

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BONNIE CUMMINGS IN HER CAPACITY AS ESTATE EXECUTRIX
OF THE ESTATE OF THE LATE JOHN CUMMINGS

Applicant

- and -

PEOPLEGE HR SERVICES INC., WINSTON PARK FINANCIAL SERVICES LTD.,
CMC FRASER LTD., 1624452 ONTARIO LIMITED

Respondents

RESPONDING FACTUM
OF DURHAM COLLEGE OF APPLIED ARTS & TECHNOLOGY
(Motion Returnable January 14, 2015)

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AND TO : THE SERVICE LIST

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PART I – OVERVIEW

1. The reality of this motion is that Durham College never “took possession of certain funds [in the Peopledge Canadian Consolidated Account] as alleged by the Receiver. Nor did Durham College exercise a remedy against Peopledge or the Property, as alleged by the Receiver. Upon learning that Peopledge would not be processing Durham College’s payrolls using the funds that Peopledge had electronically debited from Durham College’s bank account, Durham College sought reimbursement of the debited amounts from Durham College’s bank, namely Bank of Montreal (“**BMO**”) Oshawa Branch. BMO complied with its obligations as a processing member under the rules (the “**CPA Rules**”) of the Canadian Payment Association (“**CPA**”) and reimbursed Durham College - from BMO’s own funds. That is where Durham College’s

involvement in the matters complained of by the Receiver ended. After that; (i) the CPA Rules, which bind BMO as payor CPA member and bind Peopledge's bank, also BMO (Burlington branch) as sponsor payee CPA member, governed the rights and obligations of BMO as payee member and Peopledge's sponsor, and (ii) the banker-customer relationship between BMO and Peopledge governed the lawful actions taken by BMO with respect to the Consolidated Canadian Account.

2. Durham College availed itself of protections that exist between itself and its own bank under the CPA regime. Durham College did not exercise any right or remedy against the "Property" as so broadly defined in the Receivership Order. It is self-evident that Durham College had no legal or practical ability to reach into Peopledge's bank account and remove or "take possession" of Peopledge's funds - and such allegations by the Receiver are misleading and factually wrong. Only two parties can affect the amounts reflected in the BMO Peopledge Consolidated Canadian Account: Peopledge itself, and BMO. The Receiver wishes those were not the facts. But they are.

3. The Receiver would like this motion to not be about the legal regime governing automatic funds transfer ("AFT", sometimes called electronic funds transfer ("EFT")) transactions made through CPA member institutions under the CPA Rules. The Receiver would also like this motion to not involve the banker-customer relationship between Peopledge and its own bank that governs the Canadian Consolidated Account. Unfortunately for the Receiver, these matters are precisely what this motion is about.

PART II – THE FACTS

4. Durham College was established in 1967 as a result of Ontario Provincial legislation to establish colleges of applied arts and technology across the Province. Durham College is a non-profit organization funded in part by tuitions, donations and in part by the Government of

Ontario. In October 2010, Durham College entered into a Master Services Agreement with Peopledge for the provision of payroll services (the “**Master Services Agreement**”)¹.

5. Pursuant to the Master Services Agreement, Durham College appointed Peopledge as its agent for purposes of processing three Durham College payrolls². After confirming the amount of an upcoming payroll with Durham College, Peopledge would initiate the electronic funds transfer debit request to request the withdrawal of the payroll funds from Durham College’s account, by making an AFT debit request through Peopledge’s Bank (BMO Burlington), to Durham College’s Bank (BMO Oshawa), all in accordance with the CPA Rules which are specifically referenced in section 3 of the Payor Preauthorized Debit Agreement which forms an appendix to the Master Services Agreement³.

6. The Cummings Affidavit and BDO Canada Pre-filing Report filed in support of the receivership application are both dated October 24, 2012. As of October 25, 2012, Durham College had no monies on hand with Peopledge whatsoever⁴. Absent the post-October 24 conduct by Peopledge in contemplation of the *ex parte* receivership application herein, Durham College would have had no financial involvement in the Peopledge receivership proceedings. The Staff Payroll AFT debit request which is the subject matter of this motion was initiated by someone at Peopledge on October 26, 2012 for what Durham College understood was a scheduled October 30, 2012 Durham College Staff Payroll - a Payroll that as of October 24, 2012 at the latest, the Applicant, Peopledge and the prospective receiver never intended to make⁵.

7. The \$256,536 amount disputed in this motion relates to the Canada Revenue Agency, Canada Pension Plan, Employment Insurance, Workers Compensation Board and Employer Health Tax remittances relating to the Durham College October 30, 2012 Staff Payroll. In the days following the Receivership Order, Durham college utilized the \$256,328 (the \$208

¹ Affidavit of Barbara MacCheyne Sworn November 21, 2014 (“**MacCheyne Affidavit**”), paragraphs 4, 5; Respondent’s Motion Record, Tab 1

² MacCheyne Affidavit, Exhibit A, (section 2 thereof), Respondent’s Motion Record Tab A

³ MacCheyne Affidavit, Paragraph 12, Respondent’s Motion Record Tab 1

⁴ MacCheyne Affidavit, Paragraph 26, Respondent’s Motion Record Tab 1

⁵ MacCheyne Affidavit, Paragraphs 9 and 10, Respondent’s Motion Record Tab 1

difference was Peopledge's fee, which was paid by Durham College to the Receiver) to pay the Government remittance amounts relating to the October 30, 2012 Staff Payroll⁶.

8. As of October 25, 2012, Durham College had no monies on hand with Peopledge, as all prior payrolls and government remittances had been made by Peopledge in accordance with the Master Services Agreement. As a result, the justifications alleged by the Applicant and the Receiver in their October 24 materials for bringing the receivership application on an *ex parte* basis had no application whatsoever to Durham College and were indeed wholly misleading and wrong in fact. Instead, had Durham College been properly served with the receivership application materials, Durham College would have been able to take steps to prevent the flow of future payroll monies into the Peopledge Consolidated Canadian Account. Such non-disclosure by Peopledge and its advisors directly and materially prejudiced Durham College in a manner that should have been brought to the Court's attention at the time of the receivership application, given its *ex parte* nature and the disclosure obligations attendant therewith.

9. The CPA Rules bind BMO as a direct clearer member institution. The PAD Agreement and the Letter of Undertaking are the agreements under which Peopledge and Durham College agreed to conduct themselves in accordance with and be bound by the CPA Rules. As set out below, the CPA Rules relating to AFT transactions are obligations of the two CPA member banks (or one bank wearing two CPA processing member hats, in the case of Peopledge/Durham College). In particular, the obligation to reimburse the payor of an improper preauthorized debit transaction is an obligation of the payor CPA member, who in turn is entitled to reimbursement under the CPA Rules from the payee CPA member - from the member's own funds. In other words, the CPA Rules buck stops with the payee CPA member institution.

10. The extent to which a PAD payee's bank decides to give the payee access to the requested debit amounts (i.e.; as a credit to the payee's account without a hold or other restriction), while the bank remains exposed to the risks of non-settlement and rejection under the CPA Rules is a credit risk decision that is entirely up to the payee's bank.

⁶ MacCheyne Affidavit, Paragraph 18, Respondent's Motion Record Tab 1

11. If Peopledge did have access to “value” in its Consolidated Canadian Account, that value was in reality credit advanced to Peopledge by BMO as PAD payee bank until the applicable conditional periods under the CPA Rules expired and BMO’s institutional exposure to the risk of an AFT non settlement or rejection came to an end.

PART III – THE ISSUES

Peopledge Breached the Master Services Agreement and PAD Agreement

12. Under section 2 of the Master Services Agreement, Peopledge was appointed as Durham College’s agent for the performance of payroll services. As Durham College’s agent, Peopledge was given the authority to deal with Durham College’s property (i.e.: its payroll monies) solely for the purpose of extinguishing Durham College’s liabilities to its employees and taxation authorities. While in control of those funds, Peopledge was in a position which gave it the practical ability to improperly utilize Durham College’s property for other unauthorized purposes, for its own benefit or the benefit of third parties. Mr. Justice Newbould at paragraph 19 of his May 15, 2013 decision in these proceedings⁷ concluded that the Canadian Consolidated Account should be treated as a trust for the Canadian Customers who advanced payroll deposits to Peopledge.

13. As Agent and Trustee of the Canadian Consolidated Account containing Durham College’s funds, Peopledge and its principals were at all times fiduciaries to Durham College. As a fiduciary, Peopledge had an obligation to make a full disclosure of all material circumstances relating to the performance (or intended non-performance) of its obligations to Durham College. The duty to disclose requires a disclosure of everything which to the agent’s knowledge might affect the principal’s judgment⁸.

14. It is against this background that Bonnie Cummings, together with Peopledge’s advisors embarked on a course of conduct specifically designed to entrap funds of third parties by concealing the decision to put Peopledge into receivership, obtain a stay, and to terminate the

⁷ *Cummings Estate v Peopledge et al.*, (2013) O.N.S.C. 2781 at para 19; Respondent’s Book of Authorities, Tab 1

⁸ *Canadian Agency Law* (2Ed), Carl Fridman, Lexis Nexis, 2012, at page 114; Respondent’s Book of Authorities, Tab 2

provision of Payroll services, while at the same time actively debiting funds from customers' accounts with the knowledge that those funds would never be used for the purposes specifically intended by the agency and trust relationship.

15. As of October 25, 2102, Durham College has no funds whatsoever on deposit with Peopledge⁹. Between October 24 and 26, while Peopledge was preparing for these receivership proceedings, it continued to misrepresent itself to Durham College by submitting a payroll fund summary to Durham College for the Staff Payroll that Peopledge at the time knew it would not be processing, in order to induce Durham College to approve the summary which would entitle Peopledge to implement the pre-authorized debit from Durham College's bank account.

16. The Receiver's contention in paragraph 22 of the Supplement to the Fifth Report that it legally possible (and somehow appropriate) for some members of a 19 employee company to be carrying on business "in the ordinary course" vis a vis the outside world, while the directing minds of the corporation embark on a process wholly to the opposite effect, is simply wrong at law, contrary to common sense, and does not justify the manner in which these proceedings unfolded.

17. By proceeding to debit Durham College's bank account at the time when its directing mind and controlling shareholder had implemented the steps necessary to proceed to terminate payroll services to Durham College, Peopledge breached PAD Agreement and breached its Master Services Agreement with Durham College. In furtherance of its breaches, Peopledge and its advisors concealed the proposed receivership from Durham College with the specific purpose and intention of preventing Durham College from protecting its own financial interests by not authorizing the debiting of future payroll funds for the benefit of the receivership and for the ultimate benefit of parties other than Durham College.

⁹ MacCheyne Affidavit, paragraph 26

The Peopledge Letter of Undertaking

18. The PAD Agreement states that it is provided in consideration of the Financial Institution (BMO as Peopledge's bank) agreeing to process pre-authorized debits in accordance with the CPA Rules. In furtherance of those Rules, Peopledge entered into the required Payee Letter of Undertaking¹⁰ (the "**Peopledge LOU**") required by section 7 of CPA Rule H1¹¹. The Peopledge LOU states that Peopledge agrees to initiate PAD strictly in accordance with the payor's PAD Agreement signed by each payor (section 3(b)) and that Peopledge agrees to comply with, respect and apply the CPA Rules (section 1). In section 1(e) of the Peopledge LOU, Peopledge agreed to indemnify BMO against, and pay all claims made against BMO under the CPA Rules or otherwise and in respect of any disputed PADs.

19. While the CPA Rules apply only to member institutions, an AFT transaction may only be effected through a CPA Member institution, and a payee can bind itself to those Rules by contract with its sponsor member¹² - which Peopledge in this case has clearly done.

Pre-authorized Debit Transactions under the CPA Rules Generally.

20. AFT pre-authorized debit transactions in Canada are, in actuality a series of separate transactions involving four parties. Those parties are: (i) the PAD initiating payee, in this case, Peopledge; (ii) the payee's CPA member bank, in this case BMO (Burlington); (iii) the payor's CPA member bank, in this case also BMO (Oshawa), and (iv) the payor, in this case Durham College.¹³

21. To initiate the PAD transaction process, the payee submits an electronically formatted AFT debit request to its bank. Under the CPA Rules, the payee bank is the CPA member with primary responsibility for compliance with the CPA Rules and is often referred to as the

¹⁰ MacCheyne Affidavit, Exhibit C

¹¹ Canadian Payment Association Rule H1; Respondent's Book of Authorities, Tab 3

¹² Bradley Crawford, *The Law of Banking and Payments in Canada*, page 15-7 ("**Crawford**"), Respondents Book of Authorities Tab 4

¹³ *A Guide to Credit Risk in Payment Systems Owned and Operated by the CPA*; CPA Publication 2005 ("**CPA Risk Guide**"), page 34 Respondent's Book of Authorities Tab 5, and Crawford, page 15-7

“Sponsor Member”¹⁴. The payee bank transmits the AFT Debit request to: (i) the payor bank, to be processed against the payor’s bank account; and (ii) the automated clearing and settlement system (“ACSS”) maintained by the CPA for the clearing and settlement of electronic transactions between CPA member institutions, including member institutions and themselves when acting as payee member and sponsor member. Those transactions are bundled with the thousands of other AFT transactions effected through members’ clearing accounts maintained with the Bank of Canada and are settled as between CPA member institutions on the business day following the due date of the AFT transaction (CPA Rule F4-3(d))¹⁵.

22. As a result of the operation of this CPA Rule, the PAD debit request that was transmitted by Peopledge on October 26, 2012 (a Friday) had not yet cleared and settled by 12:01am October 29, 2012 (a Monday, which was the operative time of the Receivership Order herein, and paragraph 27(e) of the Receiver’s factum is factually incorrect.

23. Generally, concurrent with that process, the payee bank will provisionally credit the payee’s bank account with the amount of the AFT debit request. The provisional crediting by the payee bank is a discretionary credit risk decision on the part of the payee bank and takes into account the payee bank’s Member obligations under the CPA Rules and recognizes that there are prescribed conditions in the CPA Rules that apply to the AFT transfer that may result in the payee bank being obligated under the CPA Rules to refund the AFT amount to the payor bank through the ACSS¹⁶.

24. After receiving the inter-bank debit request from the payee bank, the payor bank provisionally debits the amount of the Debit Request from the payor’s bank account. The payor bank similarly enters the amount of the debit that it owes to the payee bank into the ACSS for clearing and settlement on the next business day under Rule F4-3(d). Until the inter-member debts are cleared, there is a debt owing by the payor bank in favour of the payee bank, waiting to be settled and cleared through the ACSS. The clearing satisfies and discharges the debt owing by the payor bank to the payee bank.

¹⁴ Crawford, page 15-6

¹⁵ CPA Rule F4-3(d), Respondent’s Book of Authorities Tab 6

¹⁶ CPA Risk Guide, page 36, Respondent’s Book of Authorities, Tab 5

25. Similarly when an EFT Debit Request is rejected by the payor in compliance with the timelines and procedures contained the CPA Rules, the CPA Rules obligate the payor's member to refund the amount of the debit request into the payor's bank account from the bank's own funds¹⁷. At that point, the payor's own involvement in the AFT rejection process is at an end. Under the CPA Rules the payor bank then submits an electronic file into the ACSS to recover the rejected EFT amount from the payee bank through the ACSS clearing process the next business day. The obligation to repay the rejected amount to the payor bank is the personal obligation of the payee bank and under the CPA Rules it must credit the payor bank by the next business day.

26. The refund obligation is a personal obligation of the sponsor payee bank. Because it is the payee bank's personal obligation under the CPA Rules to reimburse the payor bank from its own institutional funds on deposit with the Bank of Canada, it is wholly irrelevant if there is a positive balance in the payee's bank account with the payee bank at the time. Even if the payee's account is at \$0 or in overdraft, the refund obligation of the payee bank remains and must be satisfied by it in favour of the payor bank. This fact alone is a complete answer to the Receiver's motion herein.

27. After the inter-bank reimbursement under the CPA Rules, the payee bank must rely on its own bargained for rights and remedies against the payee to recover the amount of the rejected AFT debit. CPA Sponsor Members bear a number of risks as processors of AFT transactions including settlement risk (i.e. the risk that the payor's account with the payor institution has been closed or is NSF) and similarly the rejection risk prescribed by the CPA Rules (i.e. the risk that the payee bank will be required under the CPA Rules to reimburse the payor bank during the applicable improper PAD rejection period (i.e. 10 days under CPA Rule H1 s. 20(a)(ii).)¹⁸

28. In other words, while the payee member institution remains at personal risk under the CPA Rules, the decision to allow a customer to draw on amounts credited to its account is in fact a credit decision of the member institution recognizing that those amounts may not ultimately be

¹⁷ Crawford, page 15-19, Respondent's Book of Authorities Tab 4

¹⁸ CPA Rule H1, section 20(a)(ii), Respondent's Book of Authorities Tab 3

recoverable from the payee if the debited amount is required to be reimbursed by the sponsor member to the payor member bank.

29. It is this lawful step (i.e.; BMO debiting the Consolidated Canadian Account) taken by BMO that the Peopledge Receiver is actually complaining about in this motion. Unfortunately for the Receiver, the law of the banker customer relationship relating to deposit accounts is not helpful to the Receiver.

The Legal Nature of a Bank Deposit (i.e.: the Canadian Consolidated Account)

30. It is well established and followed law in Canada that all funds received by a bank for deposit to the account of a customer become the property of the Bank.¹⁹ It is similarly well established law that a balance shown in a bank deposit account is a simple contract debt owing by the bank to its customer²⁰. Both of these propositions were established by the House of Lords in 1848 in the seminal case of *Foley v Hill*²¹ and have been faithfully quoted by Canadian Courts at all levels ever since, including by the Supreme Court of Canada in 2009 in *B.M.P. v. Bank of Nova Scotia*²². The bank's customer in turn acquires a property interest in the debt of the bank owing to it, in the nature of an account receivable²³.

31. On October 29, 2012, as BMO became required to reimburse each of the payor members in respect of each of the 12 Peopledge Customers who sought reimbursement of their improper Peopledge PADs, BMO rightfully reflected the fact that it no longer owed Peopledge those PAD amounts (as recorded debits) to the Canadian Customer Account. In other words, the Peopledge account receivable owing by BMO got smaller.

32. Had the Applicant and the prospective Receiver recognized the impact of the CPA Rules, they should have been aware that there was a 10 day prescribed window for PAD reimbursement claims under Rule H1-20(a)(ii) and that Peopledge's bank as sponsor payee member would be obligated to comply with those reimbursement claims from the payor member institutions. In

¹⁹ Crawford, page 9-67, Respondent's Book of Authorities, Tab 7

²⁰ Crawford, page 9-68, Respondent's Book of Authorities, Tab 7

²¹ *Foley v Hill* (1848), 2 H.L.C 28, 9 E.R. 1002, at 1005-6, Respondent's Book of Authorities, Tab 8

²² *BMP v Bank of Nova Scotia* [2009] 1 S.C.R. 504 at p. 536, para 63, Respondent's Book of Authorities, Tab 9

²³ Crawford, page 9-70, Respondent's Book of Authorities, Tab 7

hindsight it would appear that the Applicant and its advisors were unaware of the impact of the CPA Rules and the fact that after BMO complied with those reimbursement obligations, based on the principles in *Foley v Hill* and the indemnity contained in the Peopledge LOU, the account between BMO and Peopledge would be reduced by the amounts so reimbursed.

PART IV – ORDER REQUESTED

33. Durham College asks that this Honourable Court dismiss the Receiver's motion, with costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 8th day of January, 2015.

A handwritten signature in black ink, appearing to read 'Edmond F.B. Lamek', with a long horizontal flourish extending to the right.

EDMOND F.B. LAMEK

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SCHEDULE “A” – LIST OF AUTHORITIES

1. *Cummings Estate v Peopledge et al.*, (2013) O.N.S.C. 2781
2. *Canadian Agency Law* (2ed), Carl Fridman, Lexis Nexis, 2012
3. Canadian Payment Association Rule H1
4. *The Law of Banking and Payments in Canada (Loose-leaf)*, Bradley Crawford, Canada Law Book, currency October 2014 (“**Crawford**”); pages 15-1 to 15-26.2
5. *A Guide to Credit Risk in Payment Systems Owned and Operated by the CPA*; CPA Publication 2005, pages 1-49
6. Canadian Payment Association Rule F4
7. Crawford, Pages 9-66 to 9-70.2
8. *Foley v Hill* (1848), 2 H.L.C 28, 9 E.R. 1002
9. *BMP v Bank of Nova Scotia* [2009] 1 S.C.R. 504

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