

DIRECT DEBIT REVERSAL FOLLOWING BANKRUPTCY: USE OR MISUSE OF AUTHORITY?

On 16 September 2011, the Dutch Supreme Court delivered a judgment in a case that raised the question whether, if a bank reverses a direct debit ('reversal') following the bankruptcy of its account holder, it has acted unlawfully towards the other creditors in the bankruptcy or whether it has simply exercised an authority to which it is entitled.¹ This article discusses the system of direct debit and the legal nature of the reversal. On the basis of an earlier ruling by the Supreme Court in 2004, it will become clear that the outcome in this case is not unexpected. The recent judgment by the Supreme Court also emphasizes the importance of direct debit for payment transactions. The system only functions properly if there are sufficient safeguards constituting a general authority to reverse the direct debit.

The direct debit system

In 2004, the Supreme Court ruled on the legal interpretation of the concept of reversal. For a better understanding of this ruling, we first need to examine the direct debit system. Direct debit is founded on a debt collection contract. This contract includes an authorisation by the account holder on the grounds of which the account holder's creditor can issue a payment order. This payment order is then executed automatically. There is a drawback to the authorisation, both the bank and the account holder have authority to reverse payment orders, as the direct debit authorisation might otherwise result in an excessive deficit on the account or exceed the account holder's available credit. To assess whether a bank that reverses a payment order following bankruptcy acts in accordance with its reversal authority we first have to establish the legal nature of the reversal.

Mr Mendel, LL.M., q.q. versus ABN AMRO²

In this judgment, the Supreme Court very clearly expressed its views on the reversal of payment orders and on how this phenomenon is to be interpreted legally. The case was as follows: on 29 May 2001, the company Worldexchange B.V. ("Worldexchange") was declared bankrupt. Worldexchange used a direct debit contract in its payment transactions with its clients. Under this contract, direct debit payments were debited from the Worldexchange's clients' accounts on the company's initiative. This direct debit contract gave the client/account holder and his bank the right to reverse the payment order within thirty days of the payment order being made. At the date of bankruptcy, Worldexchange had a credit balance of more than NLG 1,000,000.00. Following the bankruptcy, a number of Worldexchange's clients reversed payment orders that had already been made prior to the bankruptcy. This decreased Worldexchange's credit by more than NLG 100,000.00 after the date of bankruptcy. Worldexchange's bankruptcy trustee, Mr. Mendel, claimed this amount, invoking wrongful deduction by the bank under Section 53 of the Bankruptcy Act. According to the bankruptcy trustee, the bank wrongfully offset these debit entries against the credit balance of Worldexchange's bank account. The Supreme Court ruled against the

¹ HR 16th September 2011, LJN BQ8732

² HR 3rd December 2004, JOR 2005, 51



bankruptcy trustee. Where a credit entry arises from a direct debit, the payment is only made conditionally. The amount is indeed credited to the account, but the account holder can gain only conditional access to it. The credit entry becomes unconditional only after expiry of the period during which reversal is possible. An unconditional payment is not possible before that period has expired. Finally, the Supreme Court added that the situation was no different in the case of bankruptcy. For as long as the period of reversal had not expired, the existing right of claim on the bank at Worldexchange's date of bankruptcy was only a conditional right of claim. Once this condition had been met, the right of claim to Worldexchange's assets with the bank lapsed and the NLG 100,000.00 debited from the account did not form part of the capital, or at least of the assets, of Worldexchange.

In this judgment, the Supreme Court made clear that a direct debit reversal should be viewed purely as an accounting procedure signalling the commencement of a condition precedent marking the lapse of the creditor's right to the credit.

Use or misuse of authority

Despite this judgment, in September 2011, the Supreme Court had again to assess a comparable legal question. The case was slightly different. On 18 September 2002, Vetrans B.V. ("Vetrans") was declared bankrupt. Vetrans had a current account credit of € 225,000.00 with its bank. A few days before the bankruptcy, as a result of various direct debits, Vetrans' account was debited by a total of € 108,400.00. On the date of the bankruptcy the debit balance on Vetrans' account amounted to € 214,184.00. Despite the fact that Vetrans did not exceed its available credit, the bank decided to reverse all the money paid in by direct debit, decreasing in the debit balance on Vetrans' account € 105,748.00. Vetrans' bankruptcy trustee claimed this money from the bank. The trustee argued that, by reversing the payments, resulting in a decrease in the debit balance on Vetrans' account, the bank had misused its authority for reversal and that it had therefore acted unlawfully towards the other creditors in Vetrans' bankruptcy.

The Supreme Court disagreed. By virtue of the general wording of the reversal authority, this authority is not limited to the situation in which the account holder's account balance or the available credit is insufficient to allow execution of the direct debit. When applying the authority for reversal, the account holder (in the capacity



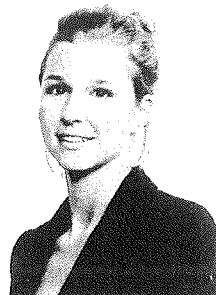
The mere fact that the bank uses the reversal authority to look after its own interests is, in any event, insufficient for misuse to be established.

either of debt collector or account holder from whom the debt is being collected) and his bank may in principle also represent their own interests. However, this does not mean that there may not be misuse of the reversal authority in special cases, with the bank acting unlawfully towards other creditors. Finally, the Supreme Court emphasized that, partly in view of the important role of direct debits in payment transactions, it is very important that the bank, the creditor and the debtor can be confident that a reversal will be performed if this is called for.

Conclusion

In its judgment of 16 September 2011, the Supreme Court ruled that the reversal authority is worded in general terms. This general wording provides a sufficient counterbalance to the sweeping authority given by the direct debit. This general wording also means that the reversal authority cannot easily be misused. Even so, the latter is not totally ruled out. The Supreme Court does not clarify under what circumstances misuse is possible. The mere fact that the bank uses the reversal authority to look after its own interests is, in any event, insufficient to establish misuse. Reversal of a payment where the available credit is not exceeded by the payment doesn't establish misuse either. The specific agreements in the direct debit contract form the point of departure, although it is conceivable

that reasonableness and fairness play a role in assessing the reversal. Case law holds that the bankruptcy trustee will obtain no comfort from invoking Section 53 of the Bankruptcy Act (setoff). Since misuse will not readily be assumed, our advice would be to reverse the payment orders where possible if the debtor becomes bankrupt. The limits of (the use of) the reversal authority will have to be tested further in court to become clear.



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