

# The Presentment and Collection of Cheques in Canada

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## I. INTRODUCTION

In 1972, there were 1.12 billion cheques drawn on deposit accounts of the chartered banks in Canada.<sup>1</sup> This excludes some 150 million Government of Canada items amounting to a payment exchange of over one billion dollars. In the United States, there were 21 billion cheques processed in 1969 and the volume of cheques is expanding at an annual rate of seven to nine per cent.<sup>2</sup> An indication of the proliferation and popularity of the cheque as a medium of payment is the fact that the number of cheques issued by Canadians averaged twenty-two per person in 1950 compared to fifty-one per person in 1972.<sup>3</sup>

The cheque has supplanted currency as the accepted form of payment for the transfer of assets and the discharge of obligations.<sup>4</sup>

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<sup>1</sup> The Canadian Bankers' Association, *Chartered Banks of Canada Factbook* (1973), 8, 9. This amount does not include "cheques" or orders written on the "near-banks" such as credit unions and trust companies that offer chequing services to their customers. Such instruments, however, are collected and paid through the normal bank clearing machinery and help account for the fact that over four million payment instruments are cleared through the chartered banks in Canada every business day.

<sup>2</sup> J. J. Clarke, H. J. Bailey, and R. Young, *Bank Deposits and Collections*, Uniform Commercial Code Practice Handbook 3, 4th ed. (1972), 237. In 1965, commercial banks in the U.S. processed more than seventy million items every day and this figure is increasing by approximately 7% each year; J. J. Clarke, *Check-Out Time for Checks* (1966) 83 *Banking L.J.* 847, 848-850.

<sup>3</sup> *Supra*, note 1, 8.

<sup>4</sup> One might think that the institution of bank credit cards such as Chargex and Mastercharge have and will reduce the increasing volume of cheques written in Canada, but so far there is no real evidence to support that proposition. Indeed, the swirl of paper between bank, merchant, and consumer is increased because transactions once paid for in cash are now paid for by credit card. Furthermore, the customer normally pays his monthly balance by cheque.

In an effort to limit the scope of this article, no attempt to discuss computerized payments systems or other electronic systems designed to

The reasons for the acceptance of the cheque as a popular medium of exchange are, *inter alia*: The relative security and ease of using a cheque; the availability of a wide range of banking services to attract deposits; and the general promotion of chequing services by banks and other financial institutions; the willingness of merchants to accept cheques; the use of cancelled cheques as evidence of payment; and a growing population accompanied by increasing affluence and use of credit.

In order to keep up with the burgeoning amount of cheques that have to be processed for collection,<sup>5</sup> banks have been hard-pressed to develop new methods and technology for handling and collection to ensure the prompt collection and payment of cheques. Fortunately, banks have managed to keep the payments system operating efficiently through reliance on automated and electronic equipment. Less fortunately, the law has not kept pace with the development of the modern system of deposit and collection of cheques, and in this context, the chartered banks in Canada have had to operate for the most part in a legal vacuum. Moreover, banks have had to work out their own inter-bank agreements regarding the mechanics of cheque processing and clearing,<sup>6</sup> so that the collection process could function in an orderly and efficient fashion despite the inadequacies of the law resulting from anachronistic

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reduce the flow of paper will be made. Nevertheless, examination of the following non-exhaustive list of articles on the subject might prove enlightening to the interested reader: Law Reform Commission of Canada, Study Paper, *The Canadian Payment System and Computers: Issues for Law Reform* (1974); H. Eddy, *Impact of the Computer on the Canadian Payment System*, Law Reform Commission of Canada, May 1973; G. T. Dunne, *Variations On A Theme by Parkinson or Some Proposals for the Uniform Commercial Code and the Checkless Society* (1965-66) 75 Yale L.J. 788; J. J. Clarke, *Mechanized Check Collection* (1959) 14 Bus. Law. 989; *The Bank-Customer Relationship In An Electronic Credit Transfer System* (1971) 2 Rutgers J. Computers & Law 1; P. E. Homrighausen, *One Large Step Toward Less-Check: The California Automated Clearing House System* (1973) 28 Bus. Law. 1143; Clarke, Bailey, and Young, *Bank Deposits and Collections*, *supra*, note 2, 237, ch.12, "New Banking Practices".

<sup>5</sup> Four out of five of all cheques drawn are deposited in one bank for collection and must travel through the clearing house machinery for presentment and payment; Clarke, Bailey and Young, *supra*, note 2.

<sup>6</sup> The Canadian Bankers' Association, comprising all the chartered banks in Canada, is an association incorporated by *An Act to incorporate the Canadian Bankers' Association*, S.C. 1900, 63-64 Vict., c.93. Among the powers of the Association is that conferred by s.7 of the statute to establish clearing houses and rules and regulations for the operation thereof. The Association has adopted such rules and regulations in its by-laws.

legislation such as the *Bills of Exchange Act*<sup>7</sup> and uninformed judicial thinking. The *Bills of Exchange Act*, indeed, gives only cursory treatment to the cheque.<sup>8</sup> While the cheque has become the nation's primary negotiable instrument for commercial purposes, the Act, as its title suggests, concerns for the most part that relatively rare creature of twentieth century commerce, the bill of exchange.

Despite a legal framework that often reflects the day of the bank runner and stage coach, when the volume of business was negligible compared with today, the payments system has been able to function thanks mainly to the efforts of the banks, and to a large degree the honesty of their customers. In the United States, a study by the Federal Reserve Bank indicates that approximately 99½% of the dollar value of all collection items are good.<sup>9</sup>

If the system of bank deposits and collection is running quite well in Canada in spite of the inadequacies of the law, why should one bother to discuss law reform in this area? Legislative reform is needed in order to give the payments system a clear and uniform legal framework in which to operate and also to provide just and fair legal guidelines for the bank/customer relationship as it relates to the deposit and collection of cheques.

## II. PRESENTMENT OF CHEQUES FOR PAYMENT — THE BILLS OF EXCHANGE ACT AND THE CASES

Presentment for payment is one of the acts required by a holder of a bill of exchange if he desires to enforce his right of recourse against other parties liable on a bill. The other general duties of a holder may include presentment for acceptance, giving notice of dishonour, and protest. Since there is no acceptor on a cheque, presentment for acceptance is not required by the holder.<sup>10</sup> The Act defines a cheque as a bill of exchange drawn on a bank, payable on demand.<sup>11</sup> Thus all the sections of the Act concerning bills of

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<sup>7</sup> R.S.C. 1970, c.B-5 (hereinafter referred to as the Act).

<sup>8</sup> *Ibid.* See especially Part III of the Act, "Cheques On A Bank", ss.165-175. Ss.168-175 deal with crossed cheques, a practice common in the U.K. but unheard of now in Canada. As provided by s.165(2), however, the other provisions of the Act applicable to a bill of exchange payable on demand apply to a cheque, save where they are inconsistent with Part III.

<sup>9</sup> D. J. Rapson, *Article 4 — Bank Deposits And Collections* (1962) 17 Rutgers L.Rev. 79, 80.

<sup>10</sup> Ss. 75-84 of the *Bills of Exchange Act*, *supra*, note 7, dealing with Presentment for Acceptance are therefore not relevant.

<sup>11</sup> *Ibid.*, s.165(1).

exchange, including sections 85 to 95 dealing with presentment for payment, apply to cheques unless otherwise expressly provided in Part III of the Act dealing with "Cheques on A Bank".

It is extremely important that the holder should present a cheque for payment promptly: Firstly, in order to guard against discharge of the parties liable on the cheque; secondly, to guard against revocation of the drawee bank's authority and duty to pay, for example, when the account is closed or overdrawn, or the bank has received notification of the customer's death or insolvency, or there is countermand of payment.

### 1. Discharge of the parties

Presentment of a bill must be duly made by the holder, otherwise the drawer and endorsers will be discharged,<sup>12</sup> unless circumstances are such that under the Act presentment is unnecessary<sup>13</sup> or dispensed with.<sup>14</sup> If there is no due presentment of a bill of exchange, a drawer or endorser is discharged from the statutory duty imposed by section 130(a) that he

... engages that on due presentment it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder or any endorser who is compelled to pay it, if the requisite proceedings on dishonour are duly taken.

#### (a) *Endorser*

A cheque (being a bill of exchange payable on demand) is duly presented for payment for the purpose of affixing liability on an endorser if by section 86(1)(b) it is presented within a reasonable

<sup>12</sup> *Ibid.*, s.85(1) and (2).

<sup>13</sup> Presentment is unnecessary under the circumstances set out in ss.82 and 96(3) of the Act, which relate only to situations where there has been dishonour by non-acceptance. These sections therefore have no relevance to cheques.

<sup>14</sup> S.92(1) sets out the circumstances in which presentment is dispensed with under the Act. For example, where, after the exercise of reasonable diligence, presentment, as required by the Act, cannot be effected; where the drawee is a fictitious person; as regards the drawer, where the drawee is not bound, as between himself and the drawer, to pay the bill, and the drawer has no reason to believe that the bill would be paid if presented; as regards an endorser, where the bill was made for the accommodation of that endorser, and he has no reason to expect that the bill would be paid if presented; by waiver of presentment, express or implied.

Note, the distinction between making presentment unnecessary and dispensing with it is that notice of dishonour and protest are still required when presentment is dispensed with under s.92(1), whereas such is not the case when presentment is made unnecessary.

time after its endorsement. In determining what is a reasonable time within the meaning of the section, attention is to be paid to "the nature of the bill, the usage of the trade with regard to similar bills and the facts of the particular case".<sup>15</sup> With regard to a cheque, what constitutes a reasonable time may well be a shorter period than what is a reasonable time for presentment of a bill or note. The rationale behind this distinction is that a cheque is generally not intended for circulation (as an instrument of credit) but rather for prompt payment.<sup>16</sup>

(b) *Drawers*

The drawer of a cheque is placed in a different legal position from a drawer of a bill of exchange or promissory note by virtue of section 166 of the Act.<sup>17</sup> The effect of section 166(1)(a) is that a drawer of a cheque will only be discharged to the extent of the actual damage he suffers through the failure of the holder to present the cheque for payment within a reasonable time. Apart from this, the drawer is normally liable on the cheque for six years — the usual period of limitation.<sup>17a</sup>

Section 166(1)(b) states that if the drawer is discharged under 166(1)(a), the holder shall stand in the same position as the drawer as creditor of the bank to the extent of the amount the drawer was discharged. This is tantamount to giving an assignment of the drawer's charge or debt against the bank as creditor, a clear deviation from the general rule of section 127 that a bill does not operate as an assignment of the funds held by the drawee bank. The only event readily envisaged under section 166 where the drawer will become

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<sup>15</sup> *Supra*, note 7, s.86(2).

<sup>16</sup> See *Down v. Halling* (1825) 4 B. & C. 330; 107 E.R. 1082, 1083 where Bayley J. said: "Now a cheque is intended for immediate payment, and not for circulation". See also the judgment of Middleton J. in *Harris Abattoir Co. v. Maybee & Wilson and Boyd* (1914) 31 O.L.R. 453, 457: "From these authorities it appears that because a cheque is intended for payment and not for general circulation, the time allowed for presentation will not be enlarged by transfer or by successive transfers ... ." This rationale for prompt presentment is also enunciated in two American cases: *Keenan v. McClure* 252 N.W. 204 (1934) and *Millett v. Miller* 280 N.W. 442 (1938), to the effect that cheques are not designed for circulation as a medium of exchange and the holder should present a cheque and demand payment with dispatch and diligence consistent with the circumstances of the case and the usual method of business transactions.

<sup>17</sup> The holder of a bill of exchange or promissory note payable on demand must by s.86(1)(b) present it for payment within a reasonable time after its issue in order to render the drawer liable.

<sup>17a</sup> *E.g.*, *The Limitations Act*, R.S.O. 1970, c.246, s.45(1)(g).

a creditor of the drawee bank for a larger amount than would have been the case had the cheque been presented on time and paid, is the failure of the drawee bank. The possibility of that event occurring today is hopefully very remote, and the likelihood that a drawer will have the occasion to rely on section 166 equally unlikely.<sup>17b</sup>

What is a reasonable time for presentment for the purposes of section 166 is determined according to section 166(2), having regard to "the nature of the instrument, the usage of trade and of banks, and the facts of the particular case". By section 91, however, "delay in making presentment is excused when the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct or negligence".

One anomaly regarding the discharge of the drawer on a cheque arises from the legal distinction between a cheque written on a bank and a "cheque" written on a financial institution such as a trust company or credit union. Under the Act, a "cheque" written on one of these financial institutions is not a cheque within the definition of section 165(1), but is a bill of exchange payable on demand. Briefly, the reasoning behind this view is that the Act defines a cheque as a bill of exchange, payable on demand and drawn on a bank,<sup>17c</sup> and a bank is defined in section 2 as "an incorporated bank or savings bank carrying on business in Canada". Clearly the "near-banks" do not fall within the definition of bank and therefore the "cheques" they provide for customers are not cheques<sup>18</sup> for the purposes of

<sup>17b</sup> Other possible situations covered by s.166 are sequestration by an authority or the suspension of operations due to the outbreak of war. An example of this latter situation is *Arab Bank Ltd v. Barclays Bank* [1954] A.C. 495.

<sup>17c</sup> *Supra*, note 7, s.165(1).

<sup>18</sup> See e.g., *Collings v. Calgary* (1917) 55 S.C.R. 406; *Rogers v. Calgary Brewing & Malting Co.* (1918) 56 S.C.R. 165; *Kilburn v. Co-op Centre Credit Union Ltd* [1973] 1 W.W.R. 757 (Alta S.C.); and s.189 of the Act, added by R.S.C. 1970, c.4 (1st supp.), s.1, which defines the concept of a consumer bill. S.189(1)(d) defines such instruments as bills of exchange and not cheques:

- "189. (1) A consumer bill is a bill of exchange
- (a) issued in respect of a consumer purchase, and
  - (b) on which the purchaser or any one signing to accommodate him is liable as a party, but does not include
  - (c) a cheque that is dated the date of its issue or prior thereto, or at the time it is issued is post-dated not more than thirty days,
  - or
  - (d) a bill of exchange that
    - (i) would be a cheque within the meaning of section 165 but for the fact that the party on which it is drawn is a financial institution,

Part III of the Act. As a result, section 166 has no application to such instruments. Thus a drawer on such an instrument may be completely discharged from liability, regardless of the extent of loss, if the bill is not presented within a reasonable time.<sup>19</sup>

This result is anomalous and unfair because whether a customer banks at a chartered bank or a credit union is often purely fortuitous. Moreover, the "cheques" written on "near-banks" are treated virtually in the same manner commercially and for clearing purposes as cheques written on banks.

## 2. What is a reasonable time for presentment?

### (a) *To maintain liability against endorsers*

The leading case concerning a reasonable time for presentment to affix liability on an endorser of a cheque is *Bank of British North America v. Haslip*, *Bank of British North America v. Elliott*.<sup>20</sup> The judgment of the Court in these two actions, which were heard together, was given by MacLaren J.A.<sup>21</sup> The actions involved two cheques drawn by the firm of Maybee and Wilson on the Standard Bank of Toronto, one dated the 30<sup>th</sup> of September, 1913 to the order of the defendant Haslip, and the other dated the 15<sup>th</sup> of October to the order of the defendant Elliott. Both cheques were endorsed and negotiated to the plaintiff bank on the morning of October 1<sup>st</sup>. The plaintiff bank proceeded to present the cheques for collection through the clearing house on the morning of October

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*other than a bank, that as part of its business accepts money on deposit from members of the public and honours any such bill of exchange directed to be paid out of any such deposit to the extent of the amount of such deposit, and*

(ii) is dated the date of its issue or prior thereto, or at the time it is issued is post-dated not more than thirty days." (emphasis added)

On the other hand, the proposition that such an instrument is a cheque by the common law and governed by the law merchant was enunciated in *Winnipeg Trustee v. Kenny* [1924] 1 D.L.R. 952 (Man. K.B.) and referred to in *Provincial Bank v. Bellefleur* [1936] 1 D.L.R. 795 (N.B. Co. Ct). By the common law, however, if a cheque was not presented within a reasonable time and the drawer suffered actual damage by the delay, the drawer was completely discharged. See, e.g., *Alexander v. Burchfield* (1842) 135 E.R. 431; *Robinson v. Hawksford* (1846) 9 Q.B. 52, 115 E.R. 1195.

<sup>19</sup> S.86(1)(b) of the Act, or even by the common law, see cases cited, *ibid*.

<sup>20</sup> (1914) 31 O.L.R. 442, aff'g 30 O.L.R. 299 (C.A.) (hereinafter referred to as *Haslip*).

<sup>21</sup> The late Mr Justice MacLaren was also author of *Bills, Notes and Cheques* (see the 6th ed., edited by F. Read, 1940).

2nd. The representatives of the Standard Bank on the afternoon of the 2nd took the cheques to the head office of that bank where they remained until the morning of the 3rd when they were eventually delivered to the drawee branch on which they were written and subsequently dishonoured for insufficient funds.

The plaintiff-appellant bank sued the defendants for breach of their statutory duty that as endorsers they warranted that on due presentment the cheques would be paid according to their tenor. Plaintiff's counsel also argued that Rule 12 of the Toronto clearing house allowed the drawee bank an additional day for presentment and that the defendants were bound by this custom of the trade with regard to cheques. Defendant's counsel argued that: a) presentment was not within a reasonable time and that by sections 85 and 86 of the Act the defendants were absolutely discharged; and b) the rule of the clearing house was not a custom that bound the defendants.

MacLaren J.A., held that the defendants were discharged because the cheques were not presented for payment within a reasonable time after their endorsement.

The learned Judge begins by saying that for the purpose of section 86 what is a reasonable time is a question of mixed law and fact. By section 70, when a demand bill is deemed to be overdue, what is a reasonable time is stated by the Act to be a question of fact, but section 86 contains no such provision. Moreover, by virtue of section 10<sup>22</sup> and the existence of well-established common law rules as to what is a reasonable time for presentment of demand bills, it is clear to MacLaren J.A. that these provisions were not meant to be overruled. He also points out that in section 166(2), in considering what is a reasonable time for presenting a cheque with reference to the liability of the drawer, regard is to be had to the usage of banks, whereas section 86(2) has no such provision. In spite of this, he nevertheless goes on to give specific reasons why the clearing house rule in question could not be given effect in the particular circumstances, one of these reasons being that the evidence fell short of proving that the rule had become a usage of the trade within section 86(2). This tacitly suggests that section 86(2) *does* incorporate the test of bank usage.

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<sup>22</sup> S.10 states that:

"The rules of the common law of England, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, apply to bills of exchange, promissory notes, and cheques."



MacLaren J.A. continues by setting out the common law rules relating to what constitutes timely presentment. Firstly, if the person who receives a cheque and the bank on which it is drawn are in the same place, the cheque must, in the absence of special circumstances, be presented for payment on the day after it is received. Secondly, if the person who receives a cheque and the bank on whom it is drawn are in different places, the cheque must, in the absence of special circumstances, be forwarded for presentment on the day after it is received, and the agent to whom it is forwarded must, in like manner, present it or forward it on the day after he receives it. Thirdly, the endorsement or delivery of the cheque to others does not extend the time for presentment against prior endorsers.<sup>23</sup>

The plaintiff had argued that the Toronto clearing house rules allowed an extra day for the drawee to take the cheque to the branch on which it was drawn. McLaren J.A. rejected this argument. The evidence fell short of proving that the rule had become a custom of the trade. It was "in no sense a usage of the trade within the meaning of section 86, which must be known, certain, uniform, reasonable, and not contrary to law".<sup>24</sup> Moreover, the evidence did not show that the defendants knew of the clearing house or of the plaintiff's membership therein, and much less were they to be presumed to have contracted with reference to the said rule. Additionally, the rule was not a rule of the Canadian Bankers' Association, who have parliamentary authority to establish clearing house rules in their by-laws, subject to approval by the federal Treasury Board.<sup>24a</sup> Lastly, a clearing house rule could not be determinative of what was a reasonable time for presentment of cheques, that power residing solely in Parliament.<sup>24b</sup>

McLaren J.A. thus gave judicial assent in Canada to the old common law "one-day" rule for presentment, despite the usage of clearing houses. By application of this strict rule, a cheque received on Monday by the payee and cashed at his bank on Tuesday, but not presented through the clearing house until Wednesday, would technically not be presented within a reasonable time for the purpose of affixing liability on the endorser. In light of modern collection conditions and machinery, the validity of such an antiquated rule

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<sup>23</sup> *Supra*, note 20, 447.

<sup>24</sup> *Ibid.*, 450.

<sup>24a</sup> *An Act to incorporate the Canadian Bankers' Association*, *supra*, note 6.

<sup>24b</sup> *British North America Act, 1867*, 30-31 Vict., c.3, s.91(15).

is highly dubious. MacLaren J.A. places great stress on the fact that the cheques were allowed to lie at the head office of the drawee bank for twenty-four hours, when the drawee branch was only three or four blocks away. There is no doubt that geographic proximity was an important factor in determining what was a reasonable time for presentment in this case.<sup>25</sup> It is submitted that given the volume of cheques in the collection system today and the reliance on automated clearing machinery, the distance between banks should be irrelevant in determining what is a reasonable time for presentment.

However, geographical proximity was also a determining factor in the case of *Harris Abattoir Co. v. Maybee & Wilson and Boyd*,<sup>26</sup> which arose out of the same circumstances as the *Haslip*<sup>27</sup> case. A cheque was drawn by M. W. on September 29<sup>th</sup> on the Standard Bank, payable to Boyd. Boyd endorsed and negotiated the cheque to the plaintiff company on the afternoon of the 29<sup>th</sup>. The plaintiff company, on the same afternoon, deposited the cheque to its credit at a branch of the Commerce Bank. Through various delays in the process of clearing, the cheque was not presented for payment at the branch of the drawee bank until October 3<sup>rd</sup>, at which time there were not sufficient funds in the drawer's account to pay for it. The cheque was subsequently dishonoured. The plaintiff company brought an action against Boyd as endorser of the cheque.

At first instance, Middleton J. held that Boyd was discharged on the cheque for failure of the plaintiff to present it within a reasonable time after his endorsement. The learned Judge invoked the "one-day" rule, citing *Boddington v. Schlenker*<sup>28</sup> as authority, where Parke J. stated that "[t]here is no doubt that the receiver of a cheque has till the close of banking hours on the following day to present it".<sup>29</sup> Although Middleton J. adopted the common law "one-day" rule for presentment he was at least prepared to acknowledge the usage of the clearing house for presentment of cheques:

From these authorities it appears that, because a cheque is intended for payment and not for general circulation, the time allowed for presentation

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<sup>25</sup> *Supra*, note 23, 447 and 452 where MacLaren J.A. cites a remark of Lord Mansfield in *Tindal v. Brown* (1786) 1 T.R. 167, 168, 99 E.R. 1033, 1034, that the fact that all parties lived within twenty minutes walk of each other was to be taken into account in deciding what was reasonable.

<sup>26</sup> (1914) 31 O.L.R. 453.

<sup>27</sup> *Supra*, note 20.

<sup>28</sup> (1833) 4 B. & Ad. 752, 110 E.R. 639.

<sup>29</sup> *Ibid.*, 759.

will not be enlarged by transfer or by successive transfers; and, *although the usage of trade fully sanctioned the deposit by the endorsee of the cheque in his own bank, and the use of the machinery of the clearing house for the presentation of the cheque*, this does not justify an extension of time which is in fact unreasonable. There was no reason in this case why the cheque in question should not have been at the market branch of the Standard Bank on the 31st. I am not called upon to say that a delay to the 1st October would have been unreasonable. What I determine is that a failure to present until the 3rd was unreasonable.<sup>30</sup>

Thus, while Middleton J. recognized the custom of collecting cheques through the clearing house, he insisted that such custom does not sanction an unreasonable delay having regard to the facts of the case, such as the geographical proximity of the banks in question.<sup>31</sup> Nonetheless it is inconceivable that a collecting bank that handles thousands of cheques every day is going to have time to determine if it should send a particular cheque through its normal clearing operations or send a messenger to collect on it personally. Such a course of action would be impractical and financially prohibitive. Even in 1913 geographical proximity should have been an irrelevant factor in determining timely presentment.

Another Canadian decision that also seems to place more emphasis on geographic distance rather than bank clearing usage in determining what is a reasonable time for presentment *vis-à-vis*

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<sup>30</sup> *Supra*, note 26, 457 (emphasis added).

<sup>31</sup> *Ibid.*, 455 where Middleton J. emphasizes the short distances between banks and the effect this should have on determining a reasonable time: "The facts of this case are that the cheque was endorsed in the office of the abattoir company, a few yards from the office of the Standard Bank, market branch, upon which it was drawn. It was deposited in the market branch of the Bank of Commerce, which is within a few yards of the other two offices. There was no physical difficulty in the way of the cheque being presented for payment at once."

MacLaren J.A., affirmed the judgment of Middleton J., on appeal and equally stressed the fact of distance: "Here the bank on which the cheque was drawn was not more than one hundred yards from the office of the plaintiff company, where it was negotiated; and it is not reasonable that it should have taken from the 29th September to the 3rd October to reach its destination." (at 460) MacLaren J.A. also rejected the argument of plaintiff's counsel that Boyd should be presumed to have contracted with reference to the custom of presenting cheques through the clearing house. The learned Judge merely stated that the case of *Firth v. Brooks* (1861) 4 L.T.N.S. 467, cited by counsel in support of his argument, did not in fact do so. Although the case upheld the propriety of sending a cheque for collection through the London County Clearing House, it still affirmed the "one-day" presentment rule; (at 460). See also *Sterling Bank v. Laughlin* (1912) 1 D.L.R. 383.

the liability of endorsers is *Provincial Bank v. Bellefleur*.<sup>32</sup> In this case, the defendant in New Brunswick endorsed a cheque drawn on a trust company in Maine (about one mile over the St John River from the plaintiff bank). The cheque was issued on February 28th, 1933 and made payable to the defendant. The plaintiff bank received the cheque from the defendant on the same day and credited it to an overdue note of the defendant. They then endorsed the cheque and mailed it to their Boston correspondent bank. It was not until March 4th that it was presented to the trust company in Maine. The trust company however had suspended operations before presentment was made.

In determining that the cheque was not presented with proper diligence and that the defendant was therefore discharged from liability, the Court considered the factors set out by section 86(2) of the Act which should be taken into account when determining a reasonable time for the purposes of section 86(1)(b). On the facts it was held that no real evidence existed of a trading or banking usage with respect to the method of collection adopted by the bank. The geographic proximity made out a *prima facie* case for lack of due diligence on the plaintiff's part. Instead of sending a messenger across the river into the U.S. to present for payment, the plaintiff bank elected to send the cheque on a circuitous 700-mile trip. This method of collection did not meet the test of common sense and ordinary business prudence.

Clearly, in view of the heavy volume of cheque collections today and the reliance on bank clearing procedures, the wisdom of the "one-day" rule is thrown into serious doubt. It is virtually inconceivable for a payee to present his cheques for payment personally at the drawee bank the day after receipt, and it is equally inconceivable for a collecting bank to adopt a practice of presenting cheques by messenger because of the geographic proximity of the drawee bank. Today, the normal route a cheque takes for collection is the following: The payee deposits the cheque in his own bank for collection. In smaller centres, the collecting bank gives provisional credit to the customer and then sends the cheque to the clearing house where it is delivered to the drawee's clerk and then taken to the drawee bank for payment and verification. In the larger centres, the cheque first goes to a data centre of the collecting bank for processing, following which exchanges of debits and credits are made by the representatives of the banks at the clearing house;

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<sup>32</sup> *Supra*, note 18.

then, the cheque is delivered to the data centre of the drawee bank, from where it is delivered to the drawee bank for final verification. It is only with this last step that the payment becomes absolute and the provisional credits given during clearance become finalized.<sup>33</sup> The average time to route a cheque through the collection system is two or three days, and involves two or more banks. But the total elapsed time from initial deposit to final payment is often considerably greater, depending on the circumstances.<sup>34</sup> To require earlier presentment is to ignore the almost universal usage of the clearing system. Legislative amendment is not, however, required to overcome the anachronistic judicial thinking embodied in the "one-day" rule. Section 86(2) of the Act provides built-in flexibility for the recognition of prevailing usages and customs and for taking into account any particular facts that may extend or limit the time considered to be reasonable for presentment.

On the other hand, adherence to a "one-day" presentment rule for establishing the liability of endorsers rather than drawers may lead to a more just result. While placing the loss on a bank *vis-à-vis* an endorser where the facts are such as in *Haslip*<sup>35</sup> might be a better result because the bank is in a better position to bear the loss on a bad cheque, in most cases, the collecting bank acts merely as an agent for collection for the payee, against whom they retain the right of charge-back.<sup>36</sup> Moreover, such a rule runs at cross-purposes to one of the fundamental principles of negotiability on which the Act is formulated, *i.e.*, an endorser guarantees to a subsequent holder or endorsee that the cheque will be honoured.

With our existing legislation, it is up to the courts to recognize the pervasiveness and necessity of the bank collection system. A drawer or endorser should not be entitled to any higher degree of diligence in presentment than that achieved by compliance with customary commercial practices, unless the practices are patently unreasonable.

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<sup>33</sup> See text, *infra*, Part III.

<sup>34</sup> Clarke, Bailey and Young, *supra*, note 2, 237-38.

<sup>35</sup> *Supra*, note 20.

<sup>36</sup> The issue of whether a collecting bank is acting as an agent for collection or as a holder for value in its own right is discussed in D. Cowen, *The Law of Negotiable Instruments in South Africa* 4th ed. by D. Cowen and L. Gering (1966), 429. The question is basically one of fact and normally comes down to the decision whether there was an express or implied agreement that the payee could draw against uncollected funds. If there is such an agreement, the bank is a holder for value and not an agent for collection.

(b) *To maintain liability against drawers*

The common law "one-day" rule for prompt presentment applied to the discharge of the drawer as well as endorsers.<sup>37</sup> Chalmers<sup>38</sup> indicates, however, that section 166(2) has placed the "one-day" rule in limbo because a reasonable time *vis-à-vis* drawers is now a question of mercantile practice. Falconbridge states that the earlier cases should be considered subject to the statutory recognition of the custom of bankers.<sup>39</sup> This proposition is reinforced in the Quebec case of *Lajambe v. St Hilaire*.<sup>40</sup>

In that case a cheque issued by the defendant on August 16<sup>th</sup>, 1923 drawn on the Home Bank in favour of the plaintiff, was delivered to the plaintiff's office on the same day. The plaintiff was absent and did not return until August 18<sup>th</sup> at which time he went to deposit the cheque in his bank but did not do so when he learned that the Home Bank had closed its doors on the afternoon of the 17<sup>th</sup>. The defendant argued that the cheque was not presented within a reasonable time. It was held: a) that there was enough evidence to prove that it was the usage of businessmen to collect cheques by depositing them in their own bank and having presentment made through the clearing house; b) that the "one-day" rule for presentment, although it has been followed in Canadian jurisprudence, is subordinate to section 166(2) of the *Bills of Exchange Act* which states that the usage of trade and banks and the facts of the case must be considered in determining what is a reasonable time for presentment within the meaning of section 166; c) that the usage authorized presentment through the clearing house, but if this had been done, the deposit according to the "one-day" rule would not have been made until the 17<sup>th</sup>, the day after it was received. The cheque therefore could not have been presented through the clearing house until the 18<sup>th</sup> and by that time the Home Bank had suspended operations; d) that even prompt presentment, following the custom and usage of presentment through the clearing house, would have been useless, and therefore the defendant was not relieved from his liability on the cheque.<sup>41</sup>

Although the case implies that a payee should deposit a cheque for collection the day after receipt, it recognizes the custom of

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<sup>37</sup> *Chalmers on Bills of Exchange* 13th ed. by D.A.L. Smout (1964), 252-3.

<sup>38</sup> *Ibid.*, 253.

<sup>39</sup> *Falconbridge on Banking and Bills of Exchange* 7th ed. by A. W. Rogers (1969), 868.

<sup>40</sup> (1924) 30 R.L.N.S. 447.

<sup>41</sup> *Ibid.*, 449.

presentment through the clearing house and overcomes the "one-day" presentment rule, at least for the purposes of determining discharge of the drawer under section 166. The courts are provided with a flexible test in section 166(2) for determining a reasonable time and are enjoined to give recognition to the custom and usage of collection and the facts of the case. The *Lajambe* case<sup>42</sup> followed the test sensibly.

There are other cases concerning what is an unreasonable time for presentment in connection with discharging a drawer in the event of bank failure under section 166 and where the drawer suffers actual loss. It was held in *Gunsolly v. Engstrom*<sup>43</sup> that a delay of thirteen days from constructive receipt of the cheque on August 4<sup>th</sup>, 1924 until its deposit for collection on August 17<sup>th</sup> was unreasonable, the drawee bank having suspended operations on August 17<sup>th</sup>. In *La Banque Jacques-Cartier v. La Corporation de Limoilou*,<sup>44</sup> a cheque issued on July 11<sup>th</sup>, 1895 and not presented for payment until the 16<sup>th</sup>, by which time the drawee bank (Banque du Peuple) had failed, was held not to have been presented within a reasonable time. Another ground for the decision was that the plaintiff/holder had had the cheque certified, and certification by the holder amounted to payment of the cheque and the substitution of the bank's liability for that of the drawer. In another Quebec case,<sup>45</sup> one day's delay was said to be unreasonable in view of the known facts that the drawee bank was in difficulty and that the suspension of operations was very likely. In view of the particular facts of the case, the holder had a duty to act with special vigilance and celerity.<sup>46</sup>

From one point of view, it is difficult to see a justification for the cases concerning endorsers<sup>47</sup> adhering to the "one-day" presentment rule and essentially ignoring clearing house usage, while in a case involving the discharge of a drawer the rule is held to be subservient to clearing house usage. MacLaren J.A. in *Haslip*<sup>48</sup> implied that the difference lay in the different wording of sections 86(2) and

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<sup>42</sup> *Ibid.*

<sup>43</sup> (1924) 2 W.W.R. 382 (Alta C.A.).

<sup>44</sup> (1899) 17 C.S. 211.

<sup>45</sup> *Légaré v. Arcand* (1895) 9 C.S. 122.

<sup>46</sup> The actual ground for decision in this case was that because the holder had the cheque certified on the day of receipt, rather than presenting it for payment when it would have been paid, the certification amounted to discharge of the drawer's liability.

<sup>47</sup> See *Haslip*, *supra*, note 20, and *Harris Abattoir Co. v. Maybee & Wilson and Boyd*, *supra*, note 16.

<sup>48</sup> *Supra*, note 20, 447.

166(2), *i.e.*, the fact that section 166(2) includes reference to usage of banks and section 86(2) does not. Yet as pointed out above, the learned Judge tacitly took the position that section 86(2) *did* intend a reference to bank usage.<sup>49</sup> Moreover, Meredith J. in *Maybee & Wilson* recognized that “usage of the trade” in section 86(2) necessarily involved the usage of banks and clearing house procedures.<sup>50</sup> Therefore, it would appear that the different wording between the two sections does not result in a different meaning. Indeed, it is submitted that it would be wrong to suggest that “usage of trade with regard to similar bills” in section 86(2) would not include reference to the practice of collection.

Nonetheless, as already suggested, there does seem to be some good sense about discharging an endorser in a shorter period of time than the drawer. The drawer is the one who issues the cheque in the first place, he is the one principally liable on the instrument and should be expected to stand behind a cheque for a longer period of time than an endorser who merely receives the instrument and passes it on by negotiation. Even if this difference is recognized, however, it cannot justify Canadian courts adhering to a “one-day” rule of presentment for affixing liability on an endorser and disregarding the fact that normal collection through a clearing house will take from two to three days. This is particularly absurd in view of the fact that the courts are willing to recognize the practice in the unlikely situation of discharge of the drawer in the event of bank failure as envisaged under section 166.<sup>50a</sup>

### 3. Revocation of the drawee bank's authority and duty to pay

It is imperative that a holder should present a cheque promptly for payment not only to avoid discharge of the parties liable on a cheque, but also to guard against determination of the bank's authority and duty to pay a cheque drawn by its customer. Section 167 of the Act states that:

The duty and authority of a bank to pay a cheque drawn on it by its customer, are determined by

- (a) countermand of payment;
- (b) notice of the customer's death.

The circumstances determining the bank's authority and duty to pay set out in section 167 are by no means exhaustive. Such authority

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<sup>49</sup> *Ibid.*, 449.

<sup>50</sup> *Supra*, note 16, 457.

<sup>50a</sup> See *supra*, note 17b.



and duty may also be curtailed on notice of the customer's insolvency or insanity, on the winding up of a corporate customer,<sup>51</sup> or by court order.<sup>52</sup> Moreover, the holder should guard against the possibility of the account being overdrawn or closed, in which case he may have to resort to the courts to recover from the drawer. Finally, the holder should be aware of the practice of banks not to pay "stale-dated" cheques<sup>53</sup> without inquiry.

(a) *Countermand of payment*

Countermand or stop-payment of a cheque terminates the bank's duty to pay and substitutes a duty to refuse payment.<sup>54</sup> To be effective, the countermand must come to the conscious knowledge of the bank, constructive knowledge being unknown in mercantile matters.<sup>55</sup> The countermand must also be made by or on behalf of the drawer, must reach the drawee bank before the cheque is paid, and refer unequivocally and unambiguously to the cheque in question.<sup>56</sup> When a cheque is countermanded, the holder has no right against the bank to demand payment but if he has duly presented the cheque and given notice of dishonour, he can proceed against the drawer and endorsers on the cheque.

(b) *Notice of the customer's death*

Actual knowledge of the customer's death, however acquired, terminates the banker's authority and duty to pay, formal notice being unnecessary.<sup>57</sup> No specific form of notice is necessary, but mere rumour would probably not be sufficient for the bank to act upon, although any fairly reliable information such as an an-

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<sup>51</sup> *Paget's Law of Banking* 8th ed. by M. Megrah and F. R. Ryder (1972), 316-17.

<sup>52</sup> Cowen, *supra*, note 36, 418.

<sup>53</sup> Generally banks consider a cheque to be "stale" that is presented after a six month or one year period; Paget, *supra*, note 51, 222 and 302-3. In Canada, the period is six months, see *infra*, note 66.

<sup>54</sup> Cowen, *supra*, note 36, 416.

<sup>55</sup> Paget, *supra*, note 51, 313.

<sup>56</sup> Cowen, *supra*, note 36, 416 citing the English cases of *Westminster Bank v. Hilton* (1926) 43 T.L.R. 124 (H.L.); and *Curtice v. London & City Midland Bank* [1908] 1 K.B. 293. See also the recent Canadian cases of *Giordano v. Royal Bank of Canada* (1973) 38 D.L.R. (3d) 191 (Ont.C.A.); and *Capital Associates Ltd v. Royal Bank of Canada* (1973) 36 D.L.R. (3d) 579 (Que.C.A.).

<sup>57</sup> Cowen, *ibid.*, 417. See also the Canadian case of *Kendrick v. Dominion Bank* (1920) 47 O.L.R. 372.

nouncement in a responsible newspaper could not be safely disregarded.<sup>58</sup>

(c) *Notice of the customer's insanity*

It is suggested by Paget that if the customer becomes mentally disordered, the banker should not honour his cheques. If the state of the customer's mind is such that he does not know what he is doing, he can give no mandate and any existing mandate is revoked. However, the mandate remains operative as long as the banker has no knowledge and no reason to suspect the situation.<sup>59</sup>

(d) *Notice of the customer's insolvency*

If a bank has notice of a customer's insolvency, the bank's duty and authority to pay are terminated. In Canada, section 56 of the *Bankruptcy Act*<sup>60</sup> governs the situation:

Where a banker has ascertained that a person having an account with him is an undischarged bankrupt, it is his duty forthwith to inform the trustee of the existence of the account, and thereafter he shall not make any payments out of the account, except under an order of the court or in accordance with instructions from the trustee, unless upon the expiration of one month from the date of giving the information no instructions have been received from the trustee.

(e) *Stale-dated cheques*

Banking custom generally regards a cheque in circulation for over six months as "stale" and a bank will not normally pay such a cheque without consulting the drawer if this is at all possible. It is to be noted that a bill payable on demand is deemed to be overdue when it appears to have been in circulation for an unreasonable length of time.<sup>61</sup> The consequence is that the cheque can only be transferred subject to existing equities, or in other words, one cannot be a holder in due course if one receives an overdue cheque.

The concept of the stale-dated cheque is reflected in bank clearing agreements. The chartered banks in Canada have agreed that a drawee bank may return unpaid a cheque over six months old.<sup>62</sup>

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<sup>58</sup> Paget, *supra*, note 51, 315.

<sup>59</sup> *Ibid.*

<sup>60</sup> R.S.C. 1970, c.B-3.

<sup>61</sup> *Bills of Exchange Act, supra*, note 7, s.70(2).

<sup>62</sup> The Royal Bank of Canada, *Interbank Procedures and Standards* (1973) (containing material taken from the by-laws of the Canadian Bankers' Association); s.1 D (3), Circular B9-05-05: "An item dated more than six

Whether a bank will face an action by the drawer in damages for wrongful dishonour, for having returned a stale-dated cheque, has not yet been decided by Canadian courts.<sup>63</sup> It is clear, however, that the drawer will not be discharged on the cheque because it is not presented until it is "stale".<sup>64</sup>

### III. THE COLLECTION OF CHEQUES THROUGH CANADIAN BANK CLEARING MACHINERY

The collection system in Canada is operated by the Canadian Bankers' Association, an organization of the chartered banks in Canada incorporated by Parliament in 1900.<sup>65</sup> Section 7 of the incorporating statute confers on the Association the power to set up clearing houses in Canada and to make rules and regulations for the operation of such clearing houses.<sup>66</sup> The Association has adopted in article 24 of its by-laws rules and regulations respecting clearing houses.<sup>67</sup>

Historically, the idea of a clearing house originated in France during the Middle Ages, and early clearing operations took place at the great fairs.<sup>68</sup> The birthplace of the modern clearing house, however, was London: Clerks would go from bank to bank in order to collect and present cheques and other items. Eventually, the clerks began to meet at public-houses to exchange cheques in an attempt to avoid the needless journey around the city to other banks. The

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months prior to the date of receipt by the drawee branch bank may be returned for the reason "Stale Dated".

<sup>63</sup> See Cowen, *supra*, note 36 on the subject of damages for wrongful dishonour, 394-416; and Paget, *supra*, note 51, 302-3.

<sup>64</sup> The drawer's liability lasts for six years on the cheque except for a s.166 situation.

<sup>65</sup> *Supra*, note 6.

<sup>66</sup> *Ibid.*; s.7 reads:

"1. The Association may from time to time establish in any place in Canada a clearing house for banks, and make rules and regulations for the operations of such clearing house: Provided always, that no bank shall be or become a member of such clearing house except with its own consent, and a bank may after becoming such member at any time withdraw therefrom.

2. All banks, whether members of the Association or not, shall have an equal voice in making from time to time the rules and regulations for the clearing house; but no such rule or regulation shall have any force or effect until approved of by the Treasury Board."

<sup>67</sup> *Supra*, note 39, 384.

<sup>68</sup> F. R. Andrews, *The Operation Of The City Clearing House* (1942) 51 Yale L.J. 582, 584.

next step was to simplify matters still further by appointing two or three of the clerks to deal with all the paper. This arrangement was formalized in 1805, when a committee of bankers "promulgated a set of rules for the clearing procedure, and in 1821 a permanent committee was appointed to assume the management of the clearing house".<sup>69</sup> Finally, a permanent clearing house was erected in 1833.<sup>70</sup>

Today, the following steps are normally taken for the simple deposit and collection of a cheque:

1. The payee deposits the cheque in his own bank (the collecting bank).
2. The bank gives its customer provisional credit pending collection of payment of the cheque by the drawee bank.
3. The collecting bank prepares the cheques for machine processing by encoding in magnetic ink the dollar amount of the cheque.<sup>71</sup>
4. The collecting bank sorts the cheques. If the cheque is an "on-us" item (drawn upon the same bank where deposited) internal processing completes the transfer of the amount of the cheque from the drawer's account to that of the payee. If the cheque is drawn on another bank (which is normally the case) the cheque usually goes through the clearing house process.
5. In the larger Canadian centres,<sup>72</sup> the cheques are processed and sorted at a data centre of the collecting bank. The bank then prepares cash letters, deposit tickets or computer printed

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<sup>69</sup> *Ibid.*, 584-85.

<sup>70</sup> *Ibid.*, 585.

<sup>71</sup> Magnetic Ink Character Recognition (MICR) encoding is a method of printing coded information on a cheque so that it can be processed automatically by machine. The bottom half inch or so of a cheque is reserved for MICR encoding. The transit number fields include: a) on the far left a field encoded with the identifying code of the drawee bank; b) the middle transit field identifies the drawer's account number; c) the field on the right indicates the amount, this last field being placed on the cheque by the first negotiating bank. The legal problems encountered by MICR encoding of cheques such as underencoding, overencoding, the "scratched-out" cheque and the "ricocheting" cheque are discussed in Clarke, Bailey and Young, *supra*, note 2, 145-154.

<sup>72</sup> The regional settlement points of the Bank of Canada are at Halifax, Saint John, Quebec, Montreal, Ottawa, Toronto, Winnipeg, Regina, Calgary, and Vancouver and these centres are therefore the sites of the larger clearing houses in Canada. See *Interbank Procedures and Standards*, *supra*, note 62, 1A(2), Circular B9-05-02. Clearing procedures differ at regional points, compared with the local or non-regional settlement points.

lists for each category sorted, showing the total dollar amount of the cheques involved.

6. One or more representatives of the bank are then sent to the clearing house where they exchange debit and credit amounts with representatives from the other member clearing banks.<sup>73</sup>
7. A list of the final balances due to or by each member is given to the local agency of the Bank of Canada and written direction is given to that agency for communication to the Bank of Canada where debits or credits are made to the members' accounts in Ottawa.
8. The cheques themselves (if not exchanged at the clearing house, and evidently this is not the practice at the larger centres) are delivered to the data centre of the drawee bank from where they are sent to the actual branch on which they were drawn.
9. The drawee bank on which the cheque was drawn verifies it. If it is an N.S.F. cheque, or there is a stop-payment on it, or it is a forgery, the drawee bank does not pay the cheque and it must be returned within a specific length of time. If the drawee bank finds no reason to dishonour the cheque, it is posted to the drawer's account (if this has not already been done at the data centre), and is cancelled and paid.
10. The provisional credits given in the collecting process become final, or, in the case of a returned cheque, are reversed.

The chartered banks in Canada have developed a fairly comprehensive set of rules and procedures for governing the collection of cheques. Clearly the law must extend recognition to these rules of clearing usage unless they become unreasonable or unfair to the banking customer. In general the banks have provided a sound service with regard to the collection of cheques, and no advantage

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<sup>73</sup> This is a simplified description of what might actually take place at a clearing house. This will depend on the location of the clearing house (whether a regional or non-regional settlement point), the nature of the cheque or item, whether other intermediary banks are employed as agents for collection, *etc.* Falconbridge, *supra*, note 39, 385 gives a more detailed description of what actually transpires at a clearing house. See also A. B. Jamieson, *Chartered Banking in Canada* (1962), ch.XXII, 341-5; Andrews, *supra*, note 68, 590-603, gives a detailed if somewhat dated description of an American city clearing house. See also Clarke, Bailey and Young, *supra*, note 2, ch.8, 155-160.

has seemingly been taken of the customer.<sup>74</sup> It is also important that the law remain flexible with respect to the deposit and collection of cheques in view of the new banking practices being adopted to further increase the efficiency of the payments system.<sup>75</sup>

#### IV. THE COLLECTION AND PAYMENT OF CHEQUES IN THE UNITED STATES — AN OVERVIEW OF THE UNIFORM COMMERCIAL CODE

The Americans have done a very thorough job of codifying the law respecting commercial paper,<sup>76</sup> bank deposits and collections.<sup>77</sup> It is intended here to set out and discuss some of the important sections of the Uniform Commercial Code relating to the collection and payment of cheques, in order to evaluate their effect and to discover whether the principles enunciated would be suitable for adoption in Canada.

##### 1. Article Three — Commercial Paper

Part 5 of Article Three of the Code deals with the subjects of presentment, notice of dishonour and protest.

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<sup>74</sup> Indeed, in view of the fact that a normal collection for payment of a cheque takes at least 2 or 3 days, the drawer can really take advantage of the bank with a later deposit. This involuntary extension of credit by a bank is one kind of "float" the banks are always trying to reduce.

<sup>75</sup> The banks are planning to develop electronic payments systems, for example. See generally the articles cited *supra*, note 4. Development of computerized and electronic payments systems will necessarily involve new legal problems. Apparently the by-laws of the Canadian Bankers' Association concerning clearing rules and procedures will be revised shortly.

<sup>76</sup> Uniform Commercial Code (U.L.A.), art.3.

<sup>77</sup> *Ibid.*, art.4. There is also a wealth of articles and papers on this article as there is on the other articles of the Code. See, *inter alia*: J. J. Clarke, *Bank Deposits and Collections* (1963) 80 Banking L.J. 1; D. J. Rapson, *supra*, note 9; W. D. Malcolm, *How Bank Collection Works — Article 4 of the U.C.C.* (1965) 11 How.L.J. 71; D. Dalony, *The Presentment Problem In The Collection of Checks Through Banks* (1957) 10 U.Fla.L.Rev. 382; W. O. Morris, *The Importance of Promptly Presenting Checks for Payment* (1959) 61 W.Va.L.Rev. 191; *Bank Procedures and the U.C.C. When Is a Cheque Finally Paid* (1968) 9 B.C. Ind. & Com.L.Rev. 957; *Final Payment And the Process of Posting Under the U.C.C.* (1968) 68 Col.L.Rev. 357; R. J. Rohner, *Posting of Cheques: Final Payment and the Four Legals* (1968) 23 Bus. Law. 1075.

This article of the Code has also been subjected to severe criticism by: F. F. Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted* (1950) 61 Yale L.J. 334, esp. 357-367.

Article 3-502 states that in the event of untimely presentment without excuse,<sup>78</sup> endorsers will be completely discharged, and the drawer will be discharged in the case of the drawee bank's insolvency to the extent of his loss, the claim for which is assigned to the holder. This article expressly limits discharge of the drawer to the situation of bank failure, which is the only situation to which section 166 of the *Bills of Exchange Act*<sup>78a</sup> will normally apply.<sup>78b</sup>

Section 3-503 of the Code states the rules applicable to the time of presentment in one section rather than dealing with the subject in different sections as does the Canadian Act:<sup>79</sup>

### 3-503. Time of Presentment

- (1) Unless a different time is expressed in the instrument the time for any presentment is determined as follows:
  - (a) where an instrument is payable at or a fixed period after a stated date any presentment for acceptance must be made on or before the date it is payable;
  - (b) where an instrument is payable after sight it must either be presented for acceptance or negotiated within a reasonable time after date or issue whichever is later;
  - (c) where an instrument shows the date on which it is payable presentment for payment is due on that date;
  - (d) where an instrument is accelerated presentment for payment is due within a reasonable time after the acceleration;
  - (e) with respect to the liability of any secondary party presentment for acceptance or payment of any other instrument is due within a reasonable time after such party becomes liable thereon.
- (2) A reasonable time for presentment is determined by the nature of the instrument, any usage of banking or trade and the facts of the particular case. In the case of an uncertified check which is drawn and payable within the United States and which is not a draft drawn by a bank the following are presumed to be reasonable periods within which to present for payment or to initiate bank collection:
  - (a) with respect to the liability of the drawer, thirty days after date or issue whichever is later; and
  - (b) with respect to the liability of an indorser, seven days after his indorsement.
- (3) Where any presentment is due on a day which is not a full business day for either the person making presentment or the party to pay or

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<sup>78</sup> The circumstances under which presentment or notice of dishonour or protest are made, or delay therein, are set out in s.3-511 of the Code.

<sup>78a</sup> *Supra*, note 7.

<sup>78b</sup> *Supra*, note 17b.

<sup>79</sup> The *Bills of Exchange Act*, *supra*, note 7, deals with a reasonable time for presentment with respect to endorsers in s.86(2) and to drawers in s.166(2). This division has created a certain amount of confusion in the cases.

accept, presentment is due on the next following day which is a full business day for both parties.

- (4) Presentment to be sufficient must be made at a reasonable hour, and if at a bank during its banking day.

Subsection (2) gives a similar flexible test to that of the Canadian Act for determining what is a reasonable time for presentment,<sup>80</sup> but also provides specific time limits presumed to be reasonable. Adoption of the specific time limits tacitly rejects the "one-day" presentment rule.<sup>81</sup> The subsection also sets down the proposition that a drawer should be responsible on a cheque for a greater period of time than an endorser. The thirty-day time period specified for the drawer's discharge also coincides with section 3-304(3)(c) of the Code which establishes a similar period for determining when a holder has notice that a cheque is "stale" or overdue.

Section 3-504 sets out the rules on how presentment is to be made. In particular, subsection 2(b) authorizes the presentment of cheques "through a clearing house" although, of course, presentment is not then actually made at the clearing house but rather when the cheque reaches the drawee bank.<sup>82</sup> The adoption of subsection 2(b) would overcome the technical and out-dated requirement of section 85(2) of the *Bills of Exchange Act*. Moreover, subsection 3 would reverse the troublesome requirement of presentment to all drawees or acceptors as set out in section 87(2) of the Act.<sup>83</sup>

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<sup>80</sup> Note that the test refers to "usage of banking or trade" and would clear up any doubts fostered in the Canadian Act by the reference to banking usage in s.166(2) and the lack of such reference in s.86(2). If a similar single section were adopted in Canada it would be clear that a court, in determining the question of reasonable time for presentment for discharge of both drawer and endorsers, would be obliged to consider clearing house rules.

<sup>81</sup> See the U.C.C. Official Comment no.3 on this section.

<sup>82</sup> This rule is also accepted by English case law. See Falconbridge, *supra*, note 39, 387.

<sup>83</sup> S.3-504 reads:

"S.3-504. How Presentment Made"

- (1) Presentment is a demand for acceptance or payment made upon the maker, acceptor, drawee or other payor by or on behalf of the holder.
- (2) Presentment may be made
  - (a) by mail, in which event the time of presentment is determined by the time of receipt of the mail;
  - or
  - (b) through a clearing house; or
  - (c) at the place of acceptance or payment specified in the instrument or if there be none at the place of business or residence of the party to accept or pay. If neither the party to accept or pay



Section 3-506 sets out the time allowed the drawee bank, on presentment for acceptance and presentment for payment, to decide whether to dishonour or pay the instrument (or accept in the case of acceptance).<sup>84</sup> This section tacitly condones the bank practice of deferred or delayed posting by allowing the drawee bank one business day after receipt of the item to pay or dishonour it.<sup>85</sup> A similar section, if adopted in Canada, would end confusion in the banking trade as to how long a drawee has to determine whether to pay or return a cheque.

## 2. Article Four — Bank Deposits and Collections

Article Four of the Code is an attempt to codify the legal relationship between banks and their customers and the law relating to the bank collection process. It also strives to attain greater clarity and certainty in the legal rules involved in the law relating to bank deposits and collections. The framers of the Code, however, recognized the need to balance certainty with flexibility. This flexibility

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nor anyone authorized to act for him is present or accessible at such place presentment is excused.

- (3) It may be made
  - (a) to any one of two or more makers, acceptors, drawees or other payors; or
  - (b) to any person who has authority to make or refuse the acceptance or payment.
- (4) A draft accepted or a note made payable at a bank in the continental United States must be presented at such bank.
- (5) In the cases described in Section 4-210 presentment may be made in the manner and with the result stated in the section. As amended 1962."

<sup>84</sup> S.3-506 reads:

"S.3-506. Time Allowed for Acceptance or Payment.

- (1) Acceptance may be deferred without dishonour until the close of the next business day following presentment. The holder may also in a good faith effort to obtain acceptance and without either dishonour of the instrument or discharge of secondary parties allow postponement of acceptance for an additional business day.
- (2) Except as a longer time is allowed in the case of documentary drafts drawn under a letter of credit, and unless an earlier time is agreed to by the party to pay, payment of an instrument may be deferred without dishonour pending reasonable examination to determine whether it is properly payable, but payment must be made in any event before the close of business on the day of presentment."

<sup>85</sup> See also, ss.4-301 and 4-302 of the Code on deferred posting.

is provided by section 4-103,<sup>86</sup> which permits, within specified limits, variation of the provisions of Article Four by authorized agreements. Subsection (1) confers a general power to vary all provisions of Article Four by agreement, within the specified limits that a bank cannot disclaim responsibility for lack of good faith or failure to exercise reasonable care or limit the measure of damages for such lack or failure. Nevertheless, the limits are made very wide by the provision that the parties can agree on the standards by which such responsibility is to be measured as long as such standards are not "manifestly unreasonable". Only parties to the agreement are affected by subsection (1) of section 4-103, unless they are bound by ratification, estoppel or the like.<sup>87</sup> On the other hand, subsection (2) provides that certain types of "official" or "quasi-official" agreements, such as clearing house rules, may affect the rights of other interested parties without their specific assent, subject, of course, to the limitations of good faith and ordinary care.<sup>88</sup> Subsection (2) is an extremely important section of Article Four and demonstrates the importance of recognizing bank usage and custom. It also demonstrates that the framers of the Code placed great faith in the integrity of the banks by allowing such great freedom. This faith is justified by the lack of evidence indicating that banks have tried to take unfair advantage of their customers either through adhesive agreements or bank clearing rules and regulations. In Canada, where clearing rules, for example, are approved by the Treasury Board and are thus "quasi-official" in nature, a similar statutory provision might instill both clarity and flexibility into the law relating to bank deposits and collections.<sup>89</sup>

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<sup>86</sup> The framers of the Code realized the wisdom of building flexibility into the article in view of the ever-changing nature of bank collections: "In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the uncertainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules."; U.C.C. Official Comment no.1 to s.4-103.

<sup>87</sup> U.C.C. Official Comment no.2 to s.4-103.

<sup>88</sup> Subsection (3) of 4-103 also provides that action or non-action in compliance with clearing house rules, *inter alia*, constitutes *prima facie* the exercise of ordinary care. According to U.C.C. Official Comment no.3 to s.4-103 defining clearing house rules, it is not the intent of subsection (2) that clearing house rules should rewrite the basic law generally but rather the effect of the rules should be limited to functions historically exercised by clearing houses.

<sup>89</sup> The rule in Canadian jurisprudence that unless it can be assumed or proved that a person sought to be charged had contracted subject to the

Section 4-202 provides rules with respect to the responsibility and reasonableness of action by a collecting bank in presenting, sending notice of dishonour and protest, and in settling for an item. The general rule is that the collecting bank must take action by midnight of the next business day after receipt. If a longer time is taken, the bank then has the burden of establishing reasonableness. The collecting bank generally must use ordinary care. Section 4-108 is important with regard to the timeliness of action by the collecting bank in that subsection 4-108(1) permits a one-day extension in special circumstances where the collecting bank is attempting in good faith to secure payment.<sup>90</sup>

Section 4-204 sets out rules governing the methods of sending and presenting items for collection by the collecting banks.<sup>91</sup> Subsection (3) is very important in light of the development of computerized collecting and posting techniques in that the validity of presentment at a centralized data centre maintained or used by the drawee bank is accepted, if that is where the drawee bank has requested presentment. The legal question of off-premises presentment has not been settled in Canada and the adoption of a similar provision would certainly clarify the law for bankers. Section 88 of the *Bills of Exchange Act* covering the proper place for presentment obviously does not deal with this relatively modern legal problem.

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rules of the clearing house (see *Sterling Bank v. Laughlin, supra*, note 31) would be laid to rest.

<sup>90</sup> Delay is also excused by s.4-108(2) if caused by interruption of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank, provided it exercises such diligence as the circumstances require.

<sup>91</sup> "S.4-204. Methods of Sending and Presenting; Sending Direct to Payor Bank

- (1) A collecting bank must send items by reasonably prompt method taking into consideration any relevant instructions, the nature of the item, the number of such items on hand, and the cost of collection involved and the method generally used by it or others to present such items.
- (2) A collecting bank may send
  - (a) any item direct to the payor bank;
  - (b) any item to any non-bank payor if authorized by its transferor; and
  - (c) any item other than documentary drafts to any non-bank payor, if authorized by Federal Reserve regulation or operating letter, clearing house rule or the like.
- (3) Presentment may be made by a presenting bank at a place where the payor bank has requested that presentment be made. As amended 1962."

Section 4-213 of the Code is also important since it deals with the point in the collection process at which the drawee bank determines whether to pay the cheque or not. If the bank makes final payment, then it becomes liable on the cheque in the place of the drawer and endorsers, and provisional credits become final. Section 4-213 sets out rules for determining when final payment is made by the drawee bank and provisional debits and credits become final.<sup>92</sup>

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<sup>92</sup> "S.4-213. Final Payment of Item by Payor Bank; When Provisional Debits and Credits Become Final; When Certain Credits Become Available for Withdrawal

- (1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:
  - (a) paid the item in cash; or
  - (b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
  - (c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
  - (d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b), (c) or (d) the payor bank shall be accountable for the amount of the item.

- (2) If provisional settlement for an item between the presentment and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.
- (3) If a collecting bank receives a settlement for an item which is or becomes final (subsection (3) of Section 4-211, subsection (2) of Section 4-213) the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.
- (4) Subject to any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in an account with its customer becomes available for withdrawal as of right
  - (a) in any case where the bank has received a provisional settlement for the item — when such settlement becomes final and the bank has had a reasonable time to learn that the settlement is final;
  - (b) in any case where the bank is both a depository bank and a payor bank and the item is finally paid, — at the opening of the bank's second banking day following receipt of the item.
- (5) A deposit of money in a bank is final when made but, subject to any right of the bank to apply the deposit to an obligation of the customer, the deposit becomes available for withdrawal as of right at the opening of the bank's next banking day following receipt of the deposit.

Closely connected is section 4-302 governing deferred posting and delayed return. Time limits are imposed on action taken by the drawee bank, which if not observed make the drawee bank responsible on the item. Generally speaking, the drawee bank must return the item or provisionally settle for it before midnight of the banking day of receipt, and it has until midnight of the business day after receipt finally to pay, return, or send notice of dishonour. The clearing rules<sup>93</sup> adopted by the chartered banks of Canada tacitly adopt the practice of delayed posting and the concept of the midnight deadline, but the issue of how long a drawee bank has to decide payment appears to be unsettled in Canadian jurisprudence. Also closely related to section 4-213 is section 4-212 dealing with the collecting banks' right of charge-back or refund, section 4-303 which establishes the times or events when notice of set-off or legal process or stop-order is too late to freeze the process of payment, and section 4-109 which defines what is meant by the process of posting for the purposes of section 4-213.<sup>94</sup>

One final provision of Article Four which is of interest is section 4-404 dealing with cheques over six months old. This section establishes that a drawee bank is not obliged to pay a "stale" cheque, other than a certified cheque, but may pay out in good faith. The drawee bank will not be liable for wrongful dishonour for non-payment of a cheque more than six months old. Adoption of a similar provision in Canadian legislation would give sanction to current bank practice<sup>95</sup> and relieve the bank refusing payment from an action by the drawer for wrongful dishonour. Because a cheque is intended as an instrument for immediate payment, and not as a continuing security, adoption of this rule would be both acceptable and beneficial.

## V. CONCLUSIONS AND RECOMMENDATIONS

In comparison to the Uniform Commercial Code of the United States, the Canadian *Bills of Exchange Act*<sup>96</sup> is jejune and out-dated. It is submitted that an examination of the modern Canadian case

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<sup>93</sup> See *Interbank Procedures and Standards*, *supra*, note 62, s.1.E.(2).

<sup>94</sup> In connection with clearing house rules, the time of final payment, the process of posting, and priorities under s.4-303, see the much discussed case of *West Side Bank v. Marine Exchange Bank* 155 N.W. 2d 587 (1968), discussed by W. D. Malcolm, *Reflections on West Side Bank: A Draftman's View* (1968) 18 *Catholic U.L.Rev.* 23, and Rohner, *supra*, note 77.

<sup>95</sup> *Interbank Procedures and Standards*, *supra*, note 62, s.10(3).

<sup>96</sup> *Supra*, note 7.

law in the area of commercial paper will show that members of the judiciary are compelled in many instances to place extremely strained interpretations on provisions of the *Bills of Exchange Act* in order to recognize the practices and needs of the public and the commercial community; some judges choose completely to ignore provisions of the statute in coming to a decision.<sup>97</sup> Perhaps what is being witnessed is the development of a new "law merchant" by a hesitant and uncertain judiciary with all the attendant caprice. The ideal course of reform would be to repeal the *Bills of Exchange Act* and enact entirely new legislation with modern concepts dealing with commercial paper and bank deposits and collections.

In the problem area relating to presentment and collection of cheques, much is being written<sup>98</sup> on the development of computerized systems designed to reduce the flow of commercial paper and eventually perhaps, produce a chequeless or cashless society. Until that era arrives, it is submitted that the law should take formal cognizance of modern conditions including the custom and usage of bankers.

To foster these aims, and until those charged with the task of legislating changes in the law arrive at a satisfactory alternative to the *Bills of Exchange Act*, the following recommendations are made, taking into account the ambit of the present statute:

Firstly, Part III of the Act should be changed so that bills of exchange drawn on financial institutions<sup>99</sup> that offer chequing services to their customers, such as credit unions and trust companies, are recognized as cheques within the meaning of section 165(1). All the sections in Part III of the Act, including section 166, should apply to such instruments. Secondly, section 86(2) should be repealed and a new section enacted, establishing a single test for determining what is a reasonable time for presentment for payment,

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<sup>97</sup> See, e.g., *J. I. Case Threshing Co. v. Desmond* (1915) 22 D.L.R. 455 (Alta C.A.); *Keys v. The Royal Bank of Canada* (1947) S.C.R. 377; *Bank of Montreal v. Independent Grain Co.* (1951) 1 W.W.R. (N.S.) 162 (Alta S.C.); *H. B. Etlin Co. v. Asselstyne* (1962) 34 D.L.R. (2d) 191 (Ont. C.A.); *Mazur v. Imperial Investment Corp.* (1963) S.C.R. 281; *Circle Acceptance Co. v. Sigouin* [1963] C.S. 97.

<sup>98</sup> *Supra*, note 4.

<sup>99</sup> In connection with the so-called "near-banks" and the clearing system, it should be noted that the *Report of the Royal Commission on Banking and Finance* (1964) 393-4 suggested that these financial institutions should be required to hold their reserves at the Bank of Canada like the chartered banks and that all clearing institutions should be part of an association created to manage the clearing system in place of the Canadian Bankers' Association.

*vis-à-vis* the discharge of the drawer and endorsers of a cheque. Adoption of a thirty-day presumed limit for the discharge of the drawer and a seven-day limit for discharge of endorsers is suggested. Section 166(2) should be repealed and a subsection to the suggested new section 86(2) added, providing that the section also applies to section 166(1). Thirdly, a section similar in intent to section 4-103 of the Uniform Commercial Code allowing variation of the legislation by agreement, and especially by clearing house rules, should be adopted. Such a section could be framed so that the courts would be bound by such rules as long as they did not violate the limits of good faith and ordinary care.

This last recommendation is by far the most important and controversial. It would give legal sanction to such common banking practices as delayed posting and the return of stale-dated cheques, and allow the banks to determine such basic principles as when a cheque is paid and how long a drawee bank has to decide whether to pay a cheque or dishonour it. Since there is little evidence of banks taking unfair advantage of their customers with respect to bank deposits and collections, and in view of the need to build flexibility into any legislation because of the development of new and improved methods and techniques for processing and collecting cheques, it is submitted that the granting of fairly broad scope to the banks is justifiable. The adoption of a section similar in intent to section 4-103 of the Uniform Commercial Code would be a large step in the right direction in the effort to bring the law up to date with modern banking practices.

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