PART V OF THE BILLS OF EXCHANGE ACT: EFFECTIVE CONSUMER PROTECTION LEGISLATION?

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I. INTRODUCTION

A. *Background*

Part V of the federal Bills of Exchange Act,[1] entitled Consumer Bills and Notes, was enacted in 1970 as part of a comprehensive effort to counter commercial inequities in consumer credit transactions.[2] Prior to the passing of Part V, the concept of negotiability under the Bills of Exchange Act shielded the financier of consumer purchases from the effects of serious breach by the seller. If a merchant failed to deliver goods purchased by the consumer, or delivered goods in defective or unsatisfactory condition, the financier was entitled to collect from the consumer the price of the purchase in full. The object of Part V was to preserve consumer claims and defences available against the delinquent seller when a party other than the merchant sought to enforce the financing paper.

One can only speculate on the impact Part V has had on the practices of lending institutions and retailers in the last nine years. Since 1970, no controlled study of sales financing or lending practices has been conducted in Canada. The primary focus of any discussion of Part V, then, must be the Act as drafted in 1970 and as judicially interpreted since then.

On its face, Part V provides less than complete protection for the consumer. The apparent shortcomings in the drafting of Part V have been exacerbated by the discrepancies in the few but disparate judgments

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* Of the Board of Editors (1978-79). The author wishes to acknowledge the helpful assistance in research provided by the Department of Consumer and Corporate Affairs. The opinions are those of the author.

[1] An Act to amend the Bills of Exchange Act, R.S.C. 1970 (1st Supp.), c. 4 (amending R.S.C. 1970, c. B-5).

[2] On March 15, 1966, a Joint Committee of the Senate and House of Commons was appointed to inquire into and report upon the problems of consumer credit. The result was the REPORT ON CONSUMER CREDIT (D. Croll, R. Basford, Chairmen 1967) [hereinafter cited as CROLL/BASFORD REPORT]. Eighteen recommendations were made, the sixth of which was the recommendation that "every bill or note given in connection with a retail credit transaction be required to be so marked on its face". *Id.* at 5. This recommendation was incorporated into Part V of the Bills of Exchange Act as s. 190(1).

which have considered its effect. Because the reported occasions for judicial comment have been few, any generalization on this basis concerning the practical effect of the Act may be specious. The disparaties in these judgments, however, are sufficient to justify the conclusion that legislative amendment to Part V is necessary.

This article examines the effectiveness of Part V as consumer protection legislation and the constitutional deficiencies inherent in such federal legislation. It also considers the extent to which Part V regulates sales financing and direct loan practices, and focuses on the language used by the draftsmen to delineate the financing practices within and outside the ambit of the Act. The introductory paragraphs below distinguish between the financing practices of sales financiers and direct lenders, in the context of the law before Part V. These paragraphs provide a background for the examination of Part V which follows. This examination takes the following format: part II describes the provisions of the Act and analyses them in terms of the four main obstacles the consumer faces when proceeding or defending an action under Part V; part III surveys the judicial treatment of Part V; finally, part IV summarizes and makes recommendations for legislative change. A draft Model Part V is appended to the article to highlight the changes proposed.[3]

B. *The Financier Before Part V: Sales Financier and Direct Lender Distinguished*

Part V was designed to relieve the consumer who purchases on particular terms of credit[4] from obligations arising out of unscrupulous sales practices. It was drafted to apply to transactions financed by the merchant who then negotiates the financing paper to a sales financier. It was also intended to apply to purchases, financed directly by a money lender, from the merchant who arranges the consumer's loan with the financier's co-operation. Each of these arrangements must be distinguished from *independent* consumer loan financing. Part V was not intended to apply to the practice of the independent purchase money lender.

The ineffectiveness of Part V as consumer protection legislation lies in the execution of the intention to incorporate these distinctions into the Act. To understand the shortcomings in the drafting of Part V, one must understand the fundamental difference between the financing practices referred to above and the inequities Part V sought to correct.

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[3] Appendix, pp. 362-65 *infra*.

[4] Part V does not apply to credit card purchases. A credit card voucher is not a bill of exchange. The "promise to pay" on the face of the voucher is subject to the conditions set out in the credit card agreement. It may be argued that these conditions do not qualify the obligation to pay and that the credit card voucher is "negotiated" in much the same way as a cheque, but the point has never been litigated and, as a matter of policy, it was not the intention of the federal government to legislate with respect to

A consumer purchase may be financed typically in one of two ways: the retailer may require the consumer to sign a conditional sales contract and a promissory note: or, he may direct the consumer to a lending institution where a loan transaction is conducted directly.

In the first situation, the retailer retains the right to recover the goods if the consumer defaults in his payments. He also holds the consumer's unconditional promise to pay for the goods on specific terms.[5] As long as the retailer retains possession of these documents, the buyer has the right to sue the seller or refuse payment if the seller fails to perform by non-delivery or delivery of defective goods. The retailer is the payee on the note, and, as an immediate party to the consumer who drew the note, he is subject to all personal, real and defect of title defences the consumer may be entitled to raise.[6]

The situation changes once the retailer transfers the paper to a third party, usually a finance company, for value. Traditionally, the finance company has relied on three devices which enable it to stand in an entirely different relationship with the purchaser: disclaimer clauses, cut-off clauses, and the status of holder in due course acquired through the promissory note. These devices have the collective effect of insulating the finance company from any recourse the purchaser may have against the seller.

The disclaimer and cut-off clauses effect a right to enforce the sales contract free of the purchaser's defences. The former limit the express or implied conditions and warranties in the sales agreement.[7] More onerous

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credit card companies. Two arguments have been used in favouring the exclusion of the credit card company: that its primary relationship is with the borrower rather than the retailer and that the credit card is essentially a means of payment and not an extension of credit with respect to a particular purchase. Countering these arguments are the merchant/financier relationship evidenced by the decal on merchant premises and the financier's profit margin earned from monthly interest rates charged on outstanding accounts. *See* L. McInnes, *Credit Cards: A Canadian Overview*, in A STUDY FOR THE LEGAL RESEARCH INSTITUTE OF THE UNIVERSITY OF MANITOBA (1975); M. Gropper, *The Credit Card in Canada: Some Problems and Some Proposals*, in A STUDY FOR THE CANADIAN CONSUMER COUNCIL (1970). In the United States, credit card companies are subject to the claims and defences credit card holders may have against retailers when the card has been used as an instrument of credit rather than a cash payment: *see* Truth In Lending, 12 C.F.R. s. 226.13 (*i*) (1) (1980).

The U.K. has recently adopted similar law, imposing on the lender an even broader range of liability: *see* The Consumer Credit Act 1974, U.K. 1974, c. 39, s. 75, brought into force by S.I. 1977/802. *See also* The Globe and Mail (Toronto), Oct. 12, 1978, at 14, col. 3. The point is noted because of the potential the credit card poses as a means of getting around Part V. The use of the credit card as a means of financing consumer purchases is increasing. *See Bank Cards Getting Around in New Ways, Places*, The Globe and Mail (Toronto), Oct. 7, 1978, at B-1, col. 1, which reports the recent acceptance of credit cards by large department stores.

[5] Bills of Exchange Act, R.S.C. 1970, c. B-5, s. 17.

[6] FALCONBRIDGE ON BANKING AND BILLS OF EXCHANGE 665-80 (7th ed. A.W. Rogers 1969).

[7] *See* 1 DEP'T OF CONSUMER AND CORPORATE AFFAIRS, A STUDY ON CONSUMER MISLEADING AND UNFAIR TRADE PRACTICES 219-25 (1976).

are the cut-off clauses, which "cut off" the buyer from raising against the finance company those defences he might have raised against the seller for his non-performance.[8] The promissory note is then fully enforceable if the finance company qualifies as a holder in due course under section 56 of the Bills of Exchange Act, having acquired the bill in good faith, for value, and without notice of any defect in the title of the transferor.[9] If the seller transfers the paper and fails to deliver the goods, the buyer may have no choice but to pay the financier the amount of the debt.

In the second situation, where the loan is made directly to the borrower by the lending institution in exchange for a promissory note, the equities between the retailer and purchaser are not at issue. The purchaser contracts independently with the lender for the purchase money loan and the lender fulfills his part of the bargain by advancing the cash. The buyer assumes a contractual obligation to repay. He also has an unconditional obligation to pay on the promissory note, subject only to grievances that may arise between the borrower and lender as immediate parties. The retailer receives the proceeds of the loan from the buyer, completing the terms of the sales agreement. If he fails to deliver or delivers unsatisfactory goods, the buyer finds he is obliged to repay a loan for value never received.

The case law illustrates the distinction between sales financing and direct loan practices. Until 1962, the consumer had little success against the financier in either situation. In that year, a decision of the Ontario Court of Appeal altered the status of the sales financier in certain circumstances and provided some relief for the consumer. In *Federal Discount Corp. v. St. Pierre*,[10] the court denied the financier holder in due course status because the merchant and financier were not dealing at arm's length. In effect, the two companies were conducting what the court viewed as a "joint venture". The relationship between seller and financier was "much more intimate than that of endorsee or endorser in a normal commercial transaction".[11] The parties were "more nearly

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[8] A typical cut-off clause states:

If the seller should assign the contract in good faith to a third party, the buyer shall be precluded as against such third party from attacking the validity of the contract on grounds of fraud, duress, mistake, want of consideration. . . .

[9] S. 56(1) of the Bills of Exchange Act provides:

A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely:

(a) that he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact;

(b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

[10] [1962] O.R. 310, 32 D.L.R. (2d) 86 (C.A.).

[11] *Id.* at 323, 32 D.L.R. (2d) at 99.

engaged in one business, each one in the conduct of its particular phase being useless without the association of the other".[12]

It is useful to examine the facts on which this conclusion was based. Fair Isle Knitting Company sold hand knitting machines on the understanding that an associate of the company, Yarncraft Industries Ltd., would market the goods knitted by purchasers and apply the proceeds of sales towards the purchase price of the machine. Mrs. St. Pierre, a prospective purchaser, signed a number of documents, including a promissory note and a conditional sales contract.[13] The documents were subsequently transferred to the plaintiff and when the knitting company became insolvent, Federal Discount claimed the amount owing on the note. None of the proceeds from sales of the knitted goods had been applied to Mrs. St. Pierre's account.

The court examined the relationship between the retailer and financier. Federal Discount had agreed to discount the retailer's paper after conducting an investigation of the retailer's financial and moral integrity, the volume of its business, and the manner in which Fair Isle conducted its selling campaign. The financier was fully aware of the general course of operation used by Fair Isle, but nothing indicated that Federal Discount had actual knowledge of facts which would have prevented it from becoming a holder in due course under the Act. There was no evidence of fraud. The court held simply that the fact of an "arrangement" of mutual advantage to merchant and lender is enough to disentitle the financier to the protection of the law merchant. Since the *St. Pierre* case, the business relationship between merchant and financier has been a factor in considering the latter's claim to holder in due course status.

The *St. Pierre* doctrine has since been applied to the situation of the direct purchase money loan. In *Beneficial Finance Co. v. Kulig*,[14] the

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[12] *Id.*

[13] There was a cut-off clause in the sales contract purporting to exonerate the assignee from any defences or other equities existing between the buyer and the sales company. This document was not relied on in the action by Federal Discount Corp.

[14] Beneficial Fin. Co. of Canada v. Kulig, [1970] 3 O.R. 370, 13 D.L.R. (3d) 134 (Cty. Ct.). *See also* Graham v. Central Mortgage & Housing Corp., 13 N.S.R. (2d) 183, 43 D.L.R. (3d) 686 (S.C. 1973), in which C.M.H.C. was held to have engaged in a "joint venture" with a construction company it had hired to build a housing project. When the houses proved defective, the right of C.M.H.C. to recover the amounts owing on the mortgages was subject to the purchasers' defences. There was no evidence of fraud in this case; the decision was founded solely on the relationship between the parties. After discussing the authorities on the "joint venture" doctrine, the court noted the following contributing factors:

(a) the involvement of C.M.H.C. in the project from the start;

(b) the hiring of the building company by C.M.H.C. to carry out the project;

(c) the fact that C.M.H.C. financed the cost of the project;

(d) the fact that sales were to specified individuals only upon approval by C.M.H.C.;

(e) the prior agreement between C.M.H.C. and the builder to exchange construction for finances;

purchaser signed a dealership contract agreeing to purchase materials needed for plastic signs and display boards. The seller, Custom Signs of Canada, dissuaded the defendant from borrowing the money from his bank and directed the customer to the Hull office of Beneficial Finance. Evidence disclosed a prior arrangement between the merchant and financier: the Hull office had agreed with the merchant to extend purchase money loans to borrowers referred to it by Custom Signs. The Hull office was notified in advance when a loan was being sought by a purchaser. The loan application was then processed in the borrower's absence. In exchange for the loan, Kulig signed a promissory note to Beneficial Finance. When the advance was made, the finance company required that the cheque be endorsed by Kulig to the merchant. The borrower had no control over the funds. Custom Signs failed to deliver all the materials ordered by the defendant and Kulig refused to pay the amount owing on the note held by the plaintiff.

The court found in Kulig's favour. Beneficial Finance had so identified itself with Custom Signs "as to deprive itself of all defence against the equities of the transaction".[15] These equities included the total failure of consideration on the part of Custom Signs.

The court summarized the factors considered in concluding that there was an "intimate relationship" between the parties:

> (a) The agreement provide[d] for payment by the customer of the financial institution of the *dealer's* choice;
> (b) The finance company displayed the dealer's product;
> (c) The finance company officials spoke favourably of the dealer's product and avoided inquiry as to the dealer's reliability;
> (d) The finance company and the dealer each acted as agent for the other during the course of the transactions with the customer;
> (e) The finance company had thorough knowledge of the arrangements between dealer and customer;
> (f) The employees of the finance company and the dealer knew each other well;
> (g) Dealer and finance company worked together concerning the loan in the absence of the customer;
> (h) The finance company assisted the dealer to obtain the proceeds of the loan from the customer.[16]

The court also concluded that the plaintiff either knew or ought to have known that Custom Signs was not engaged in a legitimate business.

The distinction between sales financier and direct lender should be emphasized at this point. The sales financier is a transferee of the bill or

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(f) the parties' contribution of money, property, skill and knowledge to a common undertaking;

(g) mutual control and management of the enterprise during the construction of the houses and the sales, the arrangement being limited to this project;

(h) while there was not a mutual sharing of profits, C.M.H.C. clearly had a financial interest at stake.

Id. at 211-12, 43 D.L.R. (3d) at 709-10.

[15] *Kulig*, *supra* note 14, at 386, 13 D.L.R. (3d) at 150.

[16] *Id.* at 379-80, 13 D.L.R. (3d) at 143-44.

note, and has protected status only if he qualifies as a holder in due course. This status is lost if the financier has "notice" of any defect in the merchant's claim on the note, but this "notice" requirement is not so stringent as to require "actual knowledge". Knowledge of suspicious circumstances surrounding a business venture is sufficient to defeat the holder in due course status of a sales financier.[17] This "notice" requirement may be satisfied though there is no "intimate relationship" or "arrangement" between the parties.

The direct lender, on the other hand, is an immediate party to the note issued by the borrower, not a transferee. His status as holder in due course is therefore never an issue. There is no onus on the direct lender to make inquiries into "suspicious circumstances" — that is, into the purpose of the loan or the credentials of the prospective merchant. Nothing short of actual knowledge or fraud will preclude his enforcement of the loan contract, a contract independent from the contract of sale. The lender's security is jeopardized *only* if he stands in an "intimate relationship" with the merchant.

On the evidence presented in the *Kulig* case, there was in fact no clear finding that Custom Signs was conducting a fraudulent business venture or that Beneficial Finance had knowledge of any such misconduct. The basis of the *Kulig* decision was the "intimate relationship" between the parties. It was this relationship which placed an onus on the finance company to make inquiries into the credentials of the merchant. Had the plaintiff made these inquiries, it would have known that Custom Signs was not engaged in a legitimate business. The *dictum* that the plaintiff *ought to have known* of the equities between merchant and purchaser should be read only in the context of this relationship.

Part V of the Bills of Exchange Act was passed just prior to the *Kulig* decision. In the course of drafting, an attempt was made to address the practices illustrated in *St. Pierre* and *Kulig*. The intention was to capture not only the sales financier who discounts consumer paper, but also the direct lender who has some sort of relationship with the merchant. The extent to which direct lenders are actually caught by the Act is a subject of controversy and is the impetus behind this critique of Part V.

The *St. Pierre* and *Kulig* decisions remain important for two reasons: they offer potential guidelines for the courts in construing the scope of Part V; and, they are available to the consumer in addition to his recourses under Part V.

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[17] *See* London Joint Stock Bank v. Simmons, [1892] A.C. 201, [1891-94] All E.R. Rep. 415 (H.L.), for a definition of "notice" in the law respecting holder in due course status.

II. Part V — Consumer Bills and Notes

A. *A Summary of the Provisions*

Part V of the Bills of Exchange Act was designed to place certain sales financiers and money lenders in the same position as the seller with respect to the consumer's obligation to pay for the goods purchased. The provisions of Part V define the extent of its application to the issuing and discounting of paper related to the financing of consumer purchases and ensure that the parties affected are notified of the preservation of consumer claims.

Part V requires that every consumer bill or note be prominently marked with the words "Consumer Purchase".[18] An unmarked consumer bill or note is void; the holder will be unable to enforce it.[19] Furthermore, it is an offence knowingly to issue or transfer such a note.[20] If the consumer bill or note is properly marked, the holder has notice of the nature of the underlying sales agreement and his right to have the note paid by the purchaser is subject to any defence or right of set-off the purchaser would have had in an action by the seller.[21]

The application of Part V is limited to the financing paper defined by the Act. A consumer bill or note is defined as one "issued in respect of a consumer purchase".[22] A "consumer purchase" is defined as "a purchase other than a cash purchase, of goods or services or an agreement to purchase goods or services" by an individual for his personal use from a seller who is engaged in the business of selling.[23] The meaning of "cash purchase" is not defined in the Act. The small businessman is not protected, though in many cases he may be as naive about commercial practices as the ordinary consumer.[24]

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[18] S. 190(1).

[19] S. 190(2). There are two exceptions to this rule: both the holder in due course and the drawee without any notice that the bill or note is a consumer bill or note remain protected. This is the law merchant that originated in Miller v. Race, 1 Burr. 452, 97 E.R. 398 (K.B. 1758), preserving the negotiability of instruments and the confidence necessary in commercial paper transactions.

[20] S. 192(1), (2).

[21] S. 191. The holder is not liable for the amount of any counter-claim the consumer may have, such as the amount of consequential economic loss or loss due to personal injuries. The consumer may only claim the amount of the loan and finance charges. The reference to "set-off" entitles the buyer to raise, as a defence against repayment of the loan, a grievance under a separate contract with the merchant not financed by the lender. For example, a consumer may refuse to pay the amount owing on a note issued with respect to the purchase of a radio on grounds of non-delivery of a television set purchased with cash from the same retailer.

[22] S. 189(1), (2). Cheques postdated for less than 30 days from the date of issue are excluded. All other cheques are included, to ensure that lending institutions and retailers do not circumvent the Act simply by accepting a series of postdated cheques.

[23] S. 188. "Goods" do not include land. An "agreement to purchase" need not be "other than a cash purchase" and will include the situation of a "down-payment" in respect of a promise of sale.

[24] *See* Ziegel, *Consumer Credit Regulation: A Consumer-Oriented Viewpoint*, 68

The Act clearly applies to sales financing practices. This is so whether or not the financier has an "intimate relationship" with the merchant.[25] The status of the direct purchase money lender is less clear. Section 189(3) provides that if the lender grants a loan to enable the purchaser to make a "consumer purchase" and the seller and lender are at "non-arm's length" as defined by the Income Tax Act,[26] the note issued by the consumer to the lender shall be "conclusively presumed" to be issued in respect of a consumer purchase. Furthermore, section 189(3) applies "without limiting the circumstances" in which a note may be considered to be issued with respect to a consumer purchase. The difficulties presented by this provision are discussed below.

B. *Analysis of Part V*

When relying on Part V, the consumer encounters two major difficulties. First, he must establish that Part V applies to the financier of his consumer purchase. Secondly, he must defeat alternative recourses available to the financier in areas beyond the reach of federal legislation. The source of these barriers to consumer protection can be found in Part V itself: (i) the meaning of "non-arm's length" under Part V; (ii) the definition of "consumer purchase"; (iii) the financier's action on the contract; (iv) section 191 — the defences the buyer would have had against the seller. These headings highlight the necessary subjects of legislative reform.

1. *The Meaning of "Non-Arm's Length" Under Part V*

S. 189(3) Without limiting or restricting the circumstances in which, for the purposes of this Part, a bill of exchange or a promissory note shall be considered to be issued in respect of a consumer purchase, a bill of exchange or a promissory note shall be *conclusively presumed* to be so issued if
(a) the consideration for its issue was the lending or advancing of money or other valuable security by a person other than the seller, in order to enable the purchaser to make the consumer purchase; and
(b) the seller and the person who lent or advanced the money or other valuable security *were*, at the time the bill or note was issued, *not dealing with each other at arm's length within the meaning of the Income Tax Act*. [Emphasis added].

COLUM. L. REV. 488 (1968). Cases illustrating the naivety of the small businessman include Traders Fin. Corp. v. Norray Distrib. Ltd., 60 W.W.R. 129, *sub nom* Keelan v. Norray Distrib. Ltd., 62 D.L.R. (2d) 466 (Man. Q.B. 1967); Interprovincial Bldg. Credits Ltd. v. Soltys, 64 D.L.R. (2d) 194 (Man. Q.B. 1967); Canadian-Dominion Leasing Corp. v. Suburban Superdrug Ltd., 55 W.W.R. 396, 56 D.L.R. (2d) 43 (Alta. C.A. 1966); Neptune Acceptance Ltd. v. Williams, 5 O.R. (2d) 158, 49 D.L.R. (3d) 662 (Cty. Ct. 1974); Canadian Imperial Bank of Commerce v. Lively, 19 N.S.R. (2d) 400, 46 D.L.R. (3d) 432 (S.C. 1974).

[25] Ss. 188, 189(1), (2). This is consistent with the position of the sales finance company prior to Part V. The distinction between the sales financier and direct purchase money lender is noted in the discussion of the *Kulig* case at pp. 324-25 *supra*.

[26] S.C. 1970-71-72, c. 63, as amended.

Section 189(3) was added after the first draft of Bill C-208 was presented to the Standing Committee on Justice and Legal Affairs.[27] Members of the Committee had expressed concern that the Act could be circumvented; rather than financing consumer purchases by discounting paper to finance institutions, within section 189(2) of Part V, the Committee perceived that a retailer might accomplish the same end by referring or accompanying the consumer to the lending institution of his choice.[28] The consumer note, addressed directly to the finance company, would appear totally independent from the sales contract. The financier could maintain that the note was issued in respect of a purchase money loan, not in respect of a consumer purchase, and did not require marking. The right to be repaid the amount of the debt would be free of the defences arising out of the purchase transaction.

The conclusive presumption provision was added, for greater certainty, with this "loophole" in mind. Unlike the general "consumer note" provision (section 189(2)), the conclusive presumption will not apply to strangers. This is consistent with the position of the direct lender prior to Part V, discussed earlier in relation to the *Kulig* case. The lender and retailer must be at "non-arm's length". The degree of familiarity necessary under Part V, however, is unclear.

Suppose that a consumer arranges a loan with his bank and applies the funds to the purchase of a mobile home. The bank may accept the borrower's loan application knowing that the borrower intends to buy a mobile home. It has no contact with the mobile home dealer and therefore no occasion for inquiring into his affairs. There is no assurance that the borrower will in fact use the funds for the purpose stated. Unlike the *Kulig* case where the financier required endorsement of the cheque to a particular merchant, the money is advanced unconditionally. In these circumstances, the loan and the purchase are separate and distinct transactions. The note issued to the financier need not be marked.[29]

Suppose, on the other hand, the lending institution is incorporated by a parent company for the purpose of financing another subsidiary, a mobile home retail outlet, on preferential terms in exchange for referrals of all loan applicants requiring assistance in financing their consumer purchases. In this case, the note must be marked "consumer purchase".

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[27] HOUSE OF COMMONS STANDING COMMITTEE, JUSTICE AND LEGAL AFFAIRS, Minutes of Proceedings and Evidence, No. 30, May 21, 1970 [hereinafter cited as Minutes, No. 30] and No. 32, May 28, 1970 [hereinafter cited as Minutes, No. 32] (28th Parl., 2d Sess.).

[28] The "loophole" is summarized best in Minutes, No. 30, *id.* at 30:11.

[29] This situation received comment at Committee, notably on May 21, 1970, *id.* at 30:13, 30:25-6, 30:29; and on May 28, 1970, Minutes, No. 32, *supra* note 27, at 32:17. The Committee rationalized the inapplicability of Part V to the independent lender, saying that the borrower who goes to the bank independently, arranges a personal loan through a bank manager and then buys something with it is more sophisticated, more aware of what he is doing, aware of what his obligations are, and less in need of protection than those taken advantage of in sales situations requiring that a number of

Between the two extremes there is a broad gray area. The casting of the Income Tax Act definition of "non-arm's length" as the range of relationships caught by section 189(3) offers little guidance.[30] Indeed, the choice is inappropriate and misleading. Opinions vary on the degree of "intimacy" required before the expression applies.[31] There is reason for concern, expressed below, that this choice of expression may render section 189(3) almost completely ineffective.

Does section 189(3) incorporate the *St. Pierre* doctrine as applied by the *Kulig* case? Or is it enough that the retailer and financier deal with each other on an ongoing basis without more? What if the parties have an express or implied understanding of a continuing business association? Must it be strictly proved that the vendor has controlling shares in the financier's operation, or are the parties sufficiently connected if the finance company supplies the retailer with its financing forms in blank? Is the granting of security (a chattel mortgage) in particular goods purchased enough to tie the retailer to the otherwise independent financier? Can a "non-arm's length" relationship be implied if the retailer simply refers all his customers to the corner bank? What is the onus on the sales finance company or lending institution to inquire into the operations of merchants with a view to making the marketplace a safer place for the consumer?[32]

Section 251(1) of the Income Tax Act[33] provides:

> For the purposes of this Act:
> (a) related persons shall be deemed not to deal with each other at arm's length; and

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different documents be signed at once. The members did not appear to grasp the distinction between direct lender and sales financier noted earlier.

[30] *But see* Minutes, No. 32, *supra* note 27, at 32:15. Mr. Thorson, then Assistant Deputy Minister of the Department of Justice, explained that the Income Tax Act definition was chosen for the purpose of clarity.

[31] *Infra* notes 38 to 45 and accompanying text.

[32] The Committee itself did not clarify its position on these questions. Initially, Part V was intended to protect the consumer only in circumstances of sales financing or discounting arrangements. *See* the "Explanatory Notes" accompanying Bill C-208, 28th Parl., 2d Sess., 1969-70 (first reading), where the purpose of Part V was explained as follows:

> At the present time, where the purchaser in a consumer purchase gives the vendor a promissory note, the vendor may assign that note to a third party who may hold it free of any defence or right of set-off that the purchaser may have had against the vendor. The purpose of the new Part V is to provide the purchaser with such a defence or right of off-set against the third party.

This purpose was abandoned during the course of the May 21st Committee hearings, *supra* note 27, when the desire to ensure that Part V applied to direct loan transactions was articulated. It appears that the Committee did not fully recognize the legal distinction between the different types of financiers. This midstream change in policy and the problems presented for the draftsmen were not fully appreciated for what they were. Government policy on the status of the direct lender was only ambiguously formulated at the hearings and it has never been documented in the form of official guidelines.

[33] S.C. 1970-71-72, c. 63, as amended.

(b) it is a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length.

The courts have interpreted this section almost exclusively in terms of the amount of control one corporation exerts over another by virtue of majority voting power.[34] This construction is narrow and inappropriate to the circumstances of consumer credit. It is unlikely that a bank would ever be affiliated with a merchant in this manner, considering the Bank Act provision which prohibits participation in the sale of goods.[35] Most of the common lending practices postulated above would fall outside this rigid definition. At the time the Bill was passed, Professor Ziegel predicted it was unlikely that the courts would apply the income tax cases to interpret section 189(3) in the context of consumer credit transactions.[36] A reading of the cases reveals, however, that the prediction was not entirely accurate.[37]

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[34] *See, e.g.*, Arctic Geophysical Ltd. v. M.N.R., [1968] 1 Ex. C.R. 485, [1967] C.T.C. 571; Army & Navy Dep't Store Ltd. v. M.N.R., [1953] 2 S.C.R. 496, [1954] 1 D.L.R. 177; Dworkin Furs (Pembroke) Ltd. v. M.N.R., [1966] Ex. C.R. 228, [1965] C.T.C. 465, *aff'd* [1967] S.C.R. 223, 60 D.L.R. (2d) 488; Gatineau Westgate Inc. v. M.N.R., 41 Tax A.B.C. 440 (1966); M.N.R. v. Sheldon's Eng'r Ltd., [1954] Ex. C.R. 507, [1954] C.T.C. 241, *aff'd* [1955] S.C.R. 637, [1955] 3 D.L.R. 801; Vineland Quarries & Crushed Stone Ltd. v. M.N.R., [1966] Ex. C.R. 417, [1966] C.T.C. 69, *aff'd* 67 D.T.C. 5283n; Yardley Plastics of Canada Ltd. v. M.N.R., [1966] Ex. C.R. 1027, [1966] C.T.C. 215. The more recent "separate interest" test which invites the possibility of "non-arm's length" relationships in the absence of "control" also fails to capture the general arrangement between commercial parties aimed at conferring mutual commercial advantages on the parties or co-operating in the advancement of compatible commercial interests. *See* Swiss Bank Corp. v. M.N.R., [1974] S.C.R. 1144, 31 D.L.R. (3d) 1 (1972).

[35] R.S.C. 1970, c. B-1, s. 75(3) (*b*). The recently proposed Financial Leasing Regulations, pursuant to Bill C-57, 30th Parl., 3d sess., 1977-78 (first reading), s. 172(1) (*i*), (reintroduced in the House of Commons 23 Oct., 1979 as the Financial Leasing Regulations pursuant to Bill C-14, 31st Parl., 1st Sess., 1979 (first reading), and again on 16 April, 1980 as the Financial Leasing Regulations pursuant to Bill C-6, 32nd Parl., 1st Sess. (second reading)), released by the Department of Finance Sept. 20, 1978, would permit banks to engage in hire-purchase arrangements with consumers without responsibility for the product leased. This has serious ramifications for Part V and consumers. The Regulations specifically provide that the bank may purchase a product at the request of a specific lessee for the purpose of leasing it to him. S. 3 of the Regulations specifies that "no financial lease of a bank shall entail responsibility of the bank to install, promote, service, clean, maintain, or repair the leased property". Though a "hire-purchase" agreement is essentially a means of purchasing on credit, such a leasing arrangement neatly circumvents Part V. Recourse against the merchant is restricted for privity reasons. The latest revision has been amended to exclude automobiles from the hire-purchase provision: *see* HOUSE OF COMMONS STANDING COMMITTEE, FINANCE, TRADE AND ECONOMIC AFFAIRS, Minutes of Proceedings and Evidence, No. 23, July 17, 1980, (32d Parl., 1st Sess.), at 23:33 (Motion to Amend).

[36] Ziegel, *Consumer Notes — Bill C-208 — Bills of Exchange Amendment Act*, 49 CAN. B. REV. 121, at 125 (1971).

[37] *See* Canadian Imperial Bank of Commerce v. Lively, *supra* note 24. This case is discussed *infra* at p. 350. Examples of relationships to which this provision may apply can be found in American case law. *See, e.g.*, Block v. Ford Motor Credit Co., 286 A. 2d 228, 63 A.L.R. 3d 1 (D.C. Ct. App. 1972), concerning an authorized Ford Motor Co.

The "non-arm's length" test should be abandoned as a guide for determining which relationships are sufficiently "intimate" to bring direct lenders within the section. Although precise definition of the boundary lying between cases within and without Part V is not possible, some of the uncertainty and unpredictability which may accompany a new provision could be eliminated with the issuance or publication of official guidelines. A better approach would be to incorporate comprehensive guidelines into the Act itself.

The Committee members made casual references to the connected lender/seller relationships they believed should be caught by the Act. A sampling of their expressions illustrates the range of possible associations caught by Part V and the potential for discrepant adjudication: where lender and retailer "are one and the same with regard to ownership";[38] where there is an "arrangement" between the department store manager and the bank;[39] where the salesman and bank manager are "in cahoots";[40] where "a pattern exists" as a result of some manager being more lenient in his approach to loans;[41] where the vendor provides the purchaser with the bank forms;[42] where the bank asks what the loan is for, takes a chattel mortgage so that there is a "direct tie-in" with the purchase transaction, and issues a cheque payable to both the vendor and the purchaser;[43] but not where a chattel mortgage is taken back by a totally separate transaction.[44] The relationships range from informal arrangements of convenience to co-operative fraudulent malpractices.[45]

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dealer and a finance company which was a subsidiary of Ford Motor Co., and Jones v. Approved Bancredit Corp., 256 A. 2d 739 (Del. Sup. Ct. 1969), in which both seller and finance company were wholly owned by another company.

[38] Minutes, No. 30 *supra* note 27, at 30:11.

[39] *Id.* at 30:30.

[40] *Id.*

[41] *Id.* at 30:31.

[42] *Id.*

[43] *Id.* at 30:31-33.

[44] *Id.* at 30:33.

[45] Some feel too lenient a view was taken by certain members of the Committee as to what constitutes a "non-arm's length" transaction. Professor Ziegel submits more restrictive guidelines in his Comment, *supra* note 36, at 127, where he states:

> The fact that the lender knows what the loan is to be used for and even issues a cheque made payable jointly to the borrower and the dealer surely is not sufficient. Nor, in my view, is a close relationship established simply by virtue of the fact that the dealer has referred the borrower to a particular lender or even accompanied him to the lender's premises. Something more would have to be shown, such as that the dealer received a commission for the introduction or received some other form of favourable treatment. Continuity of relationship between the dealer and the lender would no doubt be an important factor. Another, and more generalized test, could be whether the lender's judgment of the loan application has been coloured by the knowledge that the proceeds of the loan were to be paid to a particular individual. This test would be consonant with the overall objective of the Bill to discourage financiers from closing a blind eye to the practices of the merchants and other sellers whose business they help to finance.

Characterizing the direct lender caught by Part V is a matter of policy. In the United States, the relevant policy considerations have been canvassed in literature published on this subject, and finance practices have received closer scrutiny than in Canada. There, the practice of referring or accompanying consumers to financiers of the retailer's choice is so prevalent that the American judiciary has dubbed it "body dragging".[46] Two tests have been developed by American legislators to describe the "closely-connected" relationship inviting sanction: the "referral" test and the "affiliation" test.

"Referral" involves a conscious and continuous channeling of consumers to a particular credit outlet. Irregular and occasional referrals, or the offering of advice on potential sources of credit, do not qualify. The ongoing arrangement gives rise to an implicit understanding between the parties.[47] "Affiliation" requires a "common control, contract or business arrangement"[48] for the mutual benefit of the parties. The Federal Trade Commission provided guidelines or examples of "affiliated" relationships:[49]

1. maintenance of loan application forms in the office of the seller;
2. joint participation in the processing of loan documents;
3. creditor's referrals of customers to sales outfits;
4. payment of consideration to a seller for furnishing loan customers or to a creditor for furnishing sales prospects;
5. floor-planning or inventory financing arrangements which include or contemplate the assignment of indirect paper or the referral of loan customers;
6. active creditor participation in the sales program;
7. joint advertising efforts.

The direct purchase money loan is regulated by the Federal Trade Commission (F.T.C.) under Rule 433, recently passed pursuant to the Federal Trade Commission Act.[50] The operation of this Rule is triggered by both the "referral" and "affiliation" arrangements. The Rule is noted less as a model than for its recognition of the existence of the

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[46] Promulgation of Trade Regulation Rule and Statement of Purpose, 40 Fed. Reg. 53, 506 at 53, 515 (1975).

The F.T.C. conducted hearings and elicited testimony from consumers, industries, and public interest groups. It determined that "vendor related loans should be covered by any Commission rule in this area" on the basis of testimony that revealed that the seller and lender could finesse both state legislation and judicial decisions which limited the doctrine of holder in due course and the use of waiver of defence clauses by the vehicle of direct loans.

[47] Guidelines on Trade Regulation Rule Concerning Preservation of Consumers Claims and Defences, 41 Fed. Reg. 20, 022 at 20, 025 (1976).

[48] Preservation of Consumers' Claims and Defenses, 16 C.F.R. s. 433.1 (*d*) (2) (1980).

[49] Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 41 Fed. Reg. 20, 022, at 20, 025 (1976).

[50] Preservation of Consumers' Claims and Defenses, 16 C.F.R. s. 433.1 (*d*) (2) (1980).

problem; it is an unfair trade practice for a "connected seller" to accept proceeds of a direct loan if the loan contract does not contain a legend stating that any holder of the consumer credit contract is subject to all claims and defences the debtor has against the seller of goods or services obtained with the proceeds.[51] An amendment extended this sanction to the lender as well.[52] In its present form, the effect of compliance with the Rule is to make the lender subject to the claims and defences of the buyer.

The policy behind the regulation of direct purchase money lenders can be found in a report produced by the National Commission on Consumer Finance, published in December, 1972, following an inquiry and investigation into consumer credit in the United States.[53] The conclusions of this study were reinforced by the more recent findings of the Federal Trade Commission.[54] Recommendations contained in the 1972 report were based on data collected by the Commission and facts and views presented by individuals, consumer organizations, industry and government at public hearings. With respect to closely-connected loans, the Commission acknowledged the difficulty in drafting regulatory legislation:

> The Commission believes routine referral by a seller to a lender . . . should not be permitted to subvert the policy behind a rule restricting or prohibiting use of negotiable promissory notes or waiver of defence clauses. However, drafting legislation barring routine referrals but not inhibiting direct lending for consumer purchases by institutions totally independent of sellers is a difficult task.[55]

The Commission recommended the abolition of waiver of defence (or cut-off) clauses, as well as the holder in due course doctrine; it proposed that the connected lender be subject to the claims and defences of consumers for the following reasons:[56]

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[51] A number of articles have already appeared on the F.T.C. Rule. *See, e.g.*, Weinberg, *Commercial Law and Consumer Credit*, 65 KENTUCKY L.J. 361 (1976); *Holder in Due Course: Does the Consumer Pay? A Panel*, 32 BUS. LAW. 591 (1977) [hereinafter cited as *A Panel*]; Garner & Dunham, *FTC Rule 433 and the Uniform Commercial Code: An Analysis of Current Lender Status*, 43 MISSOURI L. REV. 199 (1978).

[52] Preservation of Consumers' Claims and Defenses, 16 C.F.R. s. 433.2 (1980).

[53] CONSUMER CREDIT IN THE UNITED STATES, REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE (I.M. Millstein Chairman 1972).

[54] *Supra* note 46.

[55] *Supra* note 53, at 35.

[56] *Id.* at 36-37, where the Commission refers to Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, at 472-73 (1968). *See also* Ziegel, *supra* note 24, and Schuchman, *Consumer Credit by Adhesion Contracts II*, 35 TEMPLE L.Q. 281 (1962). Ziegel cites similar justifications for regulation of consumer credit financing generally, including the disparity in bargaining power between the parties coupled with an almost total lack of understanding of the blanket terms of adhesion contracts, which the consumer is meant neither to read nor understand. He also points to the fact that the consumer credit industry is "the activating agent" of the consumer's indebtedness, encouraging the consumer to borrow beyond his means, and should not lightly disclaim responsibility for the consumer's plight. This

1. Finance institutions are in a better position than consumers to control credit practices of retailers: they can choose the suppliers with whom they will do business. Merchants who want to stay in business will be forced to act responsibly or risk losing their line of credit. The effect of regulation will be to put fly-by-night operators out of business.

2. Finance institutions should bear the risk of the merchant's breach of contract. While the consumer deals with the merchant only once, the financier has a continuing relationship with him. He is equipped with staff to inquire into the merchant's reputation and record, and the cost of this inquiry can be borne over the course of numerous dealings.

3. When financing commercial contracts, financiers never insert disclaimer clauses because commercial buyers would not agree to them. Unlike the consumer buyer who purports to consent to the terms of standard form or adhesion contracts, the commercial buyer has the opportunity to negotiate his own terms. Accordingly, the financier in the ordinary course of commerce inquires into the performance record of merchants, and if the percentage of unsatisfied customer complaints is too high, refuses to do business.[57] In this light, the argument that the finance institution lacks the facilities to make inquiries or should not bear responsibility for the reliability of merchants carries little weight. The added cost of credit which would result can be borne by consumers at large or by increasing the dealer reserve and decreasing the dealer's participation in the share of the finance charges in each consumer credit transaction.

The results of the American inquiries into financing of consumer purchases may apply with equal force in Canada. The pervasiveness of "body dragging" in Canada as a means of effectively evading Part V has not been measured. To determine with any degree of accuracy the effectiveness of Part V as consumer protection legislation, a formal inquiry into present financing practices would be an essential task. In any event, legislative amendment should remove the misleading reference to the Income Tax Act from section 189(3), and guidelines should be provided to aid the court in determining the meaning of "non-arm's length" as a question of fact. The "referral" and "affiliation" tests may be appropriate in the Canadian context. Indeed, they are not inconsistent with the guideline Mr. Basford, then Minister of Consumer and Corporate Affairs, offered the Committee when he submitted that, in determining each case on its facts, one should look for the "effect pattern" (referring to the conduct of the seller and lender) making the loan "a related transaction".[58]

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point was raised in an earlier publication, CONSUMER CREDIT IN CANADA, PROCEEDINGS OF A CONFERENCE ON CONSUMER CREDIT (J.S. Ziegel & R.E. Olley eds. 1966).

[57] In 1977, personal loans represented 13.7% of the total assets of chartered banks in Canada. Commercial loans represented 22.3%. The consumer credit business is sufficiently substantial to merit treatment equivalent to that of commercial credit transactions. 4 STATISTICS CANADA, FINANCIAL INSTITUTIONS, CATALOGUE 61-006, Table 1 (1977).

[58] Minutes, No. 32, *supra* note 27, at 32:20.

In the absence of legislative amendment, the effectiveness of Part V is dependent on a reading of sections 189(2) and 189(3) which extends the application of section 189(2) to the direct purchase money lender. The introductory words of section 189(3) provide that the section operates "[w]ithout limiting or restricting the circumstances" in which a note can be considered to be issued in respect of a consumer purchase. This suggests there may be cases of purchase money loan financing caught by the Act, though the lender/merchant relationship falls outside the strict purview of "non-arm's length". Applying this construction, however, creates new difficulties. The requisite degree of familiarity between direct money lender and merchant outside the scope of section 189(3) is not defined. Criticism of this reading is based on the fact that section 189(2), originally the sales financier provision, will apply as against strangers.[59] No requirement for some sort of lender/merchant relationship, essential if Part V is to be applied against the direct lender, is imported. Additionally, one confronts in section 189(2) the problem of the apparent "cash purchase", excluded from Part V by section 188. This problem is canvassed more fully in the next section.

The importance of clarifying the scope of section 189(3) and sections 188 and 189(2) cannot be overstated. Prior to the passing of Part V, the discounting business was conducted primarily by finance companies.[60] There is now some evidence that this practice has been largely curtailed by Part V and that the majority of consumer purchases are financed by direct purchase money loans.[61] In the ten years from 1967 to 1977, the banks' market share of consumer financing increased from 46% to 77%.[62] This is due, at least in part, to the Bank Act amendment in 1967 which removed the 6% ceiling on interest rates chargeable on loans.[63] If ever there was a reason for banks to favour discounting over the direct loan, this reason no longer exists. The increase in the prevalence of direct loan consumer financing emphasizes the necessity for clarifying the position of the direct lender under Part V.

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[59] *See* Ziegel, *Consumer Notes and Part V of the Bills of Exchange Act — More Trouble Abrewing*, 2 CAN. BUS. L.J. 262 (1977). This view is more fully expressed in part III, JUDICIAL TREATMENT OF PART V, *infra* p. 344.

[60] *See* Ziegel, *Recent Legislative and Judicial Trends in Consumer Credit in Canada*, 8 ALTA. L. REV. 59 (1970), and *A Panel*, *supra* note 51

[61] After Part V was passed, an informal telephone survey was conducted by the Department of Consumer and Corporate Affairs to determine how members of the various lenders' associations interpreted Part V of the Bills of Exchange Act. A spokesman for one of the associations for financial institutions informed the Consumer Credit Branch on July 7, 1977 that all sales finance companies except one had ceased taking promissory notes. One continued the discounting of notes because of a term in their constituting document that required them to do so. It is interesting to note that the spokesman was "not completely sure" how the cash lenders viewed Part V.

[62] 21 STATISTICS CANADA, CREDIT STATISTICS, CATALOGUE 61-004, NO. 7 (July 1968); 31 STATISTICS CANADA, CONSUMER CREDIT, CATALOGUE 61-004, NO. 7 (July 1978).

[63] S.C. 1966-67, c. 87, s. 91(1).

2. *The Definition of Consumer Purchase*

A consumer bill or note "issued in respect of a consumer purchase" must be so marked.[64] Consumer purchase is defined as a purchase "other than a cash purchase".[65] Cash purchase is not defined in the Act.

In a direct loan situation, proceeds of the loan are received by the seller as *cash payment*. The specific exclusion of cash purchases under sections 188 and 189(2) lends credence to the view that direct purchase money loans are not caught by Part V unless "conclusively presumed" to be issued in respect of consumer purchases under section 189(3). Unfortunately, the "conclusive presumption" section itself specifies that the loan must be issued to enable the consumer to make a *consumer purchase*,[66] importing the non-cash purchase requirement into the section as a prerequisite. The Act is effectively precluded from applying to the direct money lender except in very rare circumstances.

Argument can be made against this reading of the statute; this appears below. The argument applies equally to sections 189(2) and 189(3). In the absence of statutory amendment to Part V, the view that section 189(3) alone applies to direct loan financing, because of the apparent cash purchase barrier in section 188, is untenable. Without legislative reform, every avenue available to the court to give effect to the spirit of Part V in its present form should be explored.

The concern that consumer financing is readily practised in forms which circumvent Part V because of the "cash purchase" exception, though not formally documented, is not entirely without foundation. Recently, an informal survey of lending practices conducted by the Department of Consumer and Corporate Affairs revealed that only the Bank of Nova Scotia and the Mercantile Bank of Canada had at one time assumed the practice of marking promissory notes respecting loans.[67] The Canadian Bankers Association has advised its members that lending practices are not affected by Part V.[68] Presumably, all other banks and finance companies consider that in all circumstances the application of loan funds to purchases by consumers constitutes a cash purchase.

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[64] Ss. 190(1), 189(1), (2).

[65] S. 188.

[66] S. 189(3) (*a*).

[67] Conversation with Consumer Credit Branch, Department of Consumer and Corporate Affairs, Oct. 6, 1978. Banks appear to mark paper if clearly referrable to joint business ventures; *e.g.*, the Bank of Montreal and Air France co-produce "Fly Now-Pay Later" plans. Both names appear on the standardized loan and promissory note forms. The latter are marked "consumer purchase".

[68] Internal memoranda, Department of Consumer and Corporate Affairs, Jan. 7, 1976 and Apr. 12, 1977. In the same file, a memo dated Dec. 24, 1975 to CCA from a branch of a provincial Consumer Affairs Department which regulates co-operatives and credit unions, noted that it had advised the credit unions that direct loans were not covered by Part V. The personal loan manager at the head office of a major financial institution stated in a letter to the Consumer Credit Branch that customers credited with loan funds make cash purchases, and reasoned, "To properly fulfill our role as a financial counsellor to the customer we *should not have* any connection with the vendor

To the layman the words "cash purchase" mean "a purchase that does not generate credit", either directly or indirectly. Black's Law Dictionary defines "cash" as money or its equivalent; money in hand, either in current coin or other legal tender, or in bank bills or cheques paid and received as money; an antonym to credit. A "cash contract" (as of a municipal corporation) is one not creating a debt within the constitution. "Cash price" is a price payable in cash at the time of sale of property, in opposition to a barter or a sale on credit. "Cash sale" is a sale for money in hand, conditioned on payment concurrent with delivery.[69] Although these definitions do not lend clear support to either reading of the statute, only the "cash sale" definition seriously reinforces the reading which effectively excludes direct loans from Part V. In the consumer's favour, however, it should be noted that the Act is concerned with whether or not there is a consumer *purchase*, not a cash *sale*.

The "cash purchase" problem was anticipated when Bill C-208 was still at Committee. Mr. Thorson's answer to the challenge that "no matter what the bank does, how the bank signs the thing, the person buying is going to buy on a cash basis . . . [and] the bank is going to get away with it",[70] is worth noting:

> It is a question of examining the transaction and determining whether *taking the whole of the transaction*, and all its component elements, it was in fact a cash transaction. You may very well conclude that putting all the documents together and adding them up . . . that it was not a cash transaction, *that the granting of the credit was an integral part of the total arrangement*.[71]

The occasions which would justify this conclusion were not specified. Mr. Thorson stated that it would be "unwise to try to express opinions on each kind of possible permutation of transaction", there being "so many variants in the circumstances in which this kind of transaction can be consummated". He specified only that the "totally independent transaction . . . is not covered".[72] Implicit in Thorson's definition of non-cash purchase is some sort of relationship between retailer and lender rendering "the granting of credit . . . an integral part of the total arrangement".

Once again, whether section 189(2) or section 189(3) is invoked, the undefined yet requisite relationship between lender and retailer poses a problem for the effectiveness of Part V. The potential for the direct loan to be disguised as a "totally independent transaction", resulting in a

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with respect to the individual loan and therefore should not be responsible for the goods purchased." (Emphasis added). Inter-departmental memorandum May 27, 1977.

[69] BLACK'S LAW DICTIONARY 272 (4th ed. rev. 1975).

[70] Minutes, No. 30, *supra* note 27, at 30:34.

[71] *Id.* (emphasis added).

[72] *Id.* at 30:35. Earlier, Thorson had emphasized the distinction between the independent loan transaction and the "situation where you have tied proceeds of loan", where "the advancing of money is part and parcel of the very transaction of purchase". *Id.* at 30:31.

"cash purchase" that is excluded from Part V, can be illustrated by the case of a grievance addressed recently to Consumer and Corporate Affairs Canada, *The Complaint of Mr. R.*[73]

Mr. *R.* wanted to buy a snowmobile. He went to a snowmobile dealer, made his selection, and signed a number of documents. The dealer offered to arrange a bank loan for Mr. *R.* to enable him to purchase the model he wanted. The documents signed included a loan application, a promissory note addressed directly to the financial institution, and a direction to the financier to pay the proceeds of the loan to the vendor. The stationery used was that of the bank. The loan application when completed by the dealer stipulated that "A Bankplan loan for $880.00 is required for the following purpose: PURCHASE OF SNOWMOBILE". Mr. *R.*'s wife, *J.R.*, signed as guarantor. The purchaser did not visit or discuss the loan with the lender. A week later, the dealer notified Mr. *R.* that the bank had not approved the loan and the snowmobile was never delivered. Five years later, Mr. *R.*'s bank account was debited the amount of its balance, $783.96. The account was a joint account that Mr. *R.* held with his then common law wife, *J.J.* About $450.00 of the $783.96 had been deposited by her. The proceeds of the loan were advanced presumably to the vendor. The whereabouts of the vendor could not be traced. Letters were exchanged between the solicitors of the bank and the complainant. The bank was asked on several occasions for confirmation that it had actually paid money to the vendor on the strength of the note. Confirmation was never provided.

It was argued on Mr. *R.*'s behalf that the note was a consumer note, that Part V required the note to be marked "consumer purchase", and that the note, not stamped, was void. The bank's solicitors replied that the promissory note would not be a consumer note within the meaning of the Bills of Exchange Act since it was not issued in respect of a consumer purchase as required by section 189(2) (*a*) of the Act, and that since the snowmobile was paid for in cash, the transaction fell outside the definition of "consumer purchase" in section 188 of the Act, because that definition excluded a "cash purchase" of goods.[74] This argument would apply equally to defeat section 189(3) (*a*).

It was later noted in informal conversations with the solicitors that the bank delivered the funds to the seller on the written instruction of the purchaser. The bank, it was suggested, was acting as the agent of the purchaser by delivering the cash to the seller and therefore there was a cash, not a consumer, purchase.[75]

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[73] This matter was referred to the Department of Consumer & Corporate Affairs by the solicitor acting on the complainant's behalf. The practice of the bank in question triggered sufficient concern at the time that the Department was advised to conduct an inquiry to determine to what extent Part V was being circumvented. Inter-departmental memorandum dated Mar. 2, 1977. The inquiry has not been held.

[74] Letter dated Aug. 13, 1976 from solicitors for the plaintiff to solicitors for Mr. *R.*

[75] Inter CCA memorandum, June 14, 1977 recording the argument presented by the solicitor for the plaintiff during an informal telephone conversation.

Mr. *R.*'s solicitor believed that his client would make a good witness, that the equities favoured his client and that a County Court Judge would be inclined to rule in his favour. He also believed that the Court of Appeal would present more of a problem and that the bank would appeal any favourable verdict at trial. More importantly, Mr. *R.* could not afford the cost of litigation.

The bank in this case relied on the inference raised by the documents that an independent loan had been acquired by Mr. *R.* and the proceeds then applied to the purchase of the snowmobile in a separate transaction. The vendor's name did not appear anywhere on the forms. The extent to which such arrangements between lender and merchant are unimpeded by Part V is unknown. Only a fraction of consumers may be knowledgeable enough to seek the aid of legal personnel or government agencies. Many cases are unmonitored by the courts because the injured party cannot afford a court case. Incidents like the above complaint raise suspicions about the magnitude of the problem.

Mr. *R.*'s complaint was resolved when the bank voluntarily decided to return the funds to Mr. *R.* The bank persisted in alleging that their dealings with the vendor were at arm's length and that the purchase was a cash and not a consumer purchase. They simply acknowledged that something was sufficiently amiss (referring possibly to insufficient record of the advance to the vendor, or possibly to their conduct in confiscating funds of a joint account to satisfy the debt of only one party) and that they were willing to repay the funds. The result was a happy one for the particular consumer involved in the case. For consumers at large, however, legislative clarification of the meaning of "cash purchase" is necessary to discourage such practices. It may be advisable to remove the reference to "cash purchase" from Part V altogether.

3. *The Financier's Action on the Contract*

The holder of a consumer note is not limited to proceeding on the note to recover the amount of the debt. Whether the consumer note arises out of a purchase money loan transaction or a financed sale, it is preceded by a contract. The note itself evidences the existence of an underlying debt. The contract may be oral or written and in the form of a conditional sales agreement, a loan contract or a chattel mortgage.

Part V governs consumer bills and notes only. It does not have the effect of regulating or invalidating contracts. The regulation of contracts lies within the exclusive jurisdiction of the provinces.[76] To reinforce the effectiveness of Part V as consumer protection legislation, companion legislation at the provincial level is necessary.[77]

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[76] This is generally accepted as within the scope of provincial jurisdiction over property and civil rights. B.N.A. Act, s. 92(13).

[77] This was realized before Part V was enacted. *See* the CROLL/BASFORD REPORT, *supra* note 2, at 11-12 (respecting the outlawing of unfair clauses, including exemption and cut-off clauses). *See also* Minutes, No. 30, *supra* note 27, at 30:21-23, 27, 33-34

Two methods have been traditionally employed by retailers and lenders to insulate the latter from claims and defences raised by the consumer on the contract: exemption clauses and cut-off clauses. Exemption clauses exclude all representations, warranties and conditions other than those contained in the written agreement. However, the judiciary has employed a number of techniques to minimize the clout of the exemption clause,[78] and several provinces have legislated against the incorporation of exemption clauses into contracts for the sale of consumer goods.[79]

The cut-off clause is the more powerful mechanism of the two. Cut-off clauses were first devised to get around the equitable principle that assignees of choses in action were subject to the equities between the original two parties. They limit the ability of the buyer to refuse payment to the financier on the basis of grievances the buyer has against the seller. The validity of the cut-off clause was upheld in 1921 in *Killoran v. Monticello State Bank*[80] by the Supreme Court of Canada. Until 1962, a buyer rarely succeeded in a contest against a finance company. The *St. Pierre* case,[81] decided that year in favour of the buyer, made no reference to the *Monticello* case. The decision was founded in equity because of the

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Reference is made to federal-provincial conferences of Oct. 1968 and Apr. 1969 where the matter of promissory notes ancillary to conditional sales contracts was considered. It was agreed that the approach should be "double-barrelled", that the federal government would deal with the bill of exchange aspect and the provinces with the contractual difficulties of exemption and cut-off clauses. Thorson summarized at p. 30:27 by saying that "it really does require more than action on [the federal] front . . . to provide total protection to the consumer in this kind of a situation".

[78] Principally, the courts will not enforce an exemption clause in the case of fundamental breach: Karsales (Harrow) Ltd. v. Wallis, [1956] 1 W.L.R. 936, [1956] 2 All E.R. 866 (C.A.); Suisse Atlantique Société d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale, [1967] 1 A.C. 361, [1966] 2 All E.R. 61 (H.L.); R.G. McLean Ltd. v. Canadian Vickers Ltd., [1969] 2 O.R. 249, 5 D.L.R. (3d) 100, *rev'd on other grounds* [1971] 1 O.R. 207, 15 D.L.R. (3d) 15 (C.A. 1970); Western Tractor Ltd. v. Dyck, 70 W.W.R. 215, 7 D.L.R. (3d) 535 (Sask. C.A. 1969); Lightburn v. Belmont Sales Ltd., 69 W.W.R. 734, 6 D.L.R. (3d) 692 (B.C.S.C. 1969). *See also* Waddams, *Contracts — Exemption Clauses — Unconscionability — Consumer Protection*, 49 CAN. B. REV. 578 (1971), where recent Canadian cases are reviewed.

[79] *See, e.g.*, The Consumer Protection Amendment Act, 1971, S.O. 1971, Vol. 2, c. 24, s. 2(1) (amending R.S.O. 1970, c. 82). This provision has been criticized for failing to make it an *offence* to include exemption clauses in these contracts. Unsuspecting purchasers assume their validity and fail to assert their claim. Other examples include The Conditional Sales Act, R.S.S. 1978, c. C-25, s. 28; The Consumer Products Warranties Act, R.S.S. 1978, c. C-30, s. 7; The Consumer Protection Act, R.S.M. 1970, c. C-200, s. 58(1); Sale of Goods Act, R.S.B.C. 1979, c. 370, s. 20. The equities may concern unfair trade practices for unconscionable acts or practices, governed by provincial trade practices legislation. These Acts provide for their application *notwithstanding any agreement to the contrary*. *See* Trade Practices Act, R.S.B.C. 1979, c. 405, s. 28; The Unfair Trade Practices Act, S.A. 1975, c. 33, s. 20; The Business Practices Act, 1974, S.O. 1974, c. 131, s. 4(8); The Business Practices Act, S.P.E.I. 1977, c. 31, s. 5(8).

[80] 61 S.C.R. 528, 57 D.L.R. 359 (1921).

[81] Federal Discount Corp. v. St. Pierre, *supra* note 10.

"intimate relationship" between the vendor and financier.[82] A cut-off clause had been inserted in the sales contract here but the financier made no attempt to enforce it. The buyer succeeded on the basis of the note alone.

Eight provinces have legislated with respect to cut-off clauses to revive the pre-1921 law, placing the assignee in no better position than the assignor.[83] Because these statutes are worded in terms of "assignees", protection extends to the consumer in the sales financing situation where the sales contract is assigned and the note negotiated to the financier. It has no effect on the direct loan situation where the contracts are not assigned but issued directly to the financier. Only one province (Manitoba) has legislation which deems the lender an assignee of the seller, and this applies only where the seller has arranged the financing and the lender has taken a chattel mortgage in the goods sold.[84]

What recourse does the consumer have if the financier proceeds on the loan contract or chattel mortgage rather than on the promissory note? One might argue, assuming that the direct lender is caught by Part V, that the original debt is merged in the promissory note and that the lender is subject to the equities with respect to the transaction as a whole. In the event that the note is unmarked, the debt may be void as being assumed in relation to an illegal contract. In the United States, legislation has been enacted with respect to "consumer credit contracts" generally (defined to include any instrument which *evidences* or *embodies* a debt arising from a "Purchase Money Loan" transaction or a "Financed Sale" covering both bills of exchange and loan or sales contracts[85]). The effect of this legislation is that any holder of a "consumer credit contract" is "subject to all claims and defences which the debtor could assert against the seller of goods or services obtained with the proceeds [thereof]".[86]

This approach may not be feasible in Canada. The more practicable solution may be for the provinces to exercise their legislative authority to close this gap in the law. An attempt was made in British Columbia Consumer Protection Bill 28 (1977) to include such a provision. Section 8 provides:

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[82] The decision is discussed more fully in the text beginning at pp. 322-23

[83] The provisions generally provide that the assignee of any rights of a lender has no greater rights than the assignor and takes subject to any defence that the buyer would have had against the assignor. *See* Loi sur la protection du consommateur, S.Q. 1978, c. 9, s. 103; Consumer Protection Amendment Act, 1971, S.O. 1971, Vol. 2, c. 24, s. 1 (amending R.S.O. 1970, c. 82); Cost of Credit Disclosure Act, R.S.N.B. 1973, c. C-28, s. 22; The Consumer Protection Act, R.S.M. 1970, c. C-200, s. 67(1), (2), The Cost of Credit Disclosure Act, R.S.S. 1978, c. C-41, s. 17, An Act to Amend Chapter 53 of the Revised Statutes, 1967, the Consumer Protection Act, S.N.S 1970-71, c. 32, s. 1; Consumer Protection Act, R.S.P.E.I. 1974, c. C-17, s. 23, Consumer Protection Act, R.S.B.C. 1979, c. 65, s. 3 (to be proclaimed).

[84] R.S.M. 1970, c. C-200, s. 69, *as amended by* S.M. 1971, c. 36, s. 14, S.M. 1972, c. 51, s. 5.

[85] Preservation of Consumers' Claims and Defenses, 16 C.F.R. s. 433.1(i) (1980).

[86] Preservation of Consumers' Claims and Defenses, 16 C.F.R s. 433.2 (1980)

(1) A creditor in a purchase financing transaction has no greater rights than the seller and is subject to the same defences as may be raised against the seller.
(2) For the purpose of subsection (1), a creditor who is not dealing at arm's length with a seller shall be deemed to know that the credit proceeds will be used by the borrower to purchase goods or services from a seller.

A "purchase financing transaction" is defined as "the extension of credit to a borrower by a creditor where the creditor knows or ought to know that the credit proceeds will be used by the borrower to purchase goods or services from a seller".[87] One of the reasons this provision has not been passed is that it fails to draw a distinction between close and remote lenders. This consideration aside, the provision does serve to illustrate the kind of legislation required at the provincial level to prevent the circumvention of Part V. Without such legislation, the direct lender can circumvent Part V by proceeding against the borrower on the contract alone.

Before closing the discussion of the lender's contract, a related development concerning the relationship between the contract and the negotiable instrument needs to be mentioned. Just as Part V, being federal legislation, cannot regulate or alter the nature of the contract underlying a promissory note, so too provincial legislation regulating contracts cannot govern directly the inherent nature of negotiable instruments.

Both federal and provincial legislation has been passed in response to case law developments which have blurred the boundary between the contract and the negotiable instrument. Controversy arose principally over a 1969 decision of the Supreme Court of Canada, *Range v. Belvedere Finance Corp.*,[88] in which the Court, to protect the purchaser, formulated the anomalous solution that the promissory note was not an unconditional promise to pay when attached to a conditional sales contract. This case has been approved, followed, distinguished and criticized.[89] Financiers found they could avoid its results simply by detaching the promissory note from the contract. Legal draftsmen finally became involved to untangle the confusion: with respect to negotiable instruments, Part V was enacted to preserve the consumer's defences on the note; with respect to contracts, a number of protective measures were legislated by the provinces.

[87] The Consumer Protection Act, R.S.B.C. 1979, c. 65, was adopted Mar. 25, 1977, but s. 8 has never been proclaimed in force. One of the major concerns is that the provision is sufficiently broad to capture credit card companies. It also fails to except the independent lending practices.

[88] Range v. Corp. de Finance Belvédère, [1969] S.C.R. 492, *sub nom.* Range v. Belvedere Finance Corp., 5 D.L.R. (3d) 257.

[89] Ziegel criticizes this case in *Canada Regulates Consumer Notes*, 26 Bus. Law. 1455, at 1457 (1971) and in Comment, 48 Can. B. Rev. 309 (1970). *Compare* Traders Group Ltd. v. Fulkerth, [1972] 3 W.W.R. 481, 25 D.L.R. (3d) 452 (Alta. C.A.) *with* British Acceptance Corp. v. Hansen, [1974] 3 W.W.R. 461, 44 D.L.R. (3d) 421 (Alta. C.A.), and Industrial Acceptance Corp. v. Richard, [1975] 1 S.C.R. 512, 51 D.L.R. (3d) 559 (1974).

Curiously, the provincial legislation has been interpreted to affect the character of negotiable instruments. Provincial "seize or sue" legislation has been held to affect the unconditional nature of negotiable instruments, following reasoning similar to that in *Range v. Belevedere Finance Corp.*[90] Similarly, the provincial requirement that a copy of the sales agreement accompany the assignment of negotiable instruments raises questions of constructive notice.[91] In light of exclusive federal jurisdiction over bills of exchange and promissory notes, however, it is doubtful that these provincial enactments can in fact affect the nature of the negotiable instrument.

4. *Section 191 — The Defences the Buyer Would Have Had Against the Retailer*

Part V provides that the right of a holder of a marked consumer bill or note to enforce the instrument against the party liable to pay the debt outstanding is subject to any defences that the purchaser "would have had in an action by the seller on the consumer bill or consumer note".[92] This language is consistent with the original purpose of the Act: to protect the consumer from unscrupulous sellers who assign the finance paper to a third party without performing their obligations to the consumer. In this situation, the defences the consumer would have had in an action by the seller on the bill or note are preserved.

The Committee's change in policy to encompass certain practices of direct loan financing has already been noted.[93] It was probably an

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[90] Provincial "seize or sue" legislation, limiting the creditor either to repossession of the goods or recovery of the debt, incorporates into the chattel mortgage or conditional sales contract an occasion that would relieve the buyer from his obligation to pay: Loi sur la protection du consommateur, S.Q. 1978, c. 9, s. 138, Chattel Mortgage Act, R.S.B.C. 1979, c. 48, s. 23; The Conditional Sales Act, R.S.A. 1970, c 61, s. 19 *as amended by* S.A. 1971, c. 96, s. 2; The Conditional Sales Act, R.S.N. 1970, c. 56, s. 12(3), (4); The Bills of Sale Act, R.S.N. 1970, c. 21, s. 14 *as amended by* S. N. 1974, No. 42, s. 4. The question raised by these provisions is whether a note issued in respect of the conditional contract becomes a conditional obligation to pay along the lines of reasoning in the Range v. Belvedere Finance Corp. case. The constitutional validity of this application of the "seize or sue" provisions should be questioned. *But see* Canadian Imperial Bank of Commerce v. Materi, [1975] 2 W.W.R. 299, 50 D.L.R. (3d) 400 (B.C.S.C. 1974), where the court upheld the validity of the B.C. Bills of Sale Act, s. 22A (now Chattel Mortgage Act, s. 23), even though it purports to *extinguish* obligations arising out of the negotiable instrument once the goods have been repossessed.

[91] The Consumer Protection Act, R.S.O. 1970, c. 82, s. 42(1); The Newfoundland Consumer Protection Act, R.S.N. 1970, c. 256, s. 21(1); Cost of Credit Disclosure Act, R.S.N.B. 1973, c. C-28, s. 20; The Consumer Protection Act, R.S.M. 1970, c. C-200, s. 67(7); The Cost of Credit Disclosure Act, R.S.S. 1978, c. C-41, s. 14(1). Quebec's Consumer Protection Act, S.Q. 1978, c. 9, s. 102, goes further by stipulating that the negotiable instrument forms part of the whole contract and neither it nor the contract can be assigned separately.

[92] S. 191.

[93] *See* p. 328 *supra*.

oversight that section 191 was not then also amended. If the purchaser issues a note directly to the lender, the purchaser has no defences on that note against the seller. Section 191 must therefore be construed liberally to preserve any defences "that the purchaser would have had in an action by the seller on the consumer bill or consumer note if the note had been payable to him and subsequently negotiated by him to the lender".[94]

III. Judicial Treatment of Part V

A. *Introduction*

In eight of the ten decisions reported to date,[95] the purchases involved were financed by direct purchase money loans.[96] This underlines the importance noted earlier of clarifying the quality or nature of the relationships between lenders and merchants which attract the protection of Part V. A review of the cases reveals that the courts have done little to clarify the situation.

Part II of this paper described the major problems facing the consumer who relies on Part V, attributable to the wording of the Act. The oversight in the drafting of section 191 has never been the subject of litigation. The other problems — the nature of the relationship between the seller and lender caught by sections 189(2) and 189(3), the definition of cash purchase, and the lender's alternative contractual remedies — have each arisen at least once either directly or by inference. This section will examine the case law bearing upon the two main obstacles facing the consumer: establishing that Part V applies to the financier of his consumer purchase; and, defeating alternative recourses available to the financier. The section will take the following format:

1. The Position of the Direct Purchase Money Lender
   (i) Section 189(2) — When is a Note Issued "in Respect of a Consumer Purchase"?

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[94] This is the formula of words that was set forth by the Canadian Consumers Council in a brief presented at the Committee Hearings, Minutes, No. 30, *supra* note 27, at 30:11. *See also* Ziegel, *supra* note 36, at 128.

[95] The ten reported decisions on Part V are Canadian Imperial Bank of Commerce v. Lively, *supra* note 24; Neptune Acceptance Ltd. v. Williams, *supra* note 24; Canadian Acceptance Corp. v. Therrien, [1974] C.S. 549; Laurentide Acceptance Co. v. Russell, [1975] C.S. 548 (Headnote only: case reported Apr. 2, 1975, No. 200-05-001-068-746); Banque Provinciale du Canada v. Dugas, [1976] C.S. 1119 (Headnote only: case reported July 19, 1976, No. 05-000-618-75); Canadian Acceptance Corp. v. Galbiati, [1977] 1 W.W.R. 280 (Sask. Dist. C. 1976); Canadian Imperial Bank of Commerce v. Langlois, [1977] 2 B.C.L.R. 83, 1 B.L.R. 117 (S.C.); Royal Bank of Canada v. Siemens, [1978] 2 W.W.R. 298, 82 D.L.R. (3d) 527 (B.C.Cty. Ct.); Bank of Montreal v. Kon, 8 A.R. 593, 82 D.L.R. (3d) 609 (S.C. 1978); *Re* MacLaren, 30 N.S.R. (2d) 694, 88 D.L.R. (3d) 222 (S.C. Bank. 1978). The *Dugas* case, in which the consumer note was properly marked and enforced in the customer's favour, is not discussed in this paper.

[96] Only *Dugas* and *Neptune* concerned sales financing situations.

(ii) Section 189(3) — the Meaning of "Non-Arm's Length"
2. The Recourses of Lender and Consumer Outside Part V
   (i) The Lender's Action on the Contract
   (ii) The *St. Pierre* Doctrine and the Meaning of "Intimate Relationship"

B. *The Position of the Direct Purchase Money Lender*

1. *Section 189(2) — When is a Note Issued "in Respect of a Consumer Purchase"?*

The courts will find that a note has been issued "in respect of a consumer purchase" when they are satisfied on the evidence[97] that such a note exists. Precisely what evidence is necessary is unclear. It is clear, however, that the courts will distinguish between the case of the independent loan transaction and the case where the financial institution and the seller are acting "in concert".[98] Part V did not intend to, and does not in fact, encompass the former.

In *Canadian Imperial Bank of Commerce v. Langlois*,[99] the purchaser agreed to buy a mobile home from the dealer on the approval of his loan application. The buyer signed a loan application form on the seller's premises. He was later accompanied by the seller to the latter's bank. Authority for the loan had been granted on the basis of the information supplied by the seller prior to this meeting. The loan application form noted that the loan was required to "assist the purchase of a 1972 mobile home". On the back of the form was a promissory note to the mobile home company. The note was not marked "consumer purchase". The bank also had the buyer sign a chattel mortgage. A cheque made payable to the mobile home company was signed by the bank and handed directly by the consumer loan officer to the vendor. The cheque was negotiated at once.

Before the mobile home was delivered, the company went out of business. The bank sued the purchaser on the note. Without providing reasons, the court held that, on the evidence, it was satisfied that the promissory note was given by the buyer "in respect of a consumer purchase" and was therefore a consumer note as defined in section 189(2); the bank was well aware of "the nature of the transaction". The court adopted the language of Forbes J. of the Saskatchewan District Court in *Canadian Acceptance Corp. v. Galbiati*:[100]

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[97] *See* Canadian Acceptance Corp. v. Galbiati, *supra* note 95, at 282. This was followed in the *Langlois* case, *supra* note 95, at 86, 1 B.L.R. at 121.

[98] *See* Royal Bank of Canada v. Siemens, *supra* note 95, at 306-07, 82 D.L.R. (3d) at 534-35.

[99] *Supra* note 95.

[100] *Supra* note 95.

> Having considered the evidence I have no hesitation in making a finding that the transaction in this case was a "consumer purchase"; that the promissory note was a "consumer note" and that the words "consumer purchase" were not marked on the face of the consumer note. It follows that the consumer note is void.[101]

Under these circumstances, the court found that it was not necessary to consider the provisions of section 189(3).

The *Galbiati* case is similar in its facts and in its conclusion. In that case, the buyer purchased a second-hand car from a dealer. The transaction was financed by a direct purchase money loan arranged by the seller and financier in the buyer's absence. When the seller accompanied the buyer to the bank, they each signed a promissory note and a chattel mortgage in exchange for the loan to the buyer. The financier issued a cheque to the dealer and buyer jointly. The buyer took delivery of the car but soon discovered an oil leak the company had promised to repair. He reported the problem to the dealer and the car was repaired at the company's expense. However, the work required was so extensive that the buyer refused to take delivery of the car a second time and refused payment on the promissory note. The financier repossessed the car, sold it, and sued both the buyer and the dealer for the balance on the note.[102] The court held that a promissory note given to a finance company to assist in the purchase of a car is a consumer note under section 189(2), and that the note is void if not appropriately marked.

In neither *Langlois* nor *Galbiati* did the financier rely on the chattel mortgage or the loan contract to recover the amount of the debt.

These decisions appear to characterize as "consumer notes" those promissory notes evidencing purchase money loans in circumstances where the lender knows that the proceeds will be applied to the purchase of consumer goods. Neither case focuses on the relationship between lender and merchant specifically to clarify the relationship required. Professor Ziegel criticizes these decisions. He notes that there was "*prima facie* evidence in both cases that the lenders might not have been dealing at arm's length with the dealers", so that they might have come within section 189(3). But he points out:

> [T]his possibility is not pursued in the judgments. The ratio in both cases was that the borrower had executed a consumer note within the meaning of s. 189(2) which, not being marked as required by s. 190(2), was a complete nullity. In the *Galbiati* case, Forbes D.C.J. apparently deemed it so plain that Part V applies equally to a consumer note evidencing a purchase money loan as to a note given to a dealer for the balance of the purchase price that he did not find it necessary to go beyond a recitation of the statutory provisions.[103]

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[101] *Langlois, supra* note 95, at 86, 1 B.L.R. at 121.

[102] Counsel for the defence did not raise the Saskatchewan "seize or sue" legislation, the effect of which was to extinguish the indebtedness of a purchaser on repossession or surrender of the article: The Limitation of Civil Rights Act, R.S.S. 1965, c. 103, s. 18 *as amended by* S.S. 1970, c. 37, s. 2, S.S. 1973, c. 52, s. 2 (now R.S.S. 1978, c. L-16, s. 18).

[103] Ziegel, *supra* note 59, at 264.

On the basis of the evidence and the reasons disclosed, the judgments may be rightly criticized. One might be misled into believing that something short of a connected seller and lender would suffice to bring the direct purchase money loan within Part V. Professor Ziegel, however, criticizes the judgments as erring in the application of section 189(2) to the direct loan situation; the only provision in Part V applicable to the direct money lender is section 189(3). He interprets section 189(3) as a codification of the *St. Pierre* doctrine and feels that nothing short of that relationship should suffice.

While it may be that a *St. Pierre* relationship is required to bring the direct lender within Part V, applying section 189(2) to the direct loan situation does not necessarily deny the necessity of an "intimate relationship". Indeed, to establish that the note was issued with respect to a consumer purchase would require proof of a relationship of a kind.[104] Furthermore, nowhere is it specified in the Act that the *St. Pierre* doctrine has been incorporated into the statute. The task of defining the required "relationship" must begin with the clear language of the statute as interpreted by the courts.[105]

In both the *Langlois* and *Galbiati* cases, something more than totally independent dealings transpired. The financiers supplied the merchants with blank forms. The approval of the loan was made on the basis of information obtained by the seller and was granted in the buyer's absence. The financier took a chattel mortgage in the specific item purchased. Whether or not this evidence justifies a finding of "connected parties" is a matter of policy. Whether the judges would have based their decisions on this evidence and nothing more is not clear from the transcripts.

In a recent telephone conversation with the British Columbia Consumer Affairs Department, a member of the Legal Branch revealed that much more of a connection between the parties was in fact involved in the *Langlois* case.[106] The merchant and lender co-operated in accordance with a pre-existing arrangement in the financing of numerous purchases of mobile homes over a period of time. Evidence showed that the merchant had gone to great lengths to bring his prospective customers to this particular financial institution, even if it meant flying them in from

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[104] An interesting argument in support of the application of s. 189(2) to direct lenders was made in *Re* MacLaren, *supra* note 95, by counsel for the trustee of the purchaser who pointed to s. 189(3) (*a*) as evidence of the fact that a note, though outside the presumption in s. 189(3), could qualify as a consumer note when issued in consideration for a loan advanced to enable the borrower to make a consumer purchase.

[105] In Bank of England v. Vagliano Bros., [1891] A.C. 107, at 144, [1891-4] All E.R. Rep. 93, at 113 (H.L.), Herschell L.J. stated that "the proper course is . . . to examine the language of the statute and to ask what is its natural meaning, uninfluenced by any considerations derived from the previous state of the law . . . ".

[106] Telephone conversation, Oct. 6, 1978. At the time of the *Langlois* case, the Department of Corporate and Consumer Affairs was handling a similar complaint involving the same financial institution. This action was dropped by the financier when the decision in *Langlois* was handed down.

points some distance away. He always accompanied the buyer to the bank and the forms were always complete on the buyer's arrival. The bank was remiss in granting substantial loans without checking the security, contrary to the standard procedures practiced in the lending of mortgage money. In some cases, the vendor was selling non-existent goods. At the time of the *Langlois* trial, the merchant had already been convicted of several counts of fraud. The loans manager had left the employ of the bank. In light of this evidence, the judge was willing to find in the consumer's favour.

The *Galbiati* decision was recently criticized by a British Columbia county court in *Royal Bank of Canada v. Siemens*,[107] and by the Nova Scotia Supreme Court in *Re MacLaren*.[108] Both courts said that the *Galbiati* case concerned a "cash purchase" and therefore fell outside the scope of Part V.[109] *Langlois* was distinguished on the basis of the non-delivery of the goods at the time of payment and the conditional delivery of the buyer's cheque. Fulton J. concluded in *Siemens*, however, that

> to the extent that [these cases] are not so distinguishable and appear to support the view that a purchase, payment for which is made and accepted in full at the time of delivery as was the case here, is other than a cash purchase, I must respectfully decline to follow them.[110]

Cowan C.J., in *Re MacLaren*, adopted this same conclusion.[111]

The *Siemens* case clearly fell outside the scope of Part V on its facts. The defendant and a friend applied to the defendant's bank for a loan of $3,000. They wanted the money to purchase a car for the friend. Each signed a promissory note. Security for the loan was granted by way of a chattel mortgage covering both the defendant's car and the car purchased with the proceeds of the loan by the friend. The proceeds were paid into the borrowers' joint chequing account, opened for that purpose, and a certified cheque was drawn to complete the purchase of the car. The car was delivered at the time of payment. The defendant's friend disappeared with the car shortly afterward and the defendant was faced with meeting payments she could not afford. After an interview with the loan manager, the defendant made a new note repayable over a longer period in more affordable installments, and issued a new chattel mortgage on her car. The defendant acted without legal advice as to the consequences of these transactions.

Neither note was stamped "consumer purchase". When the defendant did seek legal advice, she was told to discontinue payments. The bank brought action on the note for the balance owing.

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[107] *Supra* note 95.

[108] *Supra* note 95.

[109] This is consistent with Professor Ziegel's view of the case, *supra* note 59.

[110] Royal Bank of Canada v. Siemens, *supra* note 95, at 311, 82 D.L.R. (3d) at 538.

[111] *Supra* note 95, at 704-06, 88 D.L.R. (3d) at 228-30.

In her defence, the defendant relied on sections 188 and 189(2), rather than on section 189(3). An issue before the court was whether the notes were issued in respect of a consumer purchase so as to be consumer notes. The situation was clearly one of a lender, acting in good faith and independently of the seller, taking a note to secure the advance of a loan. The note was issued, not in respect of the consumer purchase, but in respect of the purchase money loan. This situation was distinguished by the court from the situation where a promissory note is issued to a seller who then discounts it to a lending institution; the sales finance company receives a note "issued in respect of the consumer purchase" whether or not it was dealing at arm's length with the seller. The range of financing practices between sales financing and independent loans was not discussed.

The court decided that sections 188 and 189(2) will not apply to the direct money lender where he is *totally independent* of the vendor. To the extent that the remarks of Judge Fulton may be construed as supporting the view that sections 188 and 189(2) will *never* apply to the direct money lender, this is *obiter dictum* only.[112] On close reading, Fulton J. does not appear to go that far. He discusses section 189(3) as a provision necessary to prevent the defeat of the legislation by a dealer acting "in concert" with the lender to obtain cash payment from a loan advanced directly by the lender. He appears to say initially that, outside section 189(3), "[t]here is no reason of policy or principle of interpretation" to conclude that a note issued in a direct money loan situation should ever be held as a note in respect of a consumer purchase.[113] Shortly afterwards, however, he qualifies this statement: "[A]s I have said, there is no reason why the legislation [section 189(2)] should apply to the case of a *bona fide loan or advance* to a borrower-purchaser by a lending institution *which is acting quite independently* of the seller."[114]

Earlier, when discussing section 189(2), Judge Fulton stated that "normally" a note issued to a direct money lender would be held to be issued in respect of the loan;[115] he did not say this would "always" be so.

The court found, as a second ground for decision, that the purchases involved were not "consumer purchases". The transaction between the seller and the purchaser was a "cash purchase" because, "on each occasion the transaction was one where payment for the goods was accepted as payment in full by the seller and the goods were delivered at that time and title thereto passed to the purchaser".[116] A consumer purchase "[does] not include a purchase the price of which is accepted as

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[112] The consensus amongst financiers and consumer protectionists alike at the recent conference on consumer affairs held in Toronto, Oct. 20-21, 1978 was that *Siemens* holds ss. 188 and 189(2) inapplicable to direct lenders generally.

[113] *Supra* note 95, at 306, 82 D.L.R. (3d) at 534.

[114] *Id.* at 307, 82 D.L.R. (3d) at 535 (emphasis added).

[115] *Id.* at 306, 82 D.L.R. (3d) at 534.

[116] *Id.* at 307-08, 82 D.L.R. (3d) at 535.

paid in full at the time the purchase is made [where] the goods are delivered at that time, and no credit is extended by the seller''.[117]

In effect, the court rejected the application of sections 188 and 189(2) to direct money lenders where the goods have been delivered at the same time as payment is received. Presumably there is room to argue that there is no ''cash purchase'' if the goods are not delivered, so that in non-delivery cases the direct purchase money lender may come within sections 188 and 189(2). *Langlois* was distinguished on this basis. This is an unusual criterion for the determination of a consumer purchase. It is reminiscent of the definition of ''cash sale'' in Black's Law Dictionary discussed earlier.[118] Its weakness lies in the fact that on the face of the Act, it is a cash *purchase*, not a cash *sale*, which is effective to place the consumer outside the Act. In the event that a restrictive interpretation of section 189(3) (*b*) evolves limiting the application of section 189(3), and in the absence of legislative amendment to Part V, ''consumer purchase'' in section 188 should be liberally construed to encompass those purchases which are in essence non-cash purchases, where the consumer has no control over the funds, but cash funds pass into the hands of the seller.

2. *Section 189(3) —The Meaning of ''Non-Arm's Length''*

In *Canadian Imperial Bank of Commerce v. Lively*,[119] the buyer agreed to purchase a number of chinchillas, induced by misleading representations made by the seller about the profits that could be made from the breeding of the animals and the sale of their pelts. The seller suggested that funds could be borrowed from the plaintiff bank and produced an application form, a promissory note and a conditional sales contract supplied to the seller by the bank. The buyer signed these forms at the seller's place of business. The seller took the forms to the bank and acquired the proceeds of the loan after a credit rating check on the prospective buyer had been conducted. The buyer never met the bank loan officer and never saw the money. The note was not marked ''consumer purchase''.

The buyer received a letter from the bank acknowledging the loan. The bank asked that he sign a declaration that he had signed the

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[117] *Id.* at 308, 82 D.L.R. (3d) at 536. The decision in *Re* MacLaren, *supra* note 95, is based on similar considerations. Though no formal evaluation of the connections between seller and lender was made, the court was apparently influenced more by the fact that the seller exchanged delivery of the goods for cash payment without the presence of an officer or employee of the bank at the signing of the sales agreement, than by the fact that the seller had telephoned the bank to arrange the loan initially; that the proceeds of the loan were not advanced unconditionally but instead were in the form of a bank draft addressed to the seller; and that the bank accounted for at least a small percentage of the seller's financing arrangements and had recently contacted the seller indicating an interest in obtaining additional consumer loan business.

[118] *See* p. 337 *supra*.

[119] *Supra* note 24.

application for a loan and had authorized the bank to pay the proceeds to the seller.

The consumer loans officer of the plaintiff bank was a former employee of the seller chinchilla company and knew the seller's business. The loan officer and seller had agreed at a private meeting to process the loans in this fashion. The loan officer testified that it was not common practice for the bank to give out such forms: most people came into the bank to obtain their loans directly.

The buyer ceased payments on the promissory notes, on the basis of the seller's misrepresentations, and the bank instituted proceedings. The buyer raised sections 188, 189(2) and 189(3) in his defence. The court found that the purchase was not a consumer purchase under sections 188 and 189(2) because the object of the scheme was profit. Business ventures are not covered by these provisions. The judge did not stop there, however. He stated that the case may still fall within section 189(3): that section 189(3) (*a*) was satisfied, but that section 189(3) (*b*) was not. This reading of the statute is clearly incorrect, as was noted in *Bank of Montreal v. Kon*.[120] In that case, the court reasoned that section 189(3) (*a*) requires that the money advanced enable the consumer to make a *consumer purchase*, defined in section 188 as a non-business purchase. It should be noted that this reading imports the non-cash purchase requirement into the section as well.

The *Lively* case is noteworthy for its comments on section 189(3) (*b*). The Nova Scotia Supreme Court interpreted "non-arm's length" in terms of the construction placed on those words by decisions under the Income Tax Act. After reviewing the case law, the court concluded that "not at arm's length" applies "where one person or corporation has control, direct or indirect, over another person or corporation".[121] The bank in this case did not have such control over the merchant's affairs. The interests of the parties were completely independent in that sense. It was not enough that sales were dependent on loans advanced in pre-arranged fashion, as it was in the *St. Pierre* case.[122] The sale and the loan were separate and distinct transactions. The supply of application forms by the bank to the seller was for convenience only. The bank was otherwise uninvolved in the sale of the chinchillas.

Aside from the profit motive, the facts of the *Lively* case are not unlike those in *Langlois*. It is unclear, however, what the court would have decided had the purchase not been a business venture. Read in conjunction with the *Siemens* and *MacLaren* cases, there may have been no alternative under such circumstances but to proceed under section 189(3), since the goods had been delivered by the seller at the time of payment (though they were of lesser quality than anticipated). However,

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[120] Bank of Montreal v. Kon, *supra* note 95, at 623-24, 82 D.L.R. (3d) at 629.

[121] *Supra* note 24, at 410, 46 D.L.R. (3d) at 440.

[122] *See* the passage from the *St. Pierre* case quoted pp. 322-23, *supra*, defining the meaning of "joint venture".

the "cash purchase" problem arises under section 189(3) (*a*) as well, following the *Kon* reasoning through to its natural conclusion. Even if this is overlooked, in light of the restrictive interpretation of section 189(3) (*b*) in *Lively*, the consumer may have a better chance of success arguing the *St. Pierre* principle rather than proceeding under Part V.[123] In either event, the finance company has an alternative action on the contract.

C. *Recourses of Lender and Consumer Outside Part V*

1. *The Lender's Action on the Contract*

In *Bank of Montreal v. Kon*,[124] the Alberta Supreme Court held that Part V did not apply to the purchase of motor homes primarily for the purpose of earning income. The case invites comment, however, from the point of view of the availability of a contract action and for its interpretation of the *St. Pierre* doctrine.

The motor homes in the *Kon* case were purchased from a mobile home company, and leased back to the company by the purchasers for rental to other users. Proceeds from those rentals were to be applied by the merchant to the amounts outstanding on the consumers' notes held by the plaintiff bank. All the purchases from the company were financed by bank loans issued in exchange for promissory notes and chattel mortgages. Cheques were issued by the bank to the purchasers, endorsed, and then handed by the bank to the vendor. The bank also granted commercial loans to the company to finance the operation. When motor home rentals began to decline, the bank proposed a six month moratorium on the repayment schemes, refinanced the loans, and advanced further credit to the company.

In August, 1973, the bank received an anonymous phone call which led it to suspect that the company was converting funds earmarked for the reduction of the commercial debt, and an inventory check was initiated. The company's account was placed on a special status involving close monitoring of the company's operation.

In mid-December of that year, the company asked for further funds, indicating that the business would collapse if the funds were not advanced. The bank responded that the account had to operate in a "mutually satisfactory manner"; further credit would require the granting of additional security. In January, when the company failed to respond to the bank's invitation to discuss the matter, steps were taken to call in the loan. The company sold the motor homes, disregarding the chattel mortgages, and used the proceeds to reduce the amount of the outstanding commercial loans. No proceeds from the sales were returned

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[123] *But see* the discussion of recent developments in the law relating to the *St. Pierre* doctrine, beginning at p. 355, *infra*.

[124] *Supra* note 95.

to the purchasers. The bank brought action against the purchasers to recover on the promissory notes.

The defendant purchasers argued, *inter alia*, that the notes were not unconditional promises to pay. They drew an analogy between a chattel mortgage, and the conditional sales contract in the *Range* case,[125] alleging that the granting of security in the motor homes was a granting of the right to seize the homes in the event of non-payment.[126] The court found, however, that the note was not a part of the chattel mortgage but an entirely separate document; the only connection between the chattel mortgage and the note was that the former was rendered void on payment of the latter. Furthermore, the court found that the bank had not agreed it would pursue its remedy under the chattel mortgage prior to or in lieu of enforcing payment on the notes. Indeed, the chattel mortgage "specifically accorded to the bank the right of recourse singly or concurrently on the note and the chattel mortgage".[127] In this case, the availability of two separate and distinct causes of action allowed the finance company to enforce the promissory note as an unconditional promise to pay although the security in the chattel mortgage had been lost.

A similar view was expressed in *Re MacLaren*:

> [T]he chattel mortgage was stated to be collateral to the promissory note . . . additional to it, and not dependent, in any way, upon the validity or enforceability of the promissory note itself. Even if the promissory note were void by the operation of the sections of the *Bills of Exchange Act* . . . the debt [loan] owed . . . to the Bank would still remain outstanding. . . . [The loan] is not rendered void by the provisions of the *Bills of Exchange Act*. . . .[128]

The fact of two distinct causes of action has serious implications with respect to Part V. The lender can choose the weapon that suits him best. As was stipulated in the chattel mortgage in *Kon*, the financier "shall not be precluded by the exercise of either remedy from proceeding to exercise the other remedy".[129] Had the note been void, or not fully enforceable, the lender could still have enforced the contract for the amount of the debt outstanding.

In *Kon*, the provincial "seize or sue" legislation did not extend to the case of a chattel mortgage. Two Quebec cases illustrate the defences such provincial legislation may offer in these circumstances with respect to recovery on a promissory note.

In *Laurentide Acceptance Co. v. Russel*,[130] the defendant raised the provincial "seize or sue" legislation as a defence against enforcement of

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[125] *Supra* note 88 and accompanying text.

[126] While the Alberta Conditional Sales Act, R.S.A. 1970, c. 61, contains a "seize or sue" provision respecting the conditional sales contract (s. 19(2)), there is no equivalent provision in Alberta applying to the chattel mortgage. Counsel for the defence proceeded on the basis of common law.

[127] *Supra* note 95, at 602, 82 D.L.R. (3d) at 614.

[128] *Supra* note 95, at 708, 88 D.L.R. (3d) at 231.

[129] *Supra* note 95, at 603, 82 D.L.R. (3d) at 614.

[130] *Supra* note 95.

a consumer note. In response to the allegation that the finance company had already seized the goods so that it was precluded from suing on the note, Lufour J. found as a matter of fact that the plaintiff had not repossessed the goods. He left open the possibility that the reduction of the underlying debt or contract would affect the action brought on the promissory note. The defendant did not allege, nor was it decided, that the fact of "seize or sue" legislation itself would alter the unconditional nature of the negotiable instrument. The legislation would affect the aspect of civil remedies alone.

The case of *Canadian Acceptance Corp. v. Therrien*[131] confirmed that provincial legislation may provide a defence to payment on a promissory note. The case did not involve "seize or sue" legislation, but rather the provincial consumer protection requirements of credit contracts. Beaudoin J. found that the consumer note was void on two grounds: it was not marked "consumer purchase" as required by section 190(1) of the Bills of Exchange Act, and the underlying debt was void pursuant to section 117 of the Consumer Protection Act.[132] Without citing authorities, Beaudoin J. accepted the competence of the provincial legislature to intervene indirectly in matters within exclusive federal jurisdiction.[133]

This interpretation of the effect of the provincial Consumer Protection Act cannot be tenable. The extinction of the underlying debt may operate as a defence against payment on the note, but the character and validity of the negotiable instrument remains unchanged. The court reasoned that the contract of loan and the consumer note were part and parcel of the same transaction; one could not be dissociated from the other, even though two separate documents were involved. The Consumer Protection Act was cited as regulating "this sort of transaction".[134] The court did *not* say that the *contract* was rendered void by the fact that the promissory note was void under federal legislation. Clearly, this would have been the better approach. The case, therefore, indicates that the finance company is not limited to proceeding on the note to recover the amount of the debt. Subject to provincial legislation, the full amount of the contract debt may be recoverable.

The decision in *Therrien* is of little weight. The note was invalid without recourse to the provincial Consumer Protection Act. Furthermore, the judge misinterpreted that Act as invalidating a contract when the creditor fails to give thirty days notice of his action to recover the full amount of the debt. The final incongruity in the decision is the award to the finance company of the amount of the debt despite the finding that both the note and contract were void. The effectiveness of both federal

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[131] *Supra* note 95.

[132] *Id.* at 551.

[133] *Id.*

[134] *See* S.Q. 1971, c. 74, s. 18 (repealed and replaced by S.Q. 1978, c. 9, s. 102).

and provincial legislation in protecting consumers is brought into question.

2. *The St. Pierre Doctrine — The Meaning of "Intimate Relationship"*

In the *Kon* case, discussed earlier,[135] the defendants alleged that the relationship between the seller and lender was sufficiently close that the latter was subject to the equities between seller and purchaser. The "connected seller" argument was used both in defence of there being "a note issued in respect of a consumer purchase" under Part V, and in support of the applicability of the *St. Pierre* doctrine. A purchaser has recourse to the *St. Pierre* doctrine whether or not his case falls within Part V. It is his only recourse against the direct lender if his case falls outside Part V, as in *Kon*. Judicial interpretation of the *St. Pierre* doctrine has important implications for consumers who seek protection under Part V when the lender is technically at arm's length from the merchant under the terms of the Income Tax Act.

The purchasers sought to justify the application of the *St. Pierre* doctrine by enumerating seventeen particulars indicative of the close connection between the bank and the seller:[136]

1. the initial discussions between the credit officer of the bank and the merchant in which an understanding was reached that the merchant would refer potential purchasers of motor homes to the bank;
2. the implementation of this understanding;
3. the establishment of a consumer lending branch of the bank, one office space distant from the merchant's premises;
4. the merchant providing the bank with a list of all his customers;
5. financial statements of the merchant being on file with the bank;
6. copies of lease agreements between the merchant and owners of the motor homes being provided to the bank by the merchant;
7. the bank getting the bulk of the business in the financing of the purchase of mobile homes from the merchant;
8. payments on the promissory notes being made to the bank by the merchant;
9. basic credit information with respect to prospective borrowers being provided to the bank by the merchant;
10. the credit officer, in some cases, meeting prospective borrowers on the merchant's premises;
11. the credit officer having acknowledged visiting the merchant's offices a minimum of twice a week during the period January 1, 1973 to November, 1973;
12. the refinancing documents being signed by the borrowers on merchant's premises on appointments made by the merchant;

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[135] *See supra* note 124 and accompanying text.

[136] *Supra* note 95, at 612-14, 82 D.L.R. (3d) at 621-22

13. the bank proposing a moratorium and refinancing of the promissory notes in the fall of 1973 when the merchant experienced a drop in motor home rentals;

14. the merchant suggesting to the owners that their loans with another bank could be refinanced by the plaintiff bank if they had the necessary qualifications;

15. the credit officer having personal dealings with the merchant involving:

(1) the trade-in of a motor vehicle and the purchase of two to three vehicles;

(2) the offer of a job by the merchant;

16. the credit officer sending out a letter outlining the moratorium program agreed upon with the merchant;

17. the credit officer displaying too much indulgence towards the merchant when he took the position that the bank was being too harsh with the merchant in asking him to provide more security for their commercial loan in December, 1973.

These did not impress the court. Kirby J. took an original stance when he stated:

> To bring the relationship within the *Federal Discount* doctrine the evidence must establish or warrant the inference that the Bank . . . was a party to the wrongful acts of [the merchant] or knew, or ought to have known, of the wrongful acts; the wrongful acts [in this case] being the conversion of the proceeds from the sale of the motor homes belonging to the respective defendants.[137]

The court reasoned that no such evidence was available here: the conversion of funds suspected in August, 1973 related to the commercial, not the consumer loans, so that this was not reason for the bank to inquire into the manner in which the company was dealing with the defendants; the willingness of the bank to refinance loans when rentals dropped did not implicate the financier in the seller's subsequent misconduct, since the defendants all *agreed* to participate in the moratorium and *independently negotiated* their promissory notes to the bank; though the bank knew that the merchant sold the defendant's homes after the calling in of its loan, the merchant informed the bank that restitution was being made to the owners and evidence did not indicate that the bank was involved in any other disposition of the proceeds; the bank did not know that proceeds of these sales were being applied to the company's outstanding commercial debt. The emphasis throughout the reasons is on the apparent lack of knowledge rather than on the presence of an "intimate relationship".

The court's reasoning, as an interpretation of the application of the *St. Pierre* doctrine to the direct money lender, is not supportable. The evidence need not establish that the lender was a party to, or knew or ought to have known of, the particular misdeeds of the seller before an

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[137] *Id.* at 624-25, 82 D.L.R. (3d) at 630.

intimate relationship can be inferred. Rather, it is the evidence of an "intimate relationship" which gives rise to the inference that the otherwise independent lender knew or ought to have known of the seller's mischief. The question of knowledge arises when the status of a *sales financier* as a holder in due course is at issue in circumstances when there is no intimate relationship. The effect of the *St. Pierre* doctrine in that case is to deny the sales financier his holder in due course status even when in every other respect it is found to exist. This is borne out by the *St. Pierre* decision itself:

> The relationship and pre-arrangements between a dealer selling goods . . . and the finance company which discounts his customers' promissory notes and conditional sales contracts, . . . may be so close and intimate that, in effect, the finance company and the dealer can be considered as more nearly engaged in one business . . . with the result that the finance company cannot claim to be a holder in due course. . . . [138]
>
> Even granting that the plaintiff [finance company] did not have actual notice of facts the knowledge of which would have prevented it from becoming a holder in due course, the transfer of the note to it by [the merchant] fell short of being the type of business transaction between two parties, dealing with respect to the note in complete good faith, which would have imported to the note the power to endow with the character of holder in due course, one becoming a holder with complete knowledge of its history and the complete facts of the relationship between the maker and the payee.[139]

Where the direct money lender is concerned, the question of holder in due course status does not arise. The independent lender is not obliged to inquire into the credentials of the prospective merchant. It is the fact of an intimate relationship that places him on notice for the first time. This responsibility is sustained throughout the lender/merchant relationship. The *Kulig* case,[140] cited by the court in *Kon*, supports this view:

> If such a relationship existed between Beneficial and Custom Signs that Beneficial is affected by the wrong-doing of the other, then this difficult and somewhat academic question as to whether or not the payee in the abstract can be a holder in due course . . . is irrelevant since Beneficial, *ipso facto*, is not a holder in due course in the circumstances postulated.
>
> The facts alleged by the defendant Kulig are not such as would provide a defence even against a holder for value — let alone a holder in due course — *unless those facts indicate a relationship* between the plaintiff and Custom Signs which very relationship would serve to rebut any presumption that the plaintiff was a holder in due course.
>
> The vital consideration, therefore, is the nature of the relationship which existed between Beneficial Finance and Custom Signs *at the time of the transaction* between the plaintiff and Kulig. . . . [141]

Kirby J. appears to be formulating new law by providing the lender the opportunity of discharging his "duty of care" in defence against the

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[138] *Supra* note 10, at 310, 32 D.L.R. (2d) at 86 (Headnote, quoted in *Kon*, *supra* note 95, at 607, 82 D.L.R. (3d) at 617).

[139] *Supra* note 10, at 324, 32 D.L.R. (2d) at 100.

[140] *Supra* note 14.

[141] *Id.* at 379, 13 D.L.R. (3d) at 143 (as quoted in *Kon*, *supra* note 95, at 610, 82 D.L.R. (3d) at 620) (emphasis added).

obligation imposed on him when dealing closely with a merchant. The fact that he cited these passages without disputing their authority, however, indicates that he merely misunderstood them. The case of *Neptune Acceptance Ltd. v. Williams*[142] may be noted by way of contrast. It appears that the courts, whether construing the nature of "non-arm's length" within Part V or the requisites of the "intimate relationship" outside Part V, are equally inconsistent, requiring at one end of the spectrum the qualifications set out by the Income Tax Act, while sanctioning financiers who supply blank forms to retailers at the other.

In the *Neptune* case, the buyer purchased a cigarette vending machine on false inducements by the seller regarding expected profits, the age of the machine, the location in which it would be placed and the work involved in maintaining its operation. The buyer signed a number of documents, including a promissory note and a conditional sales contract, without reading them. The form of the note bore the name of the plaintiff finance company and had been supplied by the latter to the seller. The note was marked "consumer purchase". Funds were advanced directly to the seller following a check into the buyer's credit rating.

Most of the machines "sold" by the seller were non-existent. The seller absconded with the funds. The buyer refused to pay the amount owing on the note because of the seller's misrepresentations, and the finance company instituted proceedings on the note. The plaintiff argued that the transaction was not in fact a consumer purchase but a business venture, and that it was entitled to holder in due course status.

The Ontario county court disregarded the profit motive behind the venture and held that the note was issued with respect to a consumer purchase because the parties had so agreed. Referring to the mark on the note, the court stated that "the plain words 'Consumer Purchase' marked on the note cannot be ignored".[143] This part of the judgment would likely have been overturned by a court of appeal more inclined to look beyond labels to the substance of the transaction.

The decision in the *Neptune* case was based on the alternative ground of an "intimate relationship" between the finance company and the merchant which deprived the former of holder in due course status. The factors leading to this conclusion included:

1. the supply of forms by the finance company to the seller;
2. the declaration on the forms that payments were to be made to the finance company at the latter's place of business;
3. the name of the finance company on the forms;
4. the assumption by the finance company of the obligation of a credit search;
5. the number of transactions, and the money involved, in financing by the finance company for the seller;

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[142] *Supra* note 24.
[143] *Id.* at 161, 49 D.L.R. (3d) at 665.

5. the number of transactions and the money involved, in financing by the finance company for the seller;

6. the fact that the finance company saw the agreement between buyer and seller;

7. the fact that, without the concurrence of the finance company, there would be no sale between seller and buyer.

The factors which supported the "intimate relationship" in this case recall the American "referral test". Still, this rather progressive approach must be read against the background of apparent fraud on the facts of the case. In light of the decision in the *Kon* case, one cannot pretend that any inroad into lender liability has been made. Indeed, the *Kon* decision may represent a retrograde step for the consumer.[144]

IV. CONCLUSIONS AND RECOMMENDATIONS

The extent to which Part V applies to the direct purchase money lender is unclear. The use of the Income Tax Act test of "non-arm's length" invites an approach far more restrictive than the *St. Pierre* doctrine.[145] Whether section 189(2) or 189(3) is invoked, the problem of an apparent "cash purchase" arises.[146] Although these barriers to consumer protection may have been ignored in some cases,[147] this is hardly in Part V's favour. Legislation is more than a signal of policy change to occasion new directions in judicial decision-making, come what may. The statute should direct the course of change so that the instruction can be applied with confidence and consistency. The powers at work in consumer financing are too unequal to afford arbitrary sanctioning. Finance practices should be studied and the Act amended. In its present form, Part V does not ensure consumer protection.

Recommendations are listed in point form below and highlight the issues raised in this paper:

1. The federal government should follow the U.S. example by monitoring current financing practices as they affect consumers. The extent to which lenders deal with merchants and the extent to which they are in a position to police their practices should be considered. Which lenders readily supply retailers with paper bearing lender identification? What is the basis for selection of retailers? In what manner are these forms used to process the financing of a transaction? Does the borrower usually have direct contact with the financier? To what extent are loan finance customers introduced to the lender by sellers? What criteria do lenders use in distinguishing cash from credit purchases? When do the parties consider that the borrower has control of the funds? What

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[144] *Cf.* Geva, *Close Business Relationship Between a Purchase-Money Lender and a Seller of Goods — Bank of Montreal v. Kon*, 3 CAN. BUS. L.J. 90 (1978).

[145] *See* discussion of *Lively*, pp. 350-52 *supra*.

[146] *See* discussion of *Siemens*, pp. 348-50 *supra*. *See also Kon*, p. 352 *supra*.

[147] *E.g.*, *Galbiati*, *supra* note 95.

knowledge does the financier have of the goods to be purchased and the fact of their delivery? The answers to a number of these questions can be surmised from the results of informal surveys already conducted by federal authorities. A feasibility study of proposals for change in consumer credit financing would assist in anticipating the costs for financiers and ultimate bearers of the cost of credit. It would also determine the just and realistic placement of this liability.

2. Amendments to Part V should include:
   (i) deletion of the reference to "non-arm's length" as defined in the Income Tax Act. Alternatives may be found in the U.S. guidelines. Models include the "referral" and "affiliation" tests. Guidelines could also be drawn from the case law, matters of policy being clarified first;
   (ii) a definition of the term "cash purchase", or deletion of the expression from Part V. The definition of "consumer purchase" should extend to those purchases which are in essence credit purchases, taking all factors or circumstances into consideration, chiefly that the consumer has no control over the funds. If this definition was properly drafted, section 189(3) might become superfluous;
   (iii) making allowance for the small businessman who is in no better position than the consumer;
   (iv) a rewording of remedy section 191 to allow the consumer to raise against the direct money lender the defences arising out of the purchase transaction.

3. Companion legislation at the provincial level is needed to restrict action on the contract where the direct purchase money lender is the holder of a consumer note. Two of the provinces need similar legislation to regulate the contractual rights of assignees.

Following the enactment of the F.T.C. regulation in the U.S., an annual meeting of the American Bar Association was held to discuss the effect the Rule was expected to have on the practices of banks. The title of the session was "Holder in Due Course: Does the Consumer Pay?"[148] Professor John Prather Brown, a professor of economics and law from Cornell University in Ithaca, was invited to review the economics of the new regulation in terms of its implications for future cost of credit. His answer to the question posed: "Does the Consumer Pay?" was "Yes, of course."[149]

Professor Brown informed his audience that the effect of regulation is to reallocate certain risks from buyer to lender. Risk shifting has an inevitable impact on the market; the cost of retail financing rises: "Ordinarily, people in firms do not take risks upon themselves without being paid a premium to make taking the risk worthwhile."[150] But, the economist noted:

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[148] *A Panel*, *supra* note 51.
[149] *Id.* at 614.
[150] *Id.* at 615.

> People are adverse [sic] to risks. People in risky situations have long been willing to make offsetting financial transactions to change a risky situation into a less risky one. Insurance policies, warranties, and many other transactions that we could think of are financial transactions that are conditional on real world events, such as fires or defects, that have adverse consequences.[151]

The effect of amending Part V to broaden its scope and to make it more effective consumer protection legislation may increase the cost of credit for the consumer, even if the lender is in a position to share the cost of the risk with another party, such as the retailer or an insurance company. However, it would also be effective in putting less desirable merchants out of business. Noting these effects, the U.S. National Commission on Consumer Finance concluded in its report that "spreading the costs . . . to all consumers in the market place would be more than counter-balanced by the protections which the consuming public will receive in the form of better goods and services".[152]

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[151] *Id.* at 614-15.
[152] *Supra* note 53, at 37.

APPENDIX
DRAFT MODEL PART V
CONSUMER BILLS AND NOTES

S. 188. In this Part

"business arrangement" includes any understanding, procedure, course of dealing or agreement, formal or informal, between a purchase money lender and a seller with respect to the sale of goods or services by the seller to consumers or small businesses or the financing thereof;

"connected lender" includes any purchase money lender or any person who finances the sale of goods or services to consumers or small businesses who has a business arrangement with the seller; and, without limiting the factors and incidents of dealing which are relevant to any determination of a business arrangement sufficient to qualify the lender as a connected lender, the relevant factors and incidents of dealing for this purpose shall include any or any combination of the following:

1. the referral or direction by the seller to the lender of a consumer or small business for the arrangement of a purchase money loan;
2. maintenance in the seller's office of the lender's forms, including any or any combination of the lender's purchase money loan forms, conditional sales contracts, chattel mortgages, or promissory notes, to be used by consumers or small businesses in the application for purchase money loans;
3. preparation or assistance in preparation by the seller of documents used to evidence a loan;
4. joint participation by the seller and lender in the acquisition of credit information respecting prospective borrowers and the processing of applications for credit;
5. direct or indirect payment by the lender to the seller of commission, fees or other consideration measured by or based in any way on the consumer or small business directed to the lender by the seller;
6. the preferential or expeditious processing or approval of loan applications by the lender when the borrower meets certain lending criteria but prior to the completion of a full credit check while referrals by the seller to the lender continue;
7. knowledge possessed by the lender, whether actual or imputed, including knowledge from dealing with other customers of the seller or knowledge from records or notices of complaints by other such customers, that the seller has failed to perform agreements with customers or has failed to remedy valid complaints;
8. the repeated granting of loans by the lender which finance purchases of goods or services from the seller or persons related to or organizations affiliated with the seller;

9. the advancement of money or other valuable security to the consumer or small business on condition that the money or security advanced be deposited with or transferred, advanced, assigned or negotiated to the seller;
10. the advancement of money or other valuable security to the consumer or small business on condition that the borrower grant to the lender a security interest in the goods purchased from the seller;
11. the referral or direction by the lender of customers to the seller;
12. payment of consideration by the seller to the lender for the furnishing of sales prospects;
13. joint advertising efforts by the seller and the lender;
14. floor-planning or inventory financing arrangements which include or contemplate the assignment of paper or the referral of loan customers;

"consumer purchase" means a purchase of goods or services or an agreement to purchase goods or services
(a) by an individual other than for resale or for use in the course of his business, profession or calling, and
(b) from a person who is engaged in the business of selling or providing those goods or services;

"goods" means any article that is or may be the subject of trade or commerce, but does not include land or any interest therein;

"purchase money lender" includes any person who, in the ordinary course of business, lends or advances money or other valuable security to a purchaser to enable the purchaser to make a consumer or small business purchase;

"purchaser" means the person by whom a consumer or small business purchase is made;

"seller means the person from whom a consumer or small business purchase is made;

"services" includes repairs and improvements;

"small business" means any private corporation, partnership or sole proprietorship, other than a corporation, partnership or sole proprietorship controlled directly or indirectly in any manner whatsoever by one or more public corporations, which purchases goods or services in the ordinary course of business for the purpose of resale or for use in the course of business or for the benefit of the business, but does not include any private corporation, partnership or sole proprietorship whose gross assets are equal to or exceed an amount to be prescribed by Regulation;

"small business purchase" means a purchase of goods or services or an agreement to purchase goods or services
(a) by a small business
(b) from a person who is engaged in the business of selling or providing those goods or services;

"related lender" includes any purchase money lender or any person who finances the sale of goods or services to consumers or small businesses and who is affiliated with the seller, either

1. with regard to individuals, by reason of any familial relationship between lender and seller, or
2. with regard to corporations, firms, partnerships, sole proprietorships, trusts and other organizations, by reason of
   (i) direct or indirect control of or by any such organization over the seller; or
   (ii) interlocking directorates or other form of joint or common management of two or more organizations including the seller; or
   (iii) familial relationship between any officer, director, owner, partner, trustee or other official of any such organization and any officer, director, owner, partner, trustee or other official of the seller organization.

S. 189(1). A consumer bill is a bill of exchange
(a) used in respect of a consumer or small business 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, other than a bank, that as part of its business accepts money on deposit from members of the public and honors 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.

S. 189(2). A consumer note is a promissory note
1. issued in respect of a consumer or small business purchase, and
2. on which the purchaser or any one signing to accommodate him is liable as a party.

S. 189(3). Without limiting or restricting the circumstances in which, for the purposes of this Part, a bill of exchange or a promissory note shall be considered to be issued in respect of a consumer or small business purchase, a bill of exchange or a promissory note shall be conclusively presumed to be so issued if
(a) the consideration for its issue was the lending or advancing of money or other valuable security by a person other than a seller, in order to enable the purchaser to make the consumer or small business purchase; and
(b) the person who lent or advanced the money or other valuable security was, at the time the note was issued, a connected or a related lender.

S. 189(4). For greater certainty, and without limiting or restricting the generality of the foregoing, the provisions of this Part will not apply to a lender within paragraph 189(3) (*a*) who, at the time the bill or note was issued, had no business or other arrangement or relationship with the seller respecting the financing of the consumer or small business purchase or the financing of other consumer or small business purchases and who, at the time of the loan, did not require, directly or indirectly, that the money or other valuable security loaned or advanced be deposited with or transferred, advanced, assigned, or negotiated to the seller.

S. 189(5). Except as otherwise provided in this Part, the provisions of this Act applicable
(a) to bills of exchange apply, with necessary modifications, to consumer bills;
(b) to cheques apply, with necessary modifications, to cheques that are consumer bills; and
(c) to promissory notes apply, with necessary modifications, to consumer notes.

S. 190(1). Every consumer bill or consumer note shall be prominently and legibly marked on its face with the words "Consumer Purchase" before or at the time when the instrument is signed by the purchaser or by any one signing to accommodate the purchaser.

S. 190(2). A consumer bill or consumer note that is not marked as required by this section is void, except in the hands of a holder in due course without notice that the bill or note is a consumer bill or note or except as against a drawee without such notice.

S. 191. Notwithstanding any agreement to the contrary, the right of a holder of a consumer bill or consumer note that is marked as required by section 190, to have the whole or any part thereof paid by the purchase or any party signing to accommodate the purchaser is subject to any defence or right of set-off, other than counterclaim, that the purchaser would have had in an action by the seller on the consumer bill or consumer note if the consumer bill or note had been payable to and enforceable by the seller.

S. 192(1). Every one who, knowing that an instrument, other than an instrument described in paragraph 189(1) (*c*) or (*d*), has been, is being or is to be issued in respect of a consumer purchase, obtains the signature of the purchaser or of any one signing to accommodate the purchaser to such instrument without its being or having been marked as required by section 190 is guilty of
(a) an offence and liable on summary conviction to a fine not exceeding ten thousand dollars; or
(b) an indictable offence and liable to a fine not exceeding twenty-five thousand dollars.

S. 192(2). Everyone who, knowing that a consumer bill or consumer note not marked as required by section 190 is a consumer bill or consumer note, transfers it is, unless he is the purchaser or any one signing to accommodate the purchaser, guilty of
(a) an offence and liable on summary conviction to a fine not exceeding ten thousand dollars; or
(b) an indictable offence and liable to a fine not exceeding twenty-five thousand dollars.