role in the oversight of payment, clearing, and settlement systems, see Financial System Review - June 2006 (http://www.bankofcanada.ca/wp-content/uploads/2010/04/fsr_0606.pdf).

Direct Participants

The Canadian Payments Association sets the requirements that financial institutions must meet to be direct participants in the LVTS. An institution must:

- be a member of the CPA
- use the SWIFT telecommunications network
- have adequate backup capability for its LVTS operations
- have a settlement account at the Bank of Canada
- enter into agreements relating to taking loans from the central bank and to pledging the appropriate collateral

LVTS participants provide their customers, which include other financial institutions, as well as commercial and government entities, with indirect access to the system.

Risk-Control Mechanisms

The LVTS forms the core of Canada's national payments system. It substantially reduces systemic risk, and allows Canada to meet the best international practices for handling large-value payments. The risk-control structure of the LVTS is composed of the following elements:

- Individual payment messages are subject to risk-control tests in real-time.
- The net amount that each participating financial institution is permitted to owe is subject to bilateral and multilateral limits.
- At the beginning of each day, participants pledge to the Bank of Canada appropriate collateral with a value sufficient to cover, at a minimum, the largest permitted net debit position of a single participant. This provides sufficient collateral to make available the necessary liquidity to settle the system even if one of the participants defaults.
- The Bank of Canada guarantees settlement of the system in the extremely unlikely circumstance of more than one participant failing during the LVTS operating day. The guarantee will be called on only in the event of an unanticipated failure of more than one participant on the same day during LVTS operating hours, with the failing participants in a net owing position vis-à-vis the system, and if the amount owed by the failing participants exceeds the value of collateral pledged to the Bank of Canada.

These four elements provide the participants with certainty of settlement. In turn, this certainty permits institutions to offer their customers intraday finality of payment.

Tranche 1 and Tranche 2 Payments

When sending an LVTS payment, the sending participant can choose between two types of payment: Tranche 1 and Tranche 2. Each tranche has a corresponding risk-control limit. A participant can send a Tranche 1 payment as long as its net owing position (as a result of all its Tranche 1 payments sent and received) is no greater than the collateral that the institution has pledged to the Bank of Canada for Tranche 1 activity. If the participant should default in the course of that day, this collateral would be used to cover any net negative position in this category of payment. For this reason, Tranche 1 payments are known as "defaulter-pays."
Under Tranche 2, each participating institution begins the day by granting a bilateral line of credit to every other institution (which can be zero), i.e., the largest net exposure that it is prepared to accept vis-à-vis that institution on that day. In addition, each participant (as a sender) has a multilateral net debit cap, calculated as the sum of all bilateral lines extended to it, multiplied by a specified percentage set by the CPA. Each participating financial institution pledges to the Bank of Canada collateral equal to the largest bilateral line of credit it has extended to any other institution multiplied by the specified percentage. If a participating institution fails, the loss-allocation procedures pro-rate any losses on the basis of the bilateral lines of credit established by survivors vis-à-vis the failed institution. The collateral pledged by the participants is sufficient to cover the failure of the institution with the largest possible amount owing to the system, i.e., the institution with the largest sender net debit cap. This part of the system has been described as "survivors-pay," since surviving financial institutions absorb any losses associated with a failure (after the defaulter's collateral is seized and used to meet its obligations). Tranche 2 payments make up the great majority of the volume and value of payment transfers in the LVTS, principally because of savings in collateral relative to Tranche 1 operations.

LVTS Daily Operating Schedule

(All times are Eastern Time)

Phases of LVTS Cycle

0:00 - Commencement and Start of Initialization Period
Participants wishing to exchange CLS-related or bilaterally agreed upon non-CLS related payments will sign-on, pledge collateral, apportion collateral, confirm Participant profile information and set bilateral limits. Bank of Canada will value Participant collateral.
CLS-related payments are those payments to/from Bank of Canada for the benefit of the CLS Bank, payments delivered between Participants to fund a Participant's position or a client's position for whom a Participant is acting as the client's nostro agent.
Note: Bank of Canada will value all Participants' collateral prior to 00:30 hours regardless of when they become active.
00:30 - 06:00 - Start of Payment Message Exchange Period
LVTS is open for exchanging payments. There must be bilateral agreement between Sending and Receiving Participants to send non-CLS related payments prior to 06:00.
06:00 - 08:00
LVTS is open for payment exchange between active participants for all payments (MT 103 and MT 205) both customer and inter-Participant.
07:00 - 08:00
Participants not already active will sign-on, pledge collateral, apportion collateral, confirm Participant profile information, and set bilateral limits.
18:00 - End of Payment Message Exchange Period/Start of Pre-Settlement
(Start of Inter-Participant Payment Message Exchange Period)
LVTS is open for inter-Participant payments (MT 205 only). This period is to be used by the Participants to bring their Multilateral Net Positions closer to zero.
18:30 - End of Pre-Settlement
No further payment messages may be exchanged through the LVTS.
By 19:30 - Settlement
The Bank of Canada will settle all Participants' Multilateral Net Positions. All Participants' Multilateral Positions are settled simultaneously.
See also: "The LVTS—Canada's large-value transfer system (http://www.bankofcanada.ca/wp-content/uploads/2010/06/r984c.pdf) " and A Primer on Canada's Large Value Transfer System (http://www.bankofcanada.ca/wp-content/uploads/2010/05/lvts_neville.pdf) , by Neville Arjani and Darcey McVanel

LVTS Participants

On 4 February 1999, the CPA launched the Large Value Transfer System (LVTS), an electronic system for the transfer of payments. An LVTS participant is a member of the CPA who participates in the LVTS and maintains a settlement account at the Bank of Canada. In July 2011, there were 15 LVTS participants in addition to the Bank of Canada.

- Alberta Treasury Branches
- Bank of America, National Association
- Bank of Montreal
- The Bank of Nova Scotia
- BNP Paribas (Canada)
- La Caisse centrale Desjardins du Québec
- Canadian Imperial Bank of Commerce
- Central 1 Credit Union
- HSBC Bank Canada
- Laurentian Bank of Canada
- National Bank of Canada
- Manulife Bank of Canada
- Royal Bank of Canada
- State Street Bank and Trust Company
- The Toronto-Dominion Bank

The Automated Clearing Settlement System (ACSS)

The Automated Clearing Settlement System (ACSS) is owned and operated by the CPA. The ACSS is a deferred net settlement system that handles all payments not processed by the LVTS, including paper-based payment items (mostly cheques), as well as small-value electronic payment items, such as point-of-sale (e.g., debit card) or automated banking machine transactions, and pre-authorized debits and credits.
In 2002, the Bank of Canada examined the ACSS to determine whether it had the potential to pose systemic risk (see Systemic Risk, Designation, and the ACSS (http://www.bankofcanada.ca/wp-content/uploads/2010/05/report.pdf)). The Governor of the Bank is of the opinion that the ACSS does not pose systemic risk, and it has not been designated under the Payment Clearing and Settlement Act.

Direct and Indirect Clearers

Members of the CPA may be either direct or indirect clearers in the ACSS. Eligibility criteria for being a direct clearer include being a CPA member and maintaining a settlement account and loan facility at the Bank of Canada. The entity must also account for at least one-half of 1 per cent of the total volume of ACSS clearings. An indirect clearer is a member of the CPA that does not maintain a settlement account or loan facility at the Bank of Canada and has a direct clearer acting as its agent in the ACSS clearing and settlement process.

ACSS Clearing and Settlement Cycle

In the ACSS, payment items that are exchanged among ACSS direct and indirect participants throughout the day are cleared overnight, and are settled with interest compensation on the next business day across the settlement accounts of the Bank of Canada. The specifics of the exchange and clearing of the items vary, depending on the item (e.g., whether the payment item is paper based or is sent as an electronic data transmission). But all items follow a similar path.

Clearing is handled through six regional settlement points across the country, and the specifics differ according to the type of payment item. Generally, items collected at CPA members previous to and throughout the value day (T) are forwarded to a local data centre operated, or contracted, by a direct clearer. Direct clearers are increasingly contracting out the processing of payment items. The items are sorted at the data centre. Paper items are sorted by high-speed computerized readers/sorters, according to the institutions on which they are drawn. Items drawn on other institutions are then delivered to the data centres of the appropriate direct clearer in the same regional clearing area. The delivering direct clearer enters the information regarding the exchanged items, including the volume and value of various types of payment items, into its ACSS terminal. This information can be checked at the receiving direct clearer's data centre and disputed if necessary. The next day, the payment items are returned to the branches of the institutions on which they are drawn, according to the type of payment item. Most cheques are returned to branches no later than two days after they are deposited.

This process of exchanging items, entering information into ACSS terminals and, potentially, contesting entries continues on the value day until the final closing time, which is 11 a.m. ET for all regional settlement points. The ACSS calculates the net position across all types of payment items for each direct clearer. By 8 a.m. the next business day (T+1), the financial institutions have typically finished making adjustments to their clients' accounts, debiting payors' accounts, and crediting payees' accounts. At approximately 9:30 a.m., initial net balances are available to all the direct clearers, and bilateral reopenings of the clearing may occur to correct errors, if both parties agree. By 11 a.m., the final multilateral positions of the direct clearers are calculated and made known to the Bank of Canada.

Direct clearers' net positions are settled by adjustments to their settlement accounts at the Bank of Canada. This is typically completed by 12 noon ET on the settlement day (T+1), with interest compensation calculated on positions at the Bank Rate minus one-quarter of 1 per cent (25 basis points), that is, the Bank's target for the overnight interest rate. Direct clearers in a net debit position make an LVTS payment to their settlement account at the Bank to cover their ACSS position plus calculated interest compensation. Direct clearers in a net credit position have the funds plus interest compensation credited to their account, and value is returned to them through an LVTS payment on T+1. Note that although the exchange process begins on day T, settlement is completed the next business day for value T+1; hence the interest compensation component.

Direct Clearers in the Automated Clearing Settlement System (ACSS)

A direct clearer is a member of the CPA, participating directly in the Automated Clearing Settlement System and maintaining a settlement account at the Bank of Canada. Direct clearers act as clearing agents for other members of the CPA.

In April 2013, there were 11 direct clearers in addition to the Bank of Canada:

- Alberta Treasury Branches
- Bank of Montreal
- The Bank of Nova Scotia
- La Caisse centrale Desjardins du Québec
- Canadian Imperial Bank of Commerce
- Central 1 Credit Union
- HSBC Bank Canada
- Laurentian Bank of Canada
- National Bank of Canada
- Royal Bank of Canada
- The Toronto-Dominion Bank

April 2013

TAB 14

2009 SCC 15
Supreme Court of Canada

B.M.P. Global Distribution Inc. v. Bank of Nova Scotia

2009 CarswellBC 809, 2009 CarswellBC 810, 2009 SCC 15, [2009] 1 S.C.R. 504, [2009] 8 W.W.R. 428, [2009] B.C.W.L.D. 2147, [2009] B.C.W.L.D. 2154, [2009] B.C.W.L.D. 2156, [2009] B.C.W.L.D. 2157, [2009] B.C.W.L.D. 2158, [2009] B.C.W.L.D. 2225, [2009] B.C.W.L.D. 2226, [2009] B.C.W.L.D. 2258, [2009] B.C.W.L.D. 2260, [2009] B.C.W.L.D. 2261, [2009] A.C.S. No. 15, [2009] S.C.J. No. 15, 175 A.C.W.S. (3d) 490, 268 B.C.A.C. 1, 304 D.L.R. (4th) 292, 386 N.R. 296, 452 W.A.C. 1, 58 B.L.R. (4th) 1, 94 B.C.L.R. (4th) 1, J.E. 2009-613

B.M.P. Global Distribution Inc. (Appellant) v. Bank of Nova Scotia doing business as the Scotiabank and the said Scotiabank (Respondent)

Bank of Nova Scotia doing business as the Scotiabank and the said Scotiabank (Appellant) v. B.M.P. Global Distribution Inc., 636651 B.C. Ltd., Audie Hashka and Paul Backman (Respondents)

McLachlin C.J.C., Binnie, LeBel, Deschamps, Rothstein JJ.

Heard: May 15, 2008
Judgment: April 2, 2009
Docket: 31930

Proceedings: reversing in part *B.M.P. Global Distribution Inc. v. Bank of Nova Scotia* (2007), 2007 BCCA 52, [2007] 3 W.W.R. 649, 24 B.L.R. (4th) 201, 388 W.A.C. 252, 235 B.C.A.C. 252, 2007 CarswellBC 155, 278 D.L.R. (4th) 501, 63 B.C.L.R. (4th) 214 (B.C. C.A.); reversing in part *B.M.P. Global Distribution Inc. v. Bank of Nova Scotia* (2005), 2005 CarswellBC 1826, 2005 BCSC 1091, 8 B.L.R. (4th) 247 (B.C. S.C.)

Counsel: Paul E. Jaffe, Dean Fox, for Appellant, Respondents on cross-appeal
D. Geoffrey G. Cowper, Q.C., Brook Greenberg, Jennifer Francis, for Respondent / Appellant on cross-appeal

Subject: Corporate and Commercial; Restitution; Torts

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Bills of exchange and negotiable instruments --- Cheques — Forged or unauthorized cheques — Forged cheques — General principles

Individual plaintiffs sold plaintiff business, B Inc., which was paid for by fraudulent cheque - Plaintiffs deposited fraudulent cheque in their bank (bank N) — Hold was placed on cheque but funds were ultimately released and paid by drawee bank (bank R) — When cheque was found to be counterfeit, plaintiffs' bank accounts were frozen by bank N and charge back was executed in favour of bank R — Plaintiffs brought action for recovered amount, alleging breach of their banking contracts by bank N — Trial judge ordered bank N to pay plaintiffs $777,336.04 in damages (total of amounts debited) for breach of contract — Bank N successfully appealed; plaintiffs unsuccessfully cross-appealed seeking punitive damages — Plaintiffs further appealed and defendants cross-appealed on issue related to tracing — Appeal dismissed; cross-appeal allowed — Principle of finality of payment balanced against right to recover money paid under mistake of fact — In application of mistake of fact test, bank R had prima facie right to recover — Bank N not precluded by service contract from relying on common law related to mistake of fact — Bank R made mistaken payment, nothing precluded it from recovering and B Inc. had no defence to claim — Bank R was permitted to trace its contribution to balances in remaining accounts.

Restitution and unjust enrichment --- Benefits conferred under mistake — Mistake of fact — Recovery of overpayment

Individual plaintiffs sold plaintiff business, B Inc., which was paid for by fraudulent cheque — Plaintiffs deposited fraudulent cheque in their bank (bank N) — Hold was placed on cheque but funds were ultimately released and paid by drawee bank (bank R) — When cheque was found to be counterfeit, plaintiffs' bank accounts were frozen by bank N and charge back was executed in favour of bank R — Plaintiffs brought action for recovered amount, alleging breach of their banking contracts by bank N — Trial judge ordered bank N to pay plaintiffs $777,336.04 in damages (total of amounts debited) for breach of contract — Bank N successfully appealed; plaintiffs unsuccessfully cross-appealed seeking punitive damages — Plaintiffs further appealed and defendants cross-appealed on issue related to tracing — Appeal dismissed; cross-appeal allowed — Principle of finality of payment balanced against right to recover money paid under mistake of fact — In application of mistake of fact test, bank R had prima facie right to recover — Bank N not precluded by service contract from relying on common law related to mistake of fact — Bank R made mistaken payment, nothing precluded it from recovering and B Inc. had no defence to claim — Bank R was permitted to trace its contribution to balances in remaining accounts.

Financial institutions --- Deposits — General principles

Clearing cheques — Individual plaintiffs sold plaintiff business, B Inc., which was paid for by fraudulent cheque — Plaintiffs deposited fraudulent cheque in their bank (bank N) — Hold was placed on cheque but funds were ultimately released and paid by drawee bank (bank R) — When cheque was found to be counterfeit, plaintiffs' bank accounts were frozen by bank N and charge back was executed in favour of bank R — Plaintiffs brought action for recovered amount, alleging breach of their banking contracts by bank N — Trial judge ordered bank N to pay plaintiffs $777,336.04 in damages (total of amounts debited) for breach of contract — Bank N successfully appealed; plaintiffs unsuccessfully cross-appealed seeking punitive damages — Plaintiffs further appealed and defendants cross-appealed on issue related to tracing — Appeal dismissed; cross-appeal allowed — Principle of finality of payment balanced against right to recover money paid under mistake of fact — In application of mistake of fact test, bank R had prima facie right to recover — Bank N not precluded by service contract from relying on common law related to mistake of fact — Bank R made mistaken payment, nothing precluded it from recovering and B Inc. had no defence to claim — Bank R was permitted to trace its contribution to balances in remaining accounts.

Lettres de change et effets de commerce --- Chèques — Chèques contrefaits ou non autorisés — Chèques contrefaits — Principes généraux

Demandeurs ont vendu leur entreprise, B inc., laquelle a été achetée à l'aide d'un chèque frauduleux — Demandeurs ont déposé le chèque frauduleux à leur banque, la banque N — Chèque a été retenu mais les fonds ont plus tard été libérés et la banque R a effectué les opérations — Après qu'on eut découvert que le chèque était contrefait, la banque N a gelé les comptes bancaires des demandeurs et une annulation des crédits a été effectuée en faveur de la banque R — Demandeurs ont déposé une action en recouvrement, faisant valoir que la banque N avait contrevenu à ses obligations bancaires — Juge de première instance a condamné la banque N à payer 777 336,04 $ en dommages-intérêts aux demandeurs (soit le montant correspondant à la somme des montants débités) pour avoir contrevenu au contrat — Banque N a interjeté appel avec succès et les demandeurs ont échoué dans leur tentative d'interjeter un appel incident visant à obtenir des dommages-intérêts punitifs — Demandeurs ont par la suite formé un pourvoi et les défendeurs ont formé un pourvoi incident sur la question du suivi des fonds — Pourvoi rejeté; pourvoi incident accueilli — Principe de l'irrévocabilité du paiement doit être concilié avec le droit de recouvrer l'argent payé à la suite d'une erreur de fait — Conformément au critère établi en matière de recouvrement de sommes payées par erreur de fait, la banque R avait, à première vue, le droit au recouvrement — Il n'était pas interdit à la banque N, en vertu du contrat de service, de se fonder sur la doctrine établie en common law au sujet de l'erreur de fait — Banque R a effectué un paiement par erreur, rien ne s'opposait à ce qu'elle recouvre les fonds et B inc. n'avait aucun moyen de défense à opposer — Banque R pouvait suivre les sommes pour lesquelles elle a elle-même contribué aux soldes des comptes.

Restitution et enrichissement injustifié — Avantages conférés à cause d'une erreur — Erreur de fait — Recouvrement

Demandeurs ont vendu leur entreprise, B inc., laquelle a été achetée à l'aide d'un chèque frauduleux — Demandeurs ont déposé le chèque frauduleux à leur banque, la banque N — Chèque a été retenu mais les fonds ont plus tard été libérés et la banque R a effectué les opérations — Après qu'on eut découvert que le chèque était contrefait, la banque N a gelé les comptes bancaires des demandeurs et une annulation des crédits a été effectuée en faveur de la banque R — Demandeurs ont déposé une action en recouvrement, faisant valoir que la banque N avait contrevenu à ses obligations bancaires — Juge de première instance a condamné la banque N à payer 777 336,04 $ en dommages-intérêts aux demandeurs (soit le montant correspondant à la somme des montants débités) pour avoir contrevenu au contrat — Banque N a interjeté appel avec succès et les demandeurs ont échoué dans leur tentative d'interjeter un appel incident visant à obtenir des dommages-intérêts punitifs — Demandeurs ont par la suite formé un pourvoi et les défendeurs ont formé un pourvoi incident sur la question du suivi des fonds — Pourvoi rejeté; pourvoi incident accueilli — Principe de l'irrévocabilité du paiement doit être concilié avec le droit de recouvrer l'argent payé à la suite d'une erreur de fait — Conformément au critère établi en matière de recouvrement de sommes payées par erreur de fait, la banque R avait, à première vue, le droit au recouvrement — Il n'était pas interdit à la banque N, en vertu du contrat de service, de se fonder sur la doctrine établie en common law au sujet de l'erreur de fait — Banque R a effectué un paiement par erreur, rien ne s'opposait à ce qu'elle recouvre les fonds et B inc. n'avait aucun moyen de défense à opposer — Banque R pouvait suivre les sommes pour lesquelles elle a elle-même contribué aux soldes des comptes.

Institutions financières — Dépôts — Principes généraux

Compensation des chèques — Demandeurs ont vendu leur entreprise, B inc., laquelle a été achetée à l'aide d'un chèque frauduleux — Demandeurs ont déposé le chèque frauduleux à leur banque, la banque N — Chèque a été retenu mais les fonds ont plus tard été libérés et la banque R a effectué les opérations — Après qu'on eut découvert que le chèque était contrefait, la banque N a gelé les comptes bancaires des demandeurs et une annulation des crédits a été effectuée en faveur de la banque R — Demandeurs ont déposé une action en recouvrement, faisant valoir que la banque N avait contrevenu à ses obligations bancaires — Juge de première instance a condamné la banque N à payer 777 336,04 $ en dommages-intérêts aux demandeurs (soit le montant correspondant à la somme des montants débités) pour avoir contrevenu au contrat — Banque N a interjeté appel avec succès et les demandeurs ont échoué dans leur tentative d'interjeter un appel incident visant à obtenir des dommages-intérêts punitifs — Demandeurs ont par la suite formé un pourvoi et les défendeurs ont formé un pourvoi incident sur la question du suivi des fonds — Pourvoi rejeté; pourvoi incident accueilli — Principe de l'irrévocabilité du paiement doit être concilié avec le droit de recouvrer l'argent payé à la suite d'une erreur de fait — Conformément au critère établi en matière de recouvrement de sommes payées par erreur de fait, la banque R avait, à première vue, le droit au recouvrement — Il n'était pas interdit à la banque N, en vertu du contrat de service, de se fonder sur la doctrine établie en common law au sujet de l'erreur de fait — Banque R a effectué un paiement par erreur, rien ne s'opposait à ce qu'elle recouvre les fonds et B inc. n'avait aucun moyen de défense à opposer — Banque R pouvait suivre les sommes pour lesquelles elle a elle-même contribué aux soldes des comptes.

The plaintiffs, AH and PB, owned interests in BMP. The plaintiffs met Mr. N in the United States, who eventually, upon oral agreement, offered to purchase the rights to distribute BMP bakeware in the United States for a price of US$1.2 million.

AH went to a branch of bank N, where BMP held an account, and deposited an unendorsed cheque for C$904,563 that was payable to BMP and drawn on the account of a corporation at bank R. A hold was put on the funds, but they were ultimately released and paid by bank R. When the cheque was found to be counterfeit, the plaintiffs' bank accounts were frozen by bank N and a charge back was executed in favour of bank R.

The plaintiffs brought an action for the recovered amount, alleging a breach of their banking contracts by bank N. The trial judge ordered bank N to pay the plaintiffs $777,336.04 in damages (the total of the amounts debited). Bank N successfully appealed the trial judge's decision and the plaintiffs unsuccessfully cross-appealed, seeking punitive damages. The plaintiffs further appealed and the defendants cross-appealed on the issue related to tracing the amounts in the plaintiffs' bank accounts.

Held: The appeal was dismissed; the cross-appeal was allowed.

The principle of finality of payment was balanced against the right to recover the money paid under a mistake of fact. In the application of the mistake of fact test, bank R had a prima facie right to recover. Furthermore, bank N was not precluded by the service contract from relying on the common law related to mistake of fact. In conclusion, bank R made a mistaken payment, nothing precluded it from recovering, and BMP had no defence to the claim, as it provided no consideration for the instrument and neither BMP nor bank S had changed their respective positions.

In addition, bank R was permitted to trace its contribution to balances in the remaining accounts of the plaintiffs. Leading cases showed that it was possible at common law to trace funds into bank accounts if it was possible to identify the funds, and mixing by the recipient was not a bar to recovery. In the case at bar, since the withdrawals of all those who received funds far exceeded their contributions, bank R was permitted to trace its own contribution to the balances remaining in the accounts.

Les demandeurs, AH et PB, avaient des intérêts dans BMP. Les demandeurs ont rencontré monsieur N aux États-Unis et ce dernier a, plus tard, offert verbalement de se porter acquéreur du droit de distribuer des articles de cuisson aux États-Unis pour 1,2 million $US.

AH s'est rendu dans une succursale de la banque N où BMP avait un compte et y a déposé un chèque non endossé au montant de 904 563 $CAN, payable à l'ordre de BMP et tiré sur le compte d'une société à la banque R. Les fonds ont été retenus mais ont plus tard été libérés et la banque R a effectué les opérations. Après qu'on eut découvert que le chèque était contrefait, la banque N a gelé les comptes bancaires des demandeurs et une annulation des crédits a été effectuée en faveur de la banque R.

Les demandeurs ont déposé une action en recouvrement, faisant valoir que la banque N avait contrevenu à ses obligations bancaires. Le juge de première instance a condamné la banque N à payer 777 336,04 $ en dommages-intérêts aux demandeurs (soit le montant correspondant à la somme des montants débités). La banque N a interjeté appel avec succès à l'encontre de la décision du juge de première instance et les demandeurs ont échoué dans leur tentative d'interjeter un appel incident visant à obtenir des dommages-intérêts punitifs. Les demandeurs ont par la suite formé un pourvoi et les défendeurs ont formé un pourvoi incident sur la question du suivi des fonds dans les comptes bancaires des demandeurs.

Arrêt: Le pourvoi a été rejeté; le pourvoi incident a été accueilli.

Le principe de l'irrévocabilité du paiement doit être concilié avec le droit de recouvrer l'argent payé à la suite d'une erreur de fait. Conformément au critère établi en matière de recouvrement de sommes payées par erreur de fait, la

banque R avait, à première vue, le droit au recouvrement. De plus, il n'était pas interdit à la banque N, en vertu du contrat de service, de se fonder sur la doctrine établie en common law au sujet de l'erreur de fait. En somme, la banque R a effectué un paiement par erreur, rien ne s'opposait à ce qu'elle recouvre les fonds, et BMP n'avait aucun moyen de défense à opposer puisqu'elle n'avait fourni aucune contrepartie et que ni la situation de BMP ni celle de la banque S avait changée.

De plus, la banque R a pu suivre les sommes pour lesquelles elle a elle-même contribué aux soldes des comptes des demandeurs. Des décisions importantes montraient qu'il était possible en common law de suivre des fonds portés au crédit de comptes bancaires s'il était possible de les identifier et que le fait que le récepteur ait opéré une confusion de fonds n'était pas un obstacle au recouvrement. En l'espèce, comme les retraits effectués par tous ceux qui ont reçu des fonds dépassaient de beaucoup leur contribution aux fonds, la banque R pouvait suivre les sommes pour lesquelles elle a elle-même contribué aux soldes des comptes.

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POURVOI des demandeurs à l'encontre d'un jugement publié à *B.M.P. Global Distribution Inc. v. Bank of Nova Scotia* (2007), 2007 BCCA 52, [2007] 3 W.W.R. 649, 24 B.L.R. (4th) 201, 388 W.A.C. 252, 235 B.C.A.C. 252, 2007 CarswellBC 155, 278 D.L.R. (4th) 501, 63 B.C.L.R. (4th) 214 (B.C. C.A.); POURVOI INCIDENT des défendeurs sur la question du suivi des comptes.

Deschamps J.:

I. Facts

1 The issue in this case is whether a bank must pay damages to customers for debits made from their accounts when reversing credits that had been entered in relation to a forged cheque. The trial judge, although acknowledging that his conclusion was absurd, found for the holders of the accounts. With respect, I agree with the Court of Appeal, albeit for different reasons, that the law does not dictate such a result. I also conclude that where money has been transferred in circumstances in which it can still be identified, tracing is permitted.

2 As Saunders J.A. wrote for the Court of Appeal, the tale in this case is a strange one. It started when Audie Hashka and Paul Backman met Sunn Newman in the United States. Newman was said to be associated with a concern called Sunrise Marketing. Hashka and Backman owned interests in the appellant, BMP Global Distribution Inc. ("BMP"), a company operating in British Columbia that distributed non-stick bakeware without any formal licence or written agreement with its supplier. As the trial judge found, neither party was known to the other and neither had any business information concerning the other. According to Hashka and Backman, upon their return to Canada, an oral agreement was reached by telephone that Newman or Sunrise Marketing would purchase the right to distribute the bakeware in the United States. In the trial judge's words, "Backman agreed that Hashka arrived at the price of US$1.2 million by pulling the number out of the air" (2005 BCSC 1091, 8 B.L.R. (4th) 247 (B.C. S.C.), at para.13). No projected cash flow statements, business plans or marketing plans were used as a basis for the negotiations, and BMP had conducted no research into Newman or Sunrise Marketing. The trial judge added: "Further, Newman did not request copies of BMP Global's financial statements or sales records (indicating a net loss of approximately $3,500), nor did BMP Global offer to provide this kind of information to Newman" (para. 13) According to Backman, he and Hashka decided to do business with Newman because he "was a sharp-looking guy that seemed like he had a lot of potential". Hashka testified that Newman "seemed like a businessman" because he "dressed well".

3 On October 22, 2001, Hashka went to a Burnaby branch of the Bank of Nova Scotia ("BNS") where BMP held an account. He said that he wanted to deposit an unendorsed cheque for C$904,563 that was payable to BMP. He informed the branch manager that the cheque was a down payment for distributorship rights for BMP's products in the eastern United States (trial judgment, at para. 20). The cheque was drawn on an account of a corporation called First National Financial Corporation ("First National") at a Toronto branch of the Royal Bank of Canada ("RBC"). The cheque had been received the same day, without a cover letter, in an envelope on which the sender's name and address appeared as E. Smith of 6-6855 Airport Road, Mississauga, Ontario, L4V 1Y9, (416) 312-7205. Neither the drawer of the cheque nor the sender was known to Hashka or Backman or was apparently linked to Newman. No attempts were made to contact either First National or E. Smith before the cheque was taken to the bank.

4 On receiving the cheque, BNS recorded it as a deposit to BMP's account. The cheque was not endorsed. BNS did not provide immediate access to the $904,563, because the funds already credited to the account were not sufficient to cover the amount of the cheque: the balance prior to the deposit was $59.67. The circumstances were so unusual that the branch manager informed Hashka and Backman that the funds would be held until the bank was satisfied that the instrument was authentic (trial judgment, at para. 282). BNS contacted RBC to ensure that there were sufficient funds in First National's account and that a hold had not been placed on the cheque. BNS eventually received the funds in the ordinary course of business and released them on October 30, 2001. On that date and over the next ten days, BMP made numerous transactions, including a transfer of US$20,000 to a Citibank account in New York City whose holder Hashka and Backman said they did not know. The largest transfers were to accounts of Hashka and Backman and to an account opened on November 2, 2001 in the name of a holding company, 636651 B.C. Ltd., that was wholly controlled by Hashka. The Court of Appeal described this flurry of transactions as a dispersion of funds (2007 BCCA 52, 24 B.L.R. (4th) 201 (B.C. C.A.), at para. 11).

5 The movements of funds involving BMP's account and the accounts of Hashka, Backman and 636651 B.C. Ltd. can be summarized as follows:

1. On November 5, two cheques drawn on BMP's account were deposited in the account of 636651 B.C. Ltd., one, certified by BNS, in the amount of $100,000 and the other in the amount of $300,000. Prior to these deposits totalling $400,000, the balance of the account was zero. After the deposits, $7,000 was used to pay travelling expenses and personal expenses incurred by Hashka.

2. A total of $70,000 was transferred from BMP's account to Backman's chequing account by way of deposits of $50,000 on October 29 and $20,000 on November 1. Prior to these deposits, the balance in the account was $45.87. A total of $52, 351.81 was used to make purchases and retire outstanding debts incurred before the forged cheque was deposited in BMP's account. A deposit of $17.11 was made on November 3 as a result of a point of sale refund from a

Future Shop store.

3. An amount of $3,000 was transferred from Backman's chequing account to his savings account. The prior balance of the savings account was $74.35. No other deposits were made into this account. From the savings account, $428.56 was used to pay outstanding debts incurred prior to the receipt of the forged cheque.

4. A total of $20,000 was transferred from BMP's account to Hashka's account. The prior balance in Hashka's account was $236.29. In addition, a payroll cheque for $3,022.49 was deposited on October 30. A total of $10,153.91 was used to pay personal debts, day-to-day expenses and entertainment expenses.

5. A certified cheque in the amount of $300,000 dated November 2, drawn by BMP and made to the order of BMP, was taken to the Bank of Montreal. On November 7, a bank draft issued by the Bank of Montreal for $300,100 was deposited by BMP in its account at BNS. No explanation has been provided for the disbursement or the subsequent deposit.

6 On November 9, 2001, RBC notified BNS that the cheque for $904,563 deposited in BMP's account on October 22, 2001 was counterfeit, as the drawer's signatures were forged and asked for BNS's assistance. BNS interrupted all transactions in BMP's account and in all related accounts and asked BMP for assistance in recovering the proceeds of the forged cheque. BMP insisted on retaining the amount it still held. BNS then restrained the following amounts in accounts under its control that it had linked to the forged cheque:

BMP's account	$350,188.65
636651's account	$393,000.00
Backman's chequing account	$ 17,711.17
Hashka's account	$ 13,104.87
Backman's savings account	$ 2,645.79
Total	$776,650.48

In addition, BNS recovered $685.56 by reversing bill payments made from BMP's account. (When referring globally to the accounts other than that of BMP, I will call them the "related accounts".)

7 On December 6, 2001, RBC and BNS entered into an agreement in which RBC represented and warranted that the "cheque dated October 12, 2001, in the amount of nine hundred and four thousand five hundred and sixty-three dollars ($904,563.00) payable to BMP Global Distribution Inc. was counterfeited ... and was deposited into Scotiabank account number 30460 00178-17 ... and that the proceeds of the Counterfeit cheque are proceeds of fraud". Under this agreement, BNS was, at RBC's request, to transfer the restrained funds to RBC and RBC was to indemnify BNS for any losses related to the restraint and transfer. On December 7, 2001, BNS transferred $777,336.04 to RBC.

8 BMP's account was governed by a standard-form financial services agreement ("service agreement"). The relevant clauses are discussed below.

9 BMP, Hashka, Backman and 636651 B.C. Ltd. claimed damages equivalent to the restrained amounts, non-pecuniary damages for stress, wrongful disclosure of information and defamation, aggravated and punitive damages. Backman also claimed damages regarding BNS's failure to honour certain payment instructions while his account was restrained. The issue of damages for stress, wrongful disclosure of information and defamation is not before this Court.

2. Decisions of the Courts Below

2.1 British Columbia Supreme Court, 2005 BCSC 1091, 8 B.L.R. (4th) 247 (B.C. S.C.)

10 Cohen J. found that since BMP was not suing to enforce payment of the cheque, whether or not the cheque was a nullity or whether or not accepting BMP's position would allow a windfall to accrue to BMP had no bearing on the outcome of the litigation (paras. 284-85). In his view, BNS had violated the service agreement as well as the law applicable to banker/customer relations by charging back amounts credited to the accounts of BMP and the other plaintiffs. Cohen J. interpreted the service agreement as incorporating the clearing rules of the Canadian Payments Association ("clearing rules") and precluding BNS from charging back against its customer's account. He reasoned that once "final settlement on the deposit of the Counterfeit Cheque had been reached between the BNS and the RBC", the funds in BMP's account "went from being a 'provisional' credit to being a 'final' credit. At that stage the relationship between the BNS and the plaintiffs was that of debtor/creditor" (para. 306). Regarding the related accounts, Cohen J. found that the law prevented a bank charging back against a customer's account without the customer's permission. He awarded the plaintiffs pecuniary damages because they had "suffered a loss of their right to demand repayment from the BNS of the BNS' debt to them by reason of the BNS' wrongful charge backs against their respective bank accounts" (para. 423). He assessed the total pecuniary damages at $777,336.04, the sum of all the charge backs and the reversed payments. He also awarded Backman $13.50 for a late charge due to BNS's failure to honour certain payment instructions while his account was restrained. Cohen J. also awarded damages for wrongful disclosure of information and defamation.

2.2 British Columbia Court of Appeal, 2007 BCCA 52, 24 B.L.R. (4th) 201 (B.C. C.A.)

11 The unanimous judgment of the Court of Appeal was rendered by Saunders J.A. She framed the issue as a fraud designed to place a credit in BMP's account for which BMP gave nothing. In her view, the courts were being asked to indirectly complete the fraud. She accepted the trial judge's finding that BNS had breached its banking agreement when it reversed the credit in BMP's account over BMP's opposition. However, she found that two characteristics of the case made it unusual. The first was that

> the fact of two banks, and the consequent issues arising of clearing rules and the *Bills of Exchange Act*, confuse what would be otherwise a simple conclusion in these circumstances. The interposition in the fraudster's scheme of the Royal Bank of Canada created the screen of the clearing system. In this sense, the fraud may be described as extra-layered. The issue is whether that extra layering, in the circumstances I have just described, entitles BMP to recover from the Bank of Nova Scotia, as ordered by the trial judge. [para. 26]

Indeed, Saunders J.A. said that if only one bank had been involved in the payment, it would have been entitled to debit BMP's account, because the money was paid under a mistake of fact. The second unusual characteristic was the fact that

> BMP is an innocent in the fraud. Thus we know that BMP did not overtly assist the author of the scheme in its iniquitous aspects, whether or not the author has already been paid, unknowingly, by the cheque to Citibank, or was a gratuitous fraudster, or was a fraudster who has not yet presented his bill. For that reason, the many cases concerning recovery of monies from persons implicated in a fraud have no bearing on this case. [para. 27]

12 Saunders J.A. did not delve further into what she called "the screen of the clearing system". She went on to find that

> on a plain reading of s. 48, the counterfeit cheque, because of the forged signatures on it, was wholly inoperative, setting the stage for a claim for return of monies advanced in reliance upon it.

> Section 48 demonstrates the *prima facie* empty asset that BMP builds its claim around.
>
> In equity, then, would this cheque have provided a basis upon which BMP could hope to retain the funds credited to its account? In my view the answer is no. [paras. 33-35]

13 Saunders J.A. then found that it would be against good conscience to give a monetary judgment that would accomplish the substance of the fraud. She added that BMP could not claim the windfall — it had lost nothing: it did not change its position as a result of the charge back. She found that the arguments about the alleged rights of BMP, 636651 B.C. Ltd., Hashka and Backman under the clearing system rules were inconsistent with the principles of equity. She also found that, except for the $100 added to the original amount of $300,000, the funds linked to the bank draft issued by the Bank of Montreal bore the same character as the credit obtained from the deposit of the forged cheque. Thus, BMP could not retain any proceeds essentially derived from fraud. Saunders J.A. awarded BMP nominal damages of $1 for BNS's reversal of the credit over BMP's opposition (paras. 3.0 and 51) plus the remaining $100 from the bank draft, and dismissed the cross-appeal on punitive damages.

14 As to the funds traced in the related accounts, Saunders J.A. found that the transfers were proper and that the cheques were actual bills of exchange, unlike the forged cheque. Absent a finding that the cheques in question were improper, BNS was entitled only to "a remedy of tracing, or an enquiry into the true ownership of the accounts" (para. 56). The appeals against 636651 B.C. Ltd., Hashka and Backman were thus dismissed.

15 BMP appeals the Court of Appeal's reversal of the trial judge's conclusion on damages and also asks for punitive damages. BNS cross-appeals on the issue of tracing in the related accounts. It seeks the reversal of the Court of Appeal's decision and of the trial judge's damages award in favour of the holders of the related accounts.

3. Positions of the Parties

16 BMP asks that the award of damages be restored. It argues that, whether the claim is viewed as one for debt or for damages for breach of contract, BNS's liability is the same: "It is not necessary for BMP to prove that it suffered a loss other than the loss of its right to demand payment of the amount credited to its account at BNS" (A.F., at para. 82). BMP also asks for punitive damages to sanction BNS for its conduct.

17 BNS takes the position that BMP never had any interest in the proceeds of the forged cheque and that it is not entitled to damages, whether general or punitive, resulting from BNS's decision to return the funds to the victim of the fraud. BNS asserts what is essentially a defence *in rem*, relying on the inherent nullity of an instrument bearing the forged signatures of the drawer. It argues that this defence suffices for it to resist BMP's claim. In addition, BNS appeals the decision on the tracing of the funds in the related accounts on the basis that those funds were clearly identified as proceeds of the forged cheque and that none of the parties involved gave any consideration or suffered any detriment. BNS does not contest the $13.50 awarded as damages by the trial judge in relation to a late-payment charge Backman had to pay to a third party.

18 As the Court of Appeal mentioned, the case would have been simpler had only one bank been involved. However, in my view, BNS was not precluded from acknowledging that RBC could rely on the well-established doctrine of mistake of fact. Moreover, the conditions for tracing the funds in the related accounts are, in my view, met.

19 In sum, this case is about the restitution of amounts paid by RBC by mistake and the right to trace the proceeds. Since the case can be resolved by applying the common law rules on mistake of fact, I will begin by reviewing those rules. I will then apply the rules to the facts, and in doing so I will explain how the rules apply in the context of the relationship between the drawee and the collecting bank and between the customer and the bank; this will require a further discussion of the common law inasmuch as it has not been changed by the *Bills of Exchange Act*, R.S.C. 1985, c. B-4 ("*BEA*"). Finally, I will explain why, in my view, BNS could resist the claims of BMP and the holders of the related accounts.

4. Analysis

20 In *Bank and Customer Law in Canada* (2007), M. H. Ogilvie writes (at p. 284):

> [B]anks make payments by mistake for a variety of reasons, including simple error, either personal or by computer, in making a payment more than once, payment over an effective countermand, payment where there are insufficient funds, or payment of a forged or unauthorized cheque. *Prima facie*, in these situations, with the exception of insufficient funds which is treated as an overdraft, the bank is liable to reimburse the customer's account because it is in breach of contract with the customer. But the bank is also permitted to look to the recipient of the mistaken payment for restitution of the sum paid under a mistake of fact.

21 That a bank has a right to recover from a recipient a payment made under a mistake of fact was made clear in a restatement of the law by Goff J. (as he then was) in *Barclays Bank Ltd. v. W.J. Simms Son & Cooke (Southern) Ltd.*, [1979] 3 All E.R. 522 (Eng. Q.B.), at p. 541. Canadian courts have long recognized that right on the basis of the analytical framework adopted in *Royal Bank v. R.*, [1931] 2 D.L.R. 685 (Man. K.B.). Since *Simms*, however, and I agree with this approach, many Canadian courts have relied on the English case as setting the conditions for recovery in restitution by a bank, subject to Canadian law with respect to change of position, an issue that will be discussed below: *Royal Bank v. LVG Auctions Ltd.* (1983), 43 O.R. (2d) 582 (Ont. H.C.), aff'd (1984), 12 D.L.R. (4th) 768 (Ont. C.A.); *Toronto Dominion Bank v. Pella/Hunt Corp.* (1992), 10 O.R. (3d) 634 (Ont. Gen. Div.); *A.E. LePage Real Estate Services Ltd. v. Rattray Publications Ltd.* (1994), 120 D.L.R. (4th) 499 (Ont. C.A.), at p. 507: "*Barclay's Bank v. Simms* is the accepted authority explaining the obligations of a bank to its customer and its redress against the payee of a cheque who appears to be taking advantage of an innocent mistake on the part of a bank employee"; *Central Guaranty Trust Co. v. Dixdale Mortgage Investment Corp.* (1994), 24 O.R. (3d) 506 (Ont. C.A.), at p. 512, fn. 1; Ogilvie, at p. 285; P. D. Maddaugh and J. D. McCamus, *The Law of Restitution* (loose-leaf), at p. 10-32.

4.1 Simms Test for Recovering Money Paid Under a Mistake of Fact

22 The test laid down in *Simms* for recovering money paid under a mistake of fact (at p. 535) is straightforward:

> 1. If a person pays money to another under a mistake of fact which causes him to make the payment, he is *prima facie* entitled to recover it as money paid under a mistake of fact.
>
> 2. His claim may however fail if: (a) the payor intends that the payee shall have the money at all events, whether the fact be true or false, or is deemed in law so to intend; (b) the payment is made for good consideration, in particular if the money is paid to discharge, and does discharge, a debt owed to the payee (or a principal on whose behalf he is authorised to receive the payment) by the payer or by a third party by whom he is authorised to discharge the debt; (c) the payee has changed his position in good faith, or is deemed in law to have done so.

23 The right of BNS to resist the claims of the appellant and the cross-respondents cannot be examined without regard to RBC's right to ask BNS to transfer the funds. Consequently, RBC's position is the starting point for the analysis.

4.2 Application of the Test

4.2.1 Prima Facie Right to Recover

24 On the first step of the *Simms* test, RBC has a *prima facie* right to recover. It is common ground that payment was made on the basis of a forged instrument. According to s. 48(1) *BEA*, a forged signature is wholly inoperative. It does not create a right to give a discharge for the bill or to enforce payment. RBC made the payment before discovering that the drawer's signatures were forged. BMP no longer disputes the fact that the instrument is a forgery, but it contends that RBC must bear the loss and that BNS was not entitled to restrain the funds and transfer them to RBC. This argument goes to the second step of the test. At the first step, there is no basis for denying that RBC has a *prima facie* right to recover the funds.

4.2.2 Right of the Payee to Keep the Proceeds, Consideration and Change of Position

25 I reiterate that the second step of the test involves three enquiries: (1) did the payor intend that the payee keep the money in any event or is the payor precluded by law from raising the mistake? (2) did the payee give consideration? and (3) did the payee change its position?

4.2.2.1 Right to Keep the Proceeds

26 In the first enquiry, the question is whether the payor intends or is deemed in law to intend the payee to receive the funds. In the case at bar, the drawee provided the funds under the mistaken assumption that the drawer's signatures were genuine. It is not in dispute — and is well settled in law — that RBC, as the drawee, had no right to pay the cheque out of the funds it held to the credit of First National, the purported drawer, and that RBC would be liable to reimburse its customer if it used the customer's funds to make the payment. Nor is the relationship between BNS and RBC in dispute. It is that of a collecting bank receiving funds from the drawee in order to remit them to the payee. The issue before the Court in this case is whether, as BMP argues, the loss must fall on the drawee bank.

27 Where a drawee provides funds to a collecting bank on presentation of an instrument bearing a forged signature of the drawer, the drawee will usually — unless a specific factual context dictates otherwise — be in a position to assert that it did not intend the payee to keep the funds. As I mentioned above, the drawee in this situation pays without the authority to do so and is liable to its customer, who has not signed as the drawer. Without such an instruction from the drawer, the payor cannot be said to have intended the payee to keep the money in any event. This is not a case where a party pays a debt it owes or where other similar circumstances preclude the payor from denying that it intended the payee to keep the funds.

28 However, whether the payor is deemed in law to intend that the payee keep the money requires further elaboration. BMP put forward three arguments in support of its claim. The first is that the principle of finality of payment forms part of the common law and that it prevents the drawee bank from recovering the paid proceeds of a forged cheque from anyone other than the forger. The second is that the scheme of the *BEA* does not allow RBC to recover from BNS or BMP. The third is that the service agreement between BNS and BMP precludes BNS from recovering such proceeds from BMP.

4.2.2.1.1 Principle of Finality of Payment

29 In Canadian law, the argument that the drawee should bear the loss is sometimes said to have originated in *R. v. Bank of Montreal* (1907), 38 S.C.R. 258 (S.C.C.). I will turn to that case in a moment, but since the two judges (Girouard J., with whom MacLennan J. concurred) who supported the principle of finality relied heavily on the older case of *Price v. Neal* (1762), 3 Burr. 1354, 97 E.R. 871 (Eng. K.B.), I will begin by discussing the latter.

30 In *Price v. Neal*, a drawee paid a first bill of exchange bearing a forged signature of the drawer. He then accepted a second, also bearing a forged signature of the drawer. After that acceptance, the bearer discounted the second bill, which the drawee eventually paid. A considerable amount of time elapsed before the drawee found out that the signatures on both bills were forged. Lord Mansfield held that the drawee was not entitled to recover in such a case.

31 *Price v. Neal* has been interpreted in various ways over the centuries. One of the interpretations serves as a basis for a broad statement that the principle of finality of payment requires the drawee to bear the loss where the drawer's signature is forged, irrespective of detrimental reliance (see: S. A. Scott, "Comment on Benjamin Geva's Paper: "Reflections on the Need to Revise the Bills of Exchange Act — Some Doctrinal Aspects" (1981-82), 6 *Can. Bus. L.J.* 331 ("Comment on Reflections"), at p. 342). A second interpretation of *Price v. Neal* is that the drawee cannot rely on the forgery after acceptance (or payment) of a bill bearing a signature he should know to be forged or is deemed to have negligently omitted to verify. Yet a third interpretation put forward for *Price v. Neal* limits its scope to instances where two innocent parties have equal equities but the holder of the bill has legal title to the money (see *Gorman v. Karpnale Ltd.*, [1991] 2 A.C. 548 (U.K. H.L.); B. Geva, "Reflections on the Need to Revise the Bills of Exchange Act — Some Doctrinal Aspects: Panel Discussion" (1981-82), 6 *Can. Bus. L.J.* 269 ("Reflections"), at pp. 308-9; J. S. Ziegel, B. Geva and R. C. C. Cuming, *Commercial and Consumer Transaction: Cases, Text and Materials* (3rd ed. 1995), vol. II, at p. 396, citing J. B. Ames, "The Doctrine of Price v. Neal" (1891), 4 *Harv. L. Rev.* 297, at pp. 297-99). In view of the various interpretations of *Price v. Neal*, I do not accept that it provides a basis for an unqualified rule that a drawee will never have any recourse against either the collecting bank or the payee where payment has been made on the forged signature of the drawer.

32 In Canada, *R. v. Bank of Montreal* is sometimes relied on in support of the principle of finality of payment. Upon closer examination, however, it cannot be said to stand for a hard and fast rule that the drawee is in all circumstances precluded from recovering from the collecting bank. First, the judges in *R. v. Bank of Montreal* who invoked *Price v. Neal* as having endorsed the principle of finality of payment did not discuss the third interpretation of that case. Second, the other judges who wrote in *R. v. Bank of Montreal* took a far more nuanced approach to the problem of the forged signature of the drawer.

33 In *R. v. Bank of Montreal*, the bank had honoured cheques bearing the forged signatures of officers of the Government of Canada. As the Government of Canada had not authorized the payments, it sought to recover the amounts of the forged cheques from the Bank of Montreal. The Bank of Montreal in turn took action against the collecting banks to recover the amounts they had received as a result of the forged cheques. Four different judges wrote reasons. All of them concluded that the drawee, the Bank of Montreal, had to return the funds to the drawer, the Government of Canada. All of them also rejected the claim against the collecting banks, although the reasons they gave cannot easily be categorized.

34 Three of the five judges in *R. v. Bank of Montreal* (Davies, Idington, and Duff JJ.) were of the view that if the position

of a collecting bank is altered, that bank can resist a claim by the drawee. Two of the judges (Davies and Idington JJ.) explicitly rejected Girouard J.'s adoption of the argument, based on *Price v. Neal*, of presumed or actual negligence on the drawee's part and the third (Duff J.) did not pronounce on it. Therefore, to argue that there is a clear rule that the drawee must suffer the loss is not supported by what is labeled as the *fons et origo* of the Canadian precedents on forged instruments. In addition, the fact that the Canadian courts subsequently embraced *Simms* also weakens the finality of payment argument significantly in a case involving payment of an instrument bearing a forged signature.

35 The assessment of the drawee's rights requires a more nuanced enquiry. The principle of finality of payment underlies both the common law rules and the *BEA's* provisions and serves as a general goal, but as laudable as it is, it does not negate rights that may otherwise accrue to a party. It cannot be raised by a payee as an indiscriminate bar to the recovery of a mistaken payment. I agree with Scott, Comment on Reflections, at p. 342, that:

> [N]o very convincing reason can be offered for refusing the drawee relief in the single instance where the mistake involves acceptance or payment on a forged drawer's signature, whilst relief is freely given to the drawee on all *other* acceptances or payments by mistake (including indeed various other kinds of forgeries; even the case where the drawer's own endorsement is forged on a bill payable to his order (s. 129(*b*)) [now s. 128(*b*)].

4.2.2.1.2 Provisions of the BEA

36 On the issue of whether the payor is deemed in law to intend that the payee keep the money, two provisions of the *BEA* warrant comment: ss. 128(*a*) and 165(3). These provisions are relevant in view both of BNS's role as BMP's agent for the purposes of collection on the instrument, and of the special status granted to a bank that receives an unendorsed cheque.

37 Section 128(a) *BEA* reads as follows:

> **128.** [Estoppel] The acceptor of a bill by accepting it is precluded from denying to a holder in due course
>
> (a) the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the bill;

38 In the instant case, the drawee (RBC), in requesting restitution from the collecting bank (BNS), was in fact denying to both the collecting bank and the payee the genuineness of the drawer's signatures. Consequently, the question is whether the payee and the collecting bank were holders in due course and therefore entitled to rely on s. 128(a) *BEA*. I will discuss the payee's situation first, because the collecting bank has a special status which, in this case, is governed by s. 165(3), to which I will turn below.

39 The most common view is that a payee is not, as a general rule, a holder in due course because he or she has not acquired the instrument by way of negotiation (s. 55(1)(*b*) *BEA*). Yet in some factual circumstances, dealings may take place before the payee becomes the holder of the instrument, and some commentators consider that the negotiation requirement needs to be revisited: Geva, Reflections, at pp. 289 ff.; see also *St-Martin Supplies Inc. c. Boucley* (1968), [1969] C.S. 324 (Que. S.C.). This question need not be resolved for the purposes of the present case, however. It is another requirement for qualifying as a holder in due course under s. 55(1)(*b*) *BEA* that is lacking here: BMP did not take the instrument for value, so it was not a holder in due course. Since only a holder in due course can benefit from s. 128(a) *BEA*, even if RBC were deemed — by payment — to have accepted the forged cheque, it would not be precluded from denying to BMP the

genuineness of the drawer's signatures.

40 The other provision that is relevant to RBC's right to recover the money it paid by mistake from BNS is s. 165(3) *BEA*. This provision reads as follows:

> **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.

41 According to this provision, BNS acquired the status of a holder in due course by receiving the cheque from the payee and crediting the amount to the payee's account. Section 165(3) *BEA* deems the collecting bank to be in the same position as a party who has taken the bill free from any defect of title of prior parties. It has the same right as a party who has given consideration. Consequently, it can be argued that if BNS had chosen to do so, it could have refused to transfer to RBC the money it held on account of the fraudulent instrument. However, the question is not whether it could rely on the protection of s. 165(3) *BEA*, but whether it could restore the funds to RBC.

42 Section 165(3) *BEA* has been commented on many times. Parliament was initially criticized for acting at the request of the banking industry without understanding the potentially wide scope of the amendment (see: S. A. Scott, "The Bank is Always Right: Section 165(3) of the Bills of Exchange Act and its Curious Parliamentary History" (1973), 19 *McGill L.J.* 78. Then, following *Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce*, [1996] 3 S.C.R. 727 (S.C.C.), Ogilvie expressed the view in *Bank and Customer Law in Canada*, at p. 295, that the effect of the Court's narrow interpretation of s. 165(3) has been to make the collecting bank the drawer's insurer. The least that can be said is that the interpretation of the scope of s. 165(3) *BEA* is taking shape.

43 No prior case has concerned the effect s. 165(3) *BEA* will have where the deposited instrument bears a forged signature of the drawer. In *Boma*, at para. 43, Iacobucci J. explicitly refrained from discussing the applicability of the defence available to the collecting bank in circumstances where the instrument might be found not to be a bill of exchange. Although I have serious doubts about the soundness of an argument which would deprive the collecting bank of all protection on the basis that the instrument is a sham, not a cheque, I need not discuss it here in view of my position that the collecting bank is not required to rely on the protection potentially afforded by s. 165(3) *BEA*.

44 As Ogilvie clearly points out:

> Section 165(3) is drafted in broad terms, with the obvious policy of protecting a bank from liability in relation to cheques deposited in a customer's account by permitting a bank to presume that it was the drawer's intention that the payee receive the proceeds of the cheque, in complete contrast to the earlier law, where a bank enjoyed no such presumption. [pp. 292-93]

45 Section 165(3) *BEA* affords protection to a bank. The bank is not obligated to rely on this protection when restitution is claimed from it. The payee stands as a third party with respect to the protection. He or she cannot use the bank's shield as a sword against it. The purpose of granting the bank the status of a holder in due course is not to create an entitlement for the payee of a forged instrument. The payee may benefit from defences that are inherent in the rules on mistake of fact, but not

from the protection afforded to a bank by s. 165(3) *BEA*. In other words, if the forged instrument were held to be a bill of exchange, BMP could not argue, for the purposes of the *Simms* test, that BNS was deemed in law to be entitled to receive the funds irrespective of the validity of the drawer's signatures.

4.2.2.1.3 The Service Agreement

46 BMP also argued, and the trial judge agreed, that BNS was not entitled to restrain the funds and transfer them to RBC because the service agreement governing the contractual relationship did not authorize this.

47 Historically, a contract governing a bank account consisted mainly of implied terms: *Bank of Montreal v. Quebec (Attorney General)* (1978), [1979] 1 S.C.R. 565 (S.C.C.), at p. 569 (*per* Pratte J.), citing *Joachimson v. Swiss Bank Corp.*, [1921] 3 K.B. 110 (Eng. C.A.), at p. 117 (*per* Bankes L.J.). Those terms were developed by the common law courts, and some of them were later codified in what is now the *BEA*.

48 Today, most bank account agreements, including the service agreement between BMP and BNS, are standard form contracts. However, terms may still be implied: *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711 (S.C.C.), at pp. 776-77; G. R. Hall, *Canadian Contractual Interpretation Law* (2007), at p. 125. In the instant case, BMP argues that under the service agreement, BNS could charge back only the credits for which it had not received settlement. According to BNS, nothing in the service agreement precluded it from returning the funds to RBC and resisting the claim for damages.

4.2.2.1.3.1 The Provisional Payment Clause

49 The service agreement contains provisions under which amounts may be charged back in certain circumstances. Clause 4.7 reads as follows:

> 4.7 You authorize us to charge the following to any of your accounts, even if they are not specifically designated for the instruction or service:
>
> • the amount you ask us to pay in any instruction
>
> • the amount of any instruction we have paid to you or credited to your account and for which we do not receive settlement for any reason (including fraud, loss or endorsement error) together with all related costs
>
> • payment of any amount you owe us, including fees, charges, costs and expenses.

50 The right to charge back provisional credits when a customer's instruction to collect on a bill cannot be carried out has long been recognized at common law. Clause 4.7 clarifies that right but does not rule out other reversals of credit that are available at common law. Clause 4.7 gives the bank an explicit right to charge back amounts credited to the customer's account if an instrument is not settled. In the context of the service agreement, it is clear that the settlement referred to in this clause is the receipt of the funds through the banking system, and more particularly through the clearing mechanism available to members of the Canadian Payments Association.

51 The trial judge seems to have understood the doctrine of mistake of fact to be limited to provisional credits or, in other words, to situations where the collecting bank has not received the funds. This is not so. As a matter of fact, both the seminal cases of *R. v. Bank of Montreal* and *Royal Bank v. R.*, to which I referred above, concerned forgeries discovered long after the forged cheques had been paid. In *Royal Bank v. R.*, the drawee bank was held to be entitled to claim the amounts of the cheques from the payee, who was also its customer. *Royal Bank v. R.* shows that a bank is not necessarily precluded from claiming funds from the payee long after the instrument has been cleared.

52 The doctrine of mistake of fact is so ingrained in our law that it can be seen as an implied term of the contract. This is even more true in the case at bar, as a clause of the service agreement explicitly provides that BNS retains its rights under "any law". Clause 17.3 reads as follows:

> **17.3** This agreement takes precedence over any other agreement, service request or service materials relating to any instructions or services. However, we retain all our rights under any law respecting loans, set-offs, deposits and banking matters even if they are not described in this agreement.

53 Although the restraint of the funds by BNS could not be based on clause 4.7, since BNS had received settlement from RBC, the contract does not preclude the application of the common law where a payment has been made under a mistake of fact. Rather, the common law is implicitly incorporated, since it does not conflict with the explicit terms of the contract. Thus, clause 4.7 is not a bar to applying the common law to the relationship between BNS and BMP where BNS's role is no longer that of a collecting bank.

4.2.2.1.3.2 The Clearing Rules

54 In concluding that BNS did not have the right to restrain the funds and transfer them to RBC, the trial judge interpreted the service agreement as incorporating the clearing rules of the Canadian Payments Association. Cohen J. held that "the Agreement specifically refers to, and incorporates the time limit set out in the clearing Rules" (para. 292). With respect, I do not agree that the clearing rules are an obstacle to recovery.

55 The clearing rules themselves provide for the survival of the members' common law rights. Clause 1(*b*) of Rule A4 allows a negotiating bank to seek recourse outside the clearing system:

> Nothing in this Rule precludes a Drawee or a Negotiating Institution from exercising its rights and seeking recourse outside of the Clearing.

Moreover, the preamble to the rules contains an express disclaimer of application to third parties:

> Nothing in the Rules shall affect or be interpreted to affect the rights or liabilities of any party to any Payment Item, except as expressly provided in the Rules.

56 It is also recognized in the authorities that the clearing rules apply only to relations between members of the Canadian Payments Association and that they do not create entitlements for third parties. As B. Crawford states in *Payment, Clearing and Settlement in Canada* (2002), vol. 1, at p. 168:

> ... it must be abundantly clear in principle that the ACSS Rules, being internal documents of a corporation, may legitimately govern the relations of the members of the corporation but cannot place burdens on members of the public or bestow benefits on them in connection with their use on the CPA's clearing and settlement system.

57 I agree with the following statement by Evans J.A. in *National Bank of Greece (Canada) v. Bank of Montreal* (2000), [2001] 2 F.C. 288 (Fed. C.A.), at para. 19:

> This system operates only at the level of banking and similar institutions, and ... decisions of the compliance panel have no impact on either the private law rights and duties of banks, their customers, and the payers and payees of cheques, or the remedies available to enforce them.

(See also *Bank of Nova Scotia v. Regent Enterprises Ltd.* (1997), 157 Nfld. & P.E.I.R. 102 (Nfld. C.A.), at para. 38; *Toronto Dominion Bank v. Dauphin Plains Credit Union Ltd.* (1992), 90 D.L.R. (4th) 117 (Man. Q.B.), at p. 121, rev'd on other grounds (1992), 98 D.L.R. (4th) 736 (Man. C.A.), leave to appeal to S.C.C. refused, [1993] 2 S.C.R. vii (S.C.C.).)

58 Finally, I disagree with the trial judge that the service agreement governing the relationship between BNS and BMP incorporated the clearing rules for BMP's benefit. The trial judge based this conclusion on his analysis of clauses 4.1, 4.3, 4.4 (para. 296) and 4.7 (para. 297), as well as on the testimony of the branch manager, who stated: "[The service agreement] uses — That's correct. It used the clearing settlement system." (para. 291) This statement supports the fact that BNS "used" the clearing system. However, it does not mean that the rules were incorporated into the service agreement. Clauses 4.1, 4.3 and 4.4, to which the trial judge referred, read as follows:

> **4.1** You are responsible for settling payment of your instructions. Unless you have made specific arrangements with us, you will ensure that your accounts have sufficient cleared funds to settle any instructions at the time that you give us an instruction. We are not required to settle an instruction if sufficient cleared funds are not available in your account. The reported balances for your account may include amounts which are not cleared funds. Cleared funds means cash or any funds from any deposit which have been finally settled through the clearing system.
>
> **4.3** You acknowledge that we must clear instructions using a clearing system and are bound by the rules of any clearing system we use, including rules for endorsement of instructions, identity of payee and the time for final settlement. These rules affect our ability to honour your request to cancel instructions and the procedures we must follow to settle your instructions and clear funds for you.
>
> **4.4** We reserve the right to clear and transfer instructions by whatever method we choose, whether they are drawn on your account or negotiated by you. You grant us sufficient time to settle all instructions. You acknowledge that we may delay crediting your account until we receive the cleared funds for the instruction.

59 Clause 4.1 is a restatement of the bank's common law obligation to honour its customer's cheques and instructions when the customer has sufficient credit. Under clause 4.3, BMP acknowledged that BNS was bound by the clearing rules. The only consequence of this acknowledgment was that BMP would be precluded from claiming a breach of the agreement if a failure by BNS to honour its instructions was justified by the clearing rules BNS must abide by in dealing with other banks. Clause 4.4 essentially gave BNS three types of rights: (1) to clear instructions in whatever way it chose; (2) to take sufficient time to settle instructions; and (3) to take sufficient time to credit the account. Clause 4.4 was silent as to whether the "credit" ever became a final and irreversible credit to BMP's account. It may be that the restraint of the funds by BNS was based on no express provision, but it is clear that the clearing rules were neither expressly nor implicitly incorporated for BMP's benefit.

60 In summary, the trial judge could not rely on the clearing rules to arrive at the conclusion that BMP had a right to the proceeds of the forged cheque. Consequently, I find that the first answer at the second step of the *Simms* test is that RBC did not intend and is not deemed in law to have intended that BMP receive the funds. Two other enquiries remain: whether consideration was given and whether a change of position occurred.

4.2.2.2 Consideration

61 The question whether BMP has given consideration is easily answered in light of the trial judge's finding of fact that BMP gave no value for the instrument. At the same time, BMP's position that RBC should bear the loss entails an implicit acknowledgment that neither itself nor BNS has given consideration for the instrument.

4.2.2.3 Change of Position

62 The question in the third enquiry is whether the payee has changed its position. In *Simms*, the condition that money cannot be recovered in the event of a change of position was seen to be linked to the defendant's being deprived of an opportunity to give a notice of dishonour. This prompted comments that the defence of change of position is more specific than the label would suggest: Geva, Reflections, at pp. 308 ff. However, leading English commentators on the subject now observe that the law has evolved and may now include defences of change of position that are not related to the *BEA's* notice requirements: Lord Goff and G. Jones, *The Law of Restitution* (6th ed. 2002), at p. 852, see: *Lipkin Gorman v. Karpnale Ltd.*. Similarly, leading Canadian commentators consider that since *Storthoaks (Rural Municipality) v. Mobil Oil Canada Ltd.* (1975), [1976] 2 S.C.R. 147 (S.C.C.), the defence of change of position has been "an established feature of Canadian law of mistaken payments": Maddaugh and McCamus, at p. 10-35, §10:500.10; see also: G. H. L. Fridman, *Restitution* (2nd ed. 1992), at p. 458. I see no reason why the general defence of change of position should not apply to mistaken payments made on forged cheques.

63 To conduct the change of position enquiry, it is necessary to determine whether the payee parted with the funds. In this case, BNS, as the collecting bank, received the funds from RBC for the benefit of the payee, BMP, and credited BMP's account. Once the collecting bank receives the funds from the drawee and credits the payee, its role as a collecting bank is terminated. It then becomes the holder of the funds under its contract with its customer. It is settled law that a customer is a creditor of the bank when he or she deposits funds into an account and that the bank holds these funds as its own until the customer asks for repayment. This principle has gone unquestioned since *Foley v. Hill* (1848), 2 H.L.C. 28, 9 E.R. 1002 (U.K. H.L.). See: *Crawford and Falconbridge: Banking and Bills of Exchange* (8th ed. 1986), vol. 1, at pp. 742-43; Ogilvie, at p. 179.

64 Thus, although BNS's role was changed from that of a collecting bank to that of a borrower, for the purposes of the change of position analysis, it must be concluded that BNS remained the holder of the funds. Moreover, at the time they were restrained, the funds now claimed by BMP were still credited to its account. Therefore neither BNS as the holder of the funds nor the payee had changed its position.

65 In conclusion, BMP had not changed its position and the defence was available neither to it nor to BNS. It is worth noting that cases in which a person who is not a party to the fraud has neither given consideration nor changed its position will be rare. However, that is what has happened here according to the facts found by the trial judge. In these circumstances, all the conditions for recovery of the payment made by mistake are met. Other objections have been made, though, and I will discuss them now.

4.3 Jus Tertii Defence, Self-Help Arguments and Policy Considerations

66 The trial judge found that it was wrong for BNS to transfer the funds to RBC. He was of the view that BNS had favoured a bank to its customer's detriment. In his opinion, BNS was not entitled to exercise any of the rights that could have been exercised by RBC.

67 The *jus tertii* argument the trial judge relied on could be accepted only if RBC had no right to recover the funds from BNS. Only then could BNS be said to have acted in RBC's stead. Since I have concluded that BNS was entitled to give effect to RBC's claim for restitution of the moneys paid under mistake of fact, the *jus tertii* argument fails. This is the result of the application of the law to the highly singular facts of this case.

68 It is worth recalling some of the extremely unusual circumstances of this case: the sale price of the unlicensed distributorship was arrived at by "pulling the number out of the air", the cheque was received without a cover letter, the names of the sender and the drawer of the cheque were unknown, Newman, the purchaser, could not be reached and the payee had given no consideration. The fraud could not be clearer, nor could the origin of the funds. In my view, since the rightful owner had a legitimate claim against the recipient, BNS had no duty to give preference to BMP.

69 The funds received by BNS were RBC's own funds and RBC had no right to be repaid out of First National's account. BNS acted in a way that could have enabled the parties to avoid going through a series of judicial proceedings. This Court's reasoning in *Banque canadienne nationale v. Gingras*, [1977] 2 S.C.R. 554 (S.C.C.), at p. 564, applies with equal force here. BNS asked BMP for support in recovering the proceeds of the forged cheque. BMP insisted on retaining the funds even though it had given no consideration for them and even though the fraud was beyond dispute. In this case, BNS's actions entailed no risk of curtailing the protection from which a holder in due course is entitled to benefit.

70 Furthermore, BMP objected to the joinder of the action RBC had eventually instituted against BMP, which was pending at the time this case was heard. It might have been easier for the trial judge to assess the parties' rights had the two proceedings been joined. In these circumstances, the argument that BNS had exercised a third party right or resorted to a self-help remedy not only sounds hollow and opportunistic, but is procedurally unfounded.

71 I can conceive of no policy consideration that would preclude BNS from responding to RBC's common law right in this case. As I mentioned above, neither *Price v. Neal* nor *R. v. Bank of Montreal* stands for a strict rule that the drawee must in all circumstances bear a loss resulting from a cheque bearing a forged signature of the drawer. There is no rule preventing RBC or BNS from arguing that the payment to BMP was made by mistake. The commentators find no convincing reason to establish an absolute rule against relief in the case of payment on the drawer's forged signature (B. Geva, "Conversion of Unissued Cheques and the Fictitious or Non-Existing Payee — *Borna v. CIBC*" (1997), 28 *Can. Bus. L.J.* 177, at p. 189; Scott, Comment on Reflections, at p. 342).

72 At common law, the principle of finality of payment must be balanced against the right of the owner of the funds to recover money paid under a mistake of fact. The common law affords a defence to an innocent party who has given consideration or changed his or her position. However, the person who is still in possession of the funds is in the best position

to stop the fraud. To preclude means to prevent the continuation of a fraud in order to allow a fraudulent payment to be finalized would be a strange policy. Thus, there is no overarching policy consideration that would bar the payee's bank from resisting a claim based on a signature that has been proven to be forged where the payee has not used the funds and has neither given consideration for them nor changed his or her position.

73 The trial judge was of the view that BMP and the holders of the related accounts had suffered "a loss of their right to demand repayment from the BNS of the BNS' debt to them by reason of the BNS' wrongful charge backs against their respective bank accounts" (para. 423). In my view, BNS was entitled to object that since the cheque was forged, the funds could be and were returned to their rightful owner. The deposit of the forged instrument could not result in a debt to BMP in this case. Therefore, BMP did not lose anything, because the funds had to be returned to RBC. The trial judge's conclusion that BMP had lost the right to demand payment of a debt owed by BNS is erroneous, because the credit entry in the account had been made by mistake.

74 I have found that RBC made a mistaken payment, that nothing precluded it from recovering the funds and that BMP had no defence to the claim. More particularly, BNS was entitled not to raise a defence based on s. 165(3) *BEA*. KBC, in trying to trace the sums it had mistakenly paid, was informed that a portion amounting to over $776,000 was being held by BNS at the time the fraud was discovered. An amount of $350,188.65 was still in BMP's account. BNS also restrained funds in the related accounts. The question the Court must now answer is whether the rules of evidence are a bar to restitution. I will now discuss this issue.

4.4 Right to Claim the Amounts in BMP's Account and to Trace Funds in the Related Accounts

75 Tracing is an identification process. The common law rule is that the claimant must demonstrate that the assets being sought in the hands of the recipient are either the very assets in which the claimant asserts a proprietary right or a substitute for them.

76 In the instant case, RBC's funds were first transferred through the clearing system to BNS in its capacity as collecting bank — and thus as agent — for BMP. BNS then made the entry in BMP's account to reflect the receipt of the funds from RBC. Finally, BMP made withdrawals from its account by way of transfers or cheques for deposit in the related accounts and, in the case of the transactions involving the $300,000 cheque, back to its own account. What is at issue here is a non-specific fund.

77 Under ordinary circumstances, an agent cannot be sued in the principal's stead. However, as stated by Lord Goff and Jones in *The Law of Restitution*, at p. 847, citing *British American Continental Bank v. British Bank for Foreign Trade* (1925), [1926] 1 K.B. 328 (Eng. C.A.),

> where the agent has paid the money over to his principal but has received it back again so that his position is as it was before he paid it over, he must make restitution.

Save for the $100 added to the bank draft, there is no issue of identification of the money in BMP's account. The unchallenged evidence is that it comes from the funds received from RBC. BNS, as agent, received the funds from RBC and, after crediting them to its principal, BMP, received them back under the banking contract. Having received the funds back, BNS had to make restitution to RBC. Therefore, BNS has a valid defence against BMP (see: *Bavins, Junr. & Sims v. London*

& Southwestern Bank Ltd. (1899), [1900] 1 Q.B. 270 (Eng. C.A.)). BNS's status with respect to the funds in the related accounts is different. BNS was not acting as agent of the holders of the related accounts. A review of the rules on tracing will therefore be helpful.

78 It has been accepted that the English case of *Agip (Africa) Ltd. v. Jackson* (1990), [1992] 4 All E.R. 451 (Eng. C.A.) (aff'g (1989), [1992] 4 All E.R. 385 (Eng. Ch. Div.)), has been accepted as setting out rules with respect to tracing of money: *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805 (S.C.C.).

79 According to the Court of Appeal in *Agip*, tracing at law is permitted where a person has received money rightfully claimed by the claimant. Liability is based on mere receipt, and the extent of liability will depend on the amount received (*Agip* (C.A.), at pp. 463-64; *Agip* (Ch.), at p. 399; *Banque Belge pour l'Etranger v. Hambrouck*, [1921] 1 K.B. 321 (Eng. C.A.)). It is sometimes said that funds cannot be traced to bank accounts at common law. This view overstates the rule and fails to take into account the fact that, as an evidentiary process, tracing is possible if identification is possible (see: D. R. Klinck, "'Two Distincts, Division None': Tracing Money into (and out of) Mixed Accounts" (1988), 2 *B.F.L.R.* 147, at p. 148, and L. D. Smith, *The Law of Tracing* (1997), at pp. 183 ff.). Indeed, no statement that tracing is impossible can be found in the case that is most often cited in support of the theory that funds cannot be traced to bank accounts at common law. If Lord Ellenborough C.J.'s comment in *Taylor v. Plumer* (1815), 3 M. & S. 562, 105 E.R. 721 (Eng. K.B.), is read in its entirety, it is clear that tracing is impossible only when the means of ascertainment fail:

> It makes no difference in reason or law into what other form, different from the original, the change may have been made, whether it be into that of promissory notes for the security of the money which was produced by the sale of the goods of the principal, as in *Scott v. Surman*, Willes, 400, or into other merchandize, as in *Whitecomb v. Jacob*, Salk. 160, for the product of or substitute for the original thing still follows the nature of the thing itself, as long as it can be ascertained to be such, and the right only ceases when the means of ascertainment fail, which is the case when the subject is turned into money, and mixed and confounded in a general mass of the same description. The difficulty which arises in such a case is a difficulty of fact and not of law, and the dictum that money has no ear-mark must be understood in the same way; i.e. as predicated only of an undivided and undistinguishable mass of current money.
>
> [Emphasis added; p. 726]

80 That it is possible at common law to trace money to bank accounts is illustrated by the cases of *Hambrouck* and *Agip*. In *Hambrouck*, a man named Hambrouck had fraudulently procured cheques drawn on the Banque Belge pour l'Etranger. He endorsed the cheques and deposited them in his account at Farrow's Bank. The cheques were cleared through the banking system and credited to Hambrouck's account. "*In substance* no other funds were paid into the account than the proceeds of these forged cheques" (Atkin L.J., at p. 331 (emphasis added)). Hambrouck then paid money out of that bank account to a Ms. Spanoghe, with whom he was living. A deposit was made in Ms. Spanoghe's account at the London Joint City and Midland Bank and, according to Atkin L.J., "[n]o other sums were at any time placed to that deposit account" (p. 332). On the basis of those facts, Bankes and Atkin L.JJ. were both of the opinion that the funds could be traced at common law to Ms. Spanoghe's account (pp. 328 and 335-36). Two points drawn from that case are important for our purposes: neither the fact that a cheque is cleared through the banking system before being deposited in the payee's account nor the fact that the payee has mixed the funds with other funds is sufficient to bar recovery at common law.

81 To fully understand the parallel between *Hambrouck* and *Agip*, it is important to follow the sequence of events in the latter case. *In Agip*, the Banque du Sud ("BdS") in Tunis received a payment order of $518,822.92 in favour of Baker Oil. BdS instructed Citibank to debit its account and credit an account at Lloyds Bank. Lloyds Bank credited Baker Oil's account before receiving the funds from Citibank, thereby assuming the delivery risk. The next day, pursuant to instructions from accountants Jackson & Co., who controlled Baker Oil on behalf of their clients, Lloyds Bank transferred the funds to Jackson

& Co.'s account. At the time the credit was entered in Baker Oil's account, there was no other money in the account; however, the balance of Jackson & Co.'s account was US$7,911.80 before the transfer. The Court of Appeal agreed with the trial judge that the mixing of the funds with the amount already in Jackson & Co.'s account was of no consequence and did not preclude tracing (pp. 465-66). In first instance, Millett J., as he then was, had stated in *Agip*, at p. 399:

> A fortiori it can be no defence for [Jackson, a partner of Jackson & Co.] to show that he has so mixed it with his own money that he cannot tell whether he still has it or not. Mixing by the defendant himself must therefore, be distinguished from mixing by a prior recipient. The former is irrelevant, but the latter will destroy the claim for it will prevent proof that the money received by the defendant was the money paid by the plaintiff.
>
> [Emphasis added.]

82 In *Agip*, the time when the fonds the plaintiff sought to trace ceased to be identifiable was when Lloyds Bank made the transfer to Jackson & Co.'s account before receiving the funds from Citibank: even though Lloyds Bank later recouped them, the funds used to make the payment belonged to Lloyds, and BdS's funds had to be traced through the clearing system. On that issue, the Court of Appeal also agreed with Millett, J. and quoted him (at p. 466):

> Unless Lloyds Bank's correspondent bank in New York was also Citibank, this involves tracing the money [BdS's funds] through the accounts of Citibank and Lloyds Bank's correspondent bank with the Federal Reserve Bank where it must have been mixed with other money. The money with which Lloyds Bank was reimbursed cannot therefore, without recourse to equity, be identified as being that of the Banque du Sud.

83 What distinguishes *Agip* from *Hambrouck* is that Lloyds Bank, having assumed the delivery risk, paid with its own money. This broke the link between the funds it paid and the fonds it received from Citibank. If passage through the clearing system could on its own eliminate any possibility of identifying the money, tracing at common law would long ago have become totally obsolete and the dictum of the Court of Appeal in *Agip* that mixing in Jackson & Co.'s account was of no consequence would be of little use. I cannot accept that the result in *Hambrouck* can be explained by an oversight that occurred because the interruption caused by passage through the clearing system was not argued: P. J. Millett, "Tracing the Proceeds of Fraud" (1991), 107 *L.Q. Rev.* 71, at p. 74, fn. 7). When, as in *Agip*, the chain is broken by one of the intervening parties paying from its own funds, identification of the claimant's funds is no longer possible. However, the clearing system should be a neutral factor: P. Birks, "Overview: Tracing, Claiming and Defences", in P. Birks, ed., *Laundering and Tracing* (2003), 289 at pp. 302-5. Indeed, I prefer to assess the traceability of the asset after the clearing process and not see that process as a systematic break in the chain of possession of the funds. Just as the collecting bank receives the funds as the payee's agent, the clearing system is only a payment process. Paying through the clearing system amounts to no more than channelling the funds.

84 In *Hambrouck*, the funds received through the clearing system by Farrow's Bank, acting as the collecting bank, from the Banque Belge pour l'Étranger had not lost their "identity". In the same way, the funds in the case at bar have not lost theirs. BNS, acting as the collecting bank, received the funds from RBC through the clearing system and credited them to BMP. The asset traced by RBC is simply its own. It is not the chose in action or the account holders's personal claim against BNS: R. M. Goode, "The Right to Trace and its Impact in Commercial Transactions — I" (1976), 92 *L.Q. Rev.* 360, at p. 380. The transactions that followed were all conducted by the recipient and persons related to it who received the money from BMP. Moreover, the fact that some of the accounts had prior balances is not a bar to recovery. Not only were the balances not substantial — only one of the accounts contained over $100 — but the withdrawals by the holders significantly exceeded the balances. It is also worth noting that BNS was both the drawee and the payees' banker in all the transactions at issue, namely the transfers and payments from BMP's account and to the related accounts. There was no hiatus like the one in *Agip*, and the holders of the related accounts were not third parties who had given consideration or changed their positions.

85 In my view, *Taylor*, *Agip* and *Hambrouck* show that it is possible at common law to trace funds into bank accounts if it is possible to identify the funds. (See also: Goode, at pp. 378, 390-91 and 395.) According to *Agip* and *Hambrouck*, mixing by the recipient is not a bar to recovery. I do not see those cases as exceptions to a common law rule against tracing in mixed funds. Rather, I accept the view advanced by Lord Millett in *Foskett v. McKeown* (2000), [2001] 1 A.C. 102 (U.K. H.L.), at p. 132, that the rules for tracing money are the same as those for tracing into physical mixtures. This view is also supported by Professor L. D. Smith in his treatise *The Law of Tracing*, at pp. 74 and 194 ff. For our purposes, there is no need to review all the rules applicable to physical mixtures (*Lawrie v. Rathbun* (1876), 38 U.C.Q.B. 255 (Ont. H.C.); *Carter v. Long* (1896), 26 S.C.R. 430 (S.C.C.), at pp. 434-35; J. Ulph, "Retaining Proprietary Rights at Common Law Through Mixtures and Changes", [2001] *L.M.C.L.Q.* 449). Suffice it to say that, as between innocent contributors, contributions are followed first to amounts they have withdrawn. In the case at bar, since the withdrawals of all those who received funds far exceeded their contributions, RBC can trace its own contribution to the balances remaining in the accounts.

86 As Atkin L.J. mentioned in *Hambrouck*, the question to be asked is whether the money deposited in those accounts was "the product of, or substitute for, the original thing" (p. 335). In the instant case, the identification process is quite simple. I will not go back over the issue of the funds in BMP's account: there was no relevant movement of funds. Regarding the funds in the related accounts when BNS acted on BMP's instructions and transferred money to the accounts of 636651 B.C. Ltd., Backman (chequing and savings accounts) and Hashka, the transferred funds were clearly related to the forged cheque BNS had mistakenly credited to BMP's account. The moneys used for the transfers came from BMP's account. The link is made with the funds RBC had used to pay the forged cheque.

87 One issue that was raised is whether certification of the cheques would be a bar to tracing. When a cheque is certified, the certification does not affect the nature of the funds. In discussing the effect of certification in *A.E. LePage Real Estate Services Ltd. v. Rattray Publications Ltd.*, at p. 505, Finlayson J.A. stated that certification of a cheque, like acceptance, is irrevocable; see also *Centrac Inc. v. Canadian Imperial Bank of Commerce* (1994), 21 O.R. (3d) 161 (Ont. C.A.). As a matter of law, to hold that certification is irrevocable would contribute to the acceptability of certified cheques as substitutes for cash and would also reflect the prevailing perception in the business world that it is irrevocable. However, BNS's intention in the instant case was not to revoke the certification. In fact, the certified cheques had already been honoured. As Maddaugh and McCamus point out (at p. 10-57):

> The fact that the drawee bank cannot resist payment on a cheque it has certified does not necessarily insulate the payee, however, from a subsequent restitutionary claim by the paying bank.

88 In *Rattray*, Finlayson J.A. stated that "where a drawee bank honours a cheque notwithstanding a valid countermand and the effect is to satisfy a just debt, the bank may [debit the customer's account and] successfully defend an action by the customer/drawer for reimbursement" (p. 509). Further, where a payment does not satisfy a just debt, the bank "may have an action in restitution against the holder of a certified cheque" (*Ibid*). Indeed, if a bank has certified a cheque, it cannot deny the authenticity of the drawer's signature and the sufficiency of the funds. However, certification does not affect the traceability of the underlying funds.

89 What remains to be discussed is the claim by way of cross-appeal concerning punitive damages.

4.5 Damages

90 The Court of Appeal found that BNS had breached the service agreement by reversing the credit in BMP's account

without having been instructed to do so by BMP. However, it also found that BMP had suffered no real injury and accordingly awarded nominal damages of $1. In addition, it ordered BNS to pay BMP the difference of $100 between the bank draft of November 7, 2001, and the certified cheque of November 2, 2001. BNS does not contest this conclusion. BMP seeks an increase in the damages and Hashka, Backman and 636651 B.C. Ltd. seek an order for damages.

91 In light of my conclusion that BNS could resist BMP's claim on the basis of the doctrine of mistake of fact, it is my view that no additional damages can be awarded. Since RBC could trace the funds with the assistance of BNS, the same reasoning applies to the restraint of funds and the reversal of credits. Therefore, the claim to have the trial judge's award restored fails.

92 BMP also seeks an award of punitive damages. The trial judge rejected this claim, finding that BNS's conduct did not warrant such an award. In view of my conclusions on BNS's right, this claim, too, can only fail.

5. Conclusion

93 Beyond the strangeness of its factual substratum, this case involves an application of the well-established doctrine of mistake of fact to very unusual facts. The business of collecting banks will rarely lend itself to the application of this doctrine because most of the time, the bank will have changed its position, or its customer will have drawn on the credited amount, or the funds will have been mixed in a way that precludes tracing. In this case, however, the application of common law principles leads to a logical conclusion. The Court of Appeal found support for that conclusion in equity and it may be that support can be found there, but the same result can be obtained at common law.

94 The appeal should be dismissed with costs and the Court of Appeal order affirmed. The cross-appeal should be allowed with costs and the awards of damages in favour of 636651 B.C. Ltd., Hashka and Backman set aside, save for the amount of $13.50 payable to Backman, which BNS does not contest.

Appeal dismissed; cross-appeal allowed.

Pourvoi rejeté; pourvoi incident accueilli.

End of Document

TAB 15

CanLII

National Bank of Greece (Canada) v. Bank of Montreal, [2001] 2 FCR 288, 2000 CanLII 16791 (FCA)

Date: 2000-12-13
Docket: A-652-99
Other citations: 268 NR 235; 30 Admin LR (3d) 147; [2000] FCJ No 2070 (QL); 196 FTR 320
Citation: National Bank of Greece (Canada) v. Bank of Montreal, [2001] 2 FCR 288, 2000 CanLII 16791 (FCA), <http://canlii.ca/t/1j1rd> retrieved on 2014-12-30

A-652-99

National Bank of Greece (Canada) (*Appellant/ Applicant*)

v.

Bank of Montreal (*Respondent*)

and

Canadian Payments Association (*Respondent/ Intervener*)

Indexed as: National Bank of Greece (Canada)v. Bank of Montreal (C.A.)

Court of Appeal, Stone, Linden and Evans JJ.A.-- Ottawa, December 13, 2000.

Administrative law -- Judicial review -- Certiorari -- Canadian Payments Association panel ordering appellant to pay to Bank of Montreal (BMO) amount of cheque dishonoured as NSF -- Motions Judge dismissing judicial review application without first considering applicable standard of review -- Standard of review should always be considered by reviewing court before examining administrative tribunal's decision -- Motions Judge should only have asked whether compliance panel's determination BMO suffered "loss" unreasonable -- Did not err in dismissing application -- Panel's conclusion BMO suffered "loss" not unreasonable.

Financial Institutions -- Panel of Canadian Payments Association (CPA) finding National Bank of Greece (Canada) breached Association's Rules in returning into clearing system dishonoured cheque more than day after could have decided whether to honour it -- Motions Judge accepting CPA's argument BMO suffered