COLLECTION AND PAYMENT OF CHEQUES

*The Current Law and the Need for a Reform**

I. INTRODUCTION

Most cheques drawn in Britain, Australia and New Zealand are handled by two banks. If the cheque is not crossed, the payee or holder may, of course, present it for payment at the counter of the paying (or drawee) banker. When this is done only one banker is involved. But the general tendency among tradesmen and professional men is to forward all the cheques which they receive to their own bankers, who present each cheque for payment to the bank on which it is drawn. In this type of case the cheques are, obviously, handled by two banks.

The banker who presents the cheque to the drawee banker on behalf of the payee may assume one of two roles. If he acts merely as agent of the payee, he assumes the role of a "collecting banker". He becomes a "discounting banker" if, apart from presenting the cheque to the paying banker, he allows his customer (the payee) an overdraft against the cheque before its clearance or gives the customer some other consideration for it.

In the normal course of events the collecting (or the discounting) banker as well as the paying banker render their services to the satisfaction of all concerned. But complications may arise when cheques are forged or stolen. If a cheque is collected on behalf of a rogue and honoured by the paying banker, the drawer or a subsequent holder may attempt to recover his loss from the bankers or either of them.

It will be shown that in the majority of cases the defence of a paying, collecting or discounting banker depends on the provisions of the law of negotiable instruments. In England, these are codified in the Bills of Exchange Act 1882, in Australia in the Bills of Exchange Act 1909-1958 and in New Zealand in the Bills of Exchange Act 1908. The Acts of Australia and New Zealand are similar to the English one.[1]

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1 References are to sections of the English Act. Where sections in the Australian and New Zealand Acts vary or are numbered differently, references to them are given in square brackets.

The most recent amendment to the provisions of the Bills of Exchange Act is the Cheques Act 1957 of England, and the almost identical Cheques Act 1960 of New Zealand. There is no corresponding Act in Australia. However, the report of the Australian Bills of Exchange Committee[2] includes proposals which are partly based on the Cheques Act.

In most cases a paying, collecting or discounting banker obtains a good defence under the provisions of the Acts, provided his conduct complies with two standards, the first being a subjective one whilst the second is of an objective nature. The subjective standard is invariably that of good faith.[3] The objective one varies. In some cases the banker must be able to show that he acted "without negligence", in others that he acted "in the ordinary course of business" and in others still that he took an instrument which was "complete and regular on its face".

It is probable that the variation in the required objective mode of conduct results from the fact that the provisions relating to the position of paying, discounting and collecting bankers are scattered throughout the Bills of Exchange Act and the Cheques Act. Thus, the provisions governing the rights of the paying banker are sections 59, 60 and 80 of the English Act [64, 65, and 86 of the Australian Act] and section 1 of the Cheques Act [section 2 of the New Zealand Act]. The position of a collecting banker is governed by section 4 of the Cheques Act [section 5 N.Z.]. This section replaced section 82 of the English Bills of Exchange Act, which appeared in the part relating to crossed cheques. The provisions governing the rights of the discounting banker are sections 29 and 38(2) of the Bills of Exchange Act [section 34 and 43 (b) Australia] and sections 2 and 4 of the Cheques Act [N.Z. sections 3 and 5]. It may very well be that, if all the provisions relating to the defences of paying, collecting and discounting bankers were grouped in one part of the relevant Act or Acts, there would have been a greater degree of uniformity.

Due to the complexity of the prevailing provisions the position of the paying, collecting and discounting banker requires separate analysis. Apart from discussing the position of these bankers, an

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2 Published on May 1, 1964. Some proposals of the Committee are discussed in the course of this paper.

3 Under section 90 of the English Act [Australia s. 96; New Zealand s. 91] a thing is deemed to be done in good faith, where it is in fact done honestly, whether it is done negligently or not. See also Raphael v. Bank of England (1855) 17 C.B. 161; 139 E.R. 1030; Jones v. Gordon (1877) 2 App.Cas. 616, 628; Baker v. Barclays Bank [1955] 1 W.L.R. 822.

attempt will be made in this paper to put forward some proposals for a reform.

II. THE PAYING BANKER

A. NATURE OF RELATIONSHIP WITH CUSTOMER

The contract between the customer who draws a cheque and the "paying banker" on whom it is drawn comprises elements of two types of contract. First, any amount paid by the customer to the credit of his current account constitutes a loan made to the banker. It is repayable on demand at the branch in which the account is maintained.[4] Second, when the customer draws a cheque he instructs the banker to pay the amount specified in it to the order of a specified payee or to bearer. The customer (drawer) acts as principal and the banker, when paying the amount, as an agent.[5]

It follows that the paying banker, or agent, must adhere strictly to the terms of his authority or mandate. If he exceeds his authority, by paying a cheque which should be dishonoured, he cannot debit the customer's account with its amount. This is so even if the transgression is of a minor nature and causes the customer, or principal, a relatively small loss. The point has been explained most clearly by Devlin J., in a case relating to the liability of a banker who deviated from the instructions given to him by his customer regarding the terms of a documentary credit:

> It is a hard law sometimes which deprives an agent of the right to reimbursement if he has exceeded his authority, even though the excess does not damage his principal's interests. The corollary . . . is that the instruction to the agent must be clear and unambiguous.[6]

This, then, is the position in which the banker finds himself, if he pays a cheque that should have been dishonoured.[7] Such cases arise when a banker ignores a notice countermanding payment of a cheque

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4 Joachimson v. Swiss Bank Corporation [1921] 3 K.B. 110; Arab Bank v. Barclays Bank D.C.O. [1954] A.C. 495. Cf., as regards the need for a demand before suing: Tunstall Brick and Pottery Co. v. Mercantile Bank of Australia (1892) 18 V.L.R. 59.

5 London Joint Stock Bank v. Macmillan [1918] A.C. 777; Westminster Bank v. Hilton (1926) 43 T.L.R. 124.

6 Midland Bank Ltd. v. Seymour [1955] 2 Lloyd's Rep. 147, 168.

7 The banker may also commit a breach of contract by wrongfully dishonouring a cheque. The law concerning this type of case is well settled: PAGET, LAW OF BANKING, 295-296 (7th ed.) (hereafter cited as PAGET); CHITTY, CONTRACTS, Vol. II, para. 389-390 (23rd ed.) (hereafter cited as CHITTY).

or if he pays an irregular one. A cheque may be irregular, for example, because it is signed by one instead of by two directors of a company; because the amount expressed in figures differs from that expressed in words; or because a relevant detail, such as the payee's name, is missing. However, in some cases a banker who exceeds his authority may be able to rely against the customer on a defence available at common law or under the Bills of Exchange Act or the Cheques Act.

B. DEFENCES AGAINST THE CUSTOMER IN CASES OF WRONGFUL PAYMENT

The defences available to the paying banker against his customer in cases of wrongful payment of cheques can be classified into defences available under the principles of the common law relating to agency and into defences provided by the Bills of Exchange Act and the Cheques Act. The former include estoppel, payment occasioned by the customer's negligence, and ratification. The latter include "payment in the ordinary course of business", payment "without negligence" of a crossed cheque and, it is sometimes said, "payment in due course". For reasons that will become apparent, it is convenient to start with the discussion of "payment in due course". This will be followed by a discussion of the common law defences and these by a study of the remaining defences available under the Act.

(i) *Payment in due course*

Under section 59 (1) of the Bills of Exchange Act 1882 [section 64 (1) Australia] a bill of exchange is discharged by payment in due course by or on behalf of the drawee or acceptor. According to section 73 [section 78 Australia] a cheque is a bill of exchange payable on demand. It follows that section 59 (1) applies to payment in due course of cheques.

The remaining part of section 59 (1) clarifies the meaning of "payment in due course". In the case of cheques, it is payment by the drawee banker to a holder, provided it is made in good faith and without knowledge of a defect in the holder's title. The word "holder" is defined in section 2 of the Bills of Exchange Act [section 4 Australia] and means "the payee or indorsee of a cheque who is in possession of it or the bearer".

It must be emphasised that not every person who has the possession of a cheque or a bill is a "holder". Thus, a person who takes a cheque payable to the order of a specified payee, whose indorsement has been

forged by a thief, is not the payee, indorsee or bearer of the cheque and therefore not a holder.[8] Payment of a cheque to him will not constitute payment in due course. The position is different if a person takes a cheque payable to bearer (or to "X or bearer") which bears a forged indorsement. Under section 31 (2) of the Bills of Exchange Act [section 36 (2) Australia] such a bearer cheque is transferred by delivery. The person who takes it does not, therefore, derive his title from an indorsement but from its delivery to him. Moreover, he is a "bearer" and therefore a "holder". Payment to him is made "in due course".

It is said that the paying banker is protected against an action by a customer if he can prove that he has paid the cheque in due course.[9] But this view is, it is submitted, inaccurate. Section 59 (1) enacts that, by such payment, the cheque is discharged; but it does not specifically provide that such a discharge protects the paying banker against an action by his customer. It is important to bear in mind that the relationship between the paying banker and his customer is not governed by the cheque: the banker, as drawee, is not even a party to it. Their contract is regulated by the terms agreed upon at the time of the opening of the current account. This contract requires the banker to adhere to the customer's instructions. If the banker fails to adhere to these instructions, he commits a breach of his contract even if he pays the cheque in due course. A good example is that in which a banker pays a cheque which has been countermanded by his customer. If the banker pays the cheque in the honest belief that the payee has a good title, then, despite the fact that the banker may have been negligent, this constitutes payment in due course. But as the banker has exceeded his mandate,[10] he will not be entitled to debit the customer's account.

Undoubtedly, in many cases, "payment in due course" protects the paying banker against claims of his customer. But this is due to the fact that, in most cases, the customer instructs the banker to pay it in

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8 Lacave & Co. v. Crédit Lyonnais [1897] 1 Q.B. 148; Embiricos v. Anglo-Austrian Bank [1905] 1 K.B. 677; CHITTY, para. 287; PAGET, 322; CHALMERS, BILLS OF EXCHANGE 127-128 (13th ed.) (hereafter cited as CHALMERS).

9 PAGET, 308-310.

10 s. 75 (1) of the Bills of Exchange Act 1882 [Australia s. 81 (*a*)] and before the Act: Marzetti v. Williams (1830) 1 B. & Ad. 415; 109 E.R. 842. Another example is that in which a cheque is drawn on the company's account by one instead of by two directors. As against the holder of such a cheque, it is discharged by payment in due course. But the banker will not be entitled to debit the company's account.

such manner. For example, a cheque payable to the order of a specified payee may be indorsed by him in blank and posted to his bankers. Under section 8 (3) [section 13 (3) Australia] an indorsement in blank renders the cheque payable to bearer. If the cheque is stolen while in transit and is finally paid by the paying banker to a person who has obtained it from the thief, this constitutes payment in due course. The reason for this is that payment has been made to a bearer.[11] Moreover, the paying banker is protected against an action by the customer. But the reason for this is that, in effect, payment has been made in compliance with the mandate. The customer instructed the banker to pay the cheque to the original payee or to his order. By indorsing the cheque in blank the original payee ordered that it should be paid to the bearer, and this was done by the banker.

Thus, the banker is not necessarily protected against claims by his customer by paying a cheque in due course. He must, basically, be able to show that he paid the cheque in compliance with his mandate.

In point of fact, section 59 (1) appears in the part of the Act which is concerned with the discharge of bills of exchange. Its aim is to protect an acceptor (or drawee) of a bill, who pays it in due course, against claims by previous parties, such as the original payee who lost the bill after indorsing it. But, as pointed out above, the relationship between the paying banker and his customer is not governed by the cheque; and it is to be doubted whether section 59 (1) was meant to apply in this type of relationship.

(ii) *Estoppel and the customer's negligence*

In many cases the customer's conduct might preclude him from asserting that the banker exceeded his mandate by paying a cheque. Thus, if the customer assured the banker, before the cheque was paid, that the signature was genuine or that the cheque was regular, he would later on be precluded from alleging that the signature had been forged or that the cheque was irregular. In *Brown v. Westminster Bank*,[12] the servants of the plaintiff, an aged woman, forged her signature on cheques drawn on her bankers. The manager of the

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11 Smith v. Sheppard (1776) cited by CHITTY, BILLS OF EXCHANGE 278 (11th ed.) Contrast: PAGET, 309.

12 [1904] 2 Lloyd's Rep. 187. See also Leach v. Buchanan (1802) 4 Esp. 226, 170 E.R. 700; Brook v. Hook (1871) L.R. 6 Ex. 89; M'Kenzie v. British Linen Co. (1881) 6 App.Cas. 82; Greenwood v. Martins Bank [1933] A.C. 51. Cf. Ontario Woodsworth Memorial Foundation v. Grozbord (1964) 48 D.L.R. (2d) 385; Jarvis B. Webb Co. v. Bank of Nova Scotia (1965) 49 D.L.R. (2d) 692.

branch with which she kept her account called on her on several occasions to inquire about some cheques, but was assured by her that all were regular and genuine. It was held that her conduct precluded her from asserting, subsequently, that some of these cheques were forged.

In *West v. Commercial Bank of Australia Ltd.*[13] the plaintiff opened an account with the defendant bank. The account was to be used for the purpose of a business managed by the plaintiff's son and the defendant bank was instructed to pay cheques signed jointly by the son and by the plaintiff's wife. After a few months the son arranged with a teller of the defendant bank to honour cheques signed only by himself. The plaintiff became aware of this arrangement but took no steps to stop this practice. Moreover, on one occasion, when a promissory note was executed for the purposes of the business and made payable at the defendant bank, the plaintiff indorsed it although it was not signed by the wife. It was held that the plaintiff was, under these circumstances, estopped from denying the authority of the defendant bank to honour the cheques signed by the son alone. The plaintiff could not acquiesce in the practice and then depart from the assumption to the detriment of the defendant bank.

It should be added that estoppel may arise not only from a representation or course of conduct of the customer but can also be based on a single negligent act. Thus, if the customer has been so careless when drawing a cheque as to facilitate a fraud by a third party, he is precluded from asserting the forgery against the bank. In *London Joint Stock Bank v. Macmillan*[14] a clerk prepared a cheque for £2 payable to bearer. There was no sum in words then written on the cheque, but after it had been signed by his employers the clerk altered the figures to £120 and wrote the words "one hundred and twenty pounds" in the space provided. The clerk presented the cheque, and as the forgery was not readily apparent, received payment and absconded. The banker was held entitled to debit the customer's account. Lord Finlay L.C. said:

> A cheque drawn by the customer is in point of law a mandate to the banker to pay the amount according to the tenor of the cheque. It is beyond dispute that the customer is bound to exercise reasonable care in drawing the cheque to prevent the banker being misled. If he draws the cheque in a manner which facilitates fraud, he is guilty of a breach of duty as between himself and

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[13] (1935) 55 C.L.R. 315.

[14] [1918] A.C. 777. See also Will v. Bank of Montreal [1931] 3 D.L.R. 526. Contrast: Colonial Bank of Australasia v. Marshall [1906] A.C. 559.

> the banker, and he will be responsible to the banker for any loss sustained by the banker as a natural and direct consequence of this breach of duty.[15]

But a customer is not always considered negligent if he leaves a blank space in a cheque. The question is, always, whether a reasonable man would leave such a blank space. In *Slingsby v. District Bank*[16] the customer left a blank space between the name of the payee and the words "or order", and a rogue filled up this space by making the cheque payable to the payee *"per pro"* himself. The rogue then negotiated the cheque by indorsing it in his own name. It was held that the customer was not negligent and that, although the alteration was not apparent, the banker could not debit the cusomer's account with the amount paid against the cheque.

In point of fact, the estoppel principle has a rather narrow scope of application. Negligence which is not connected with the actual drawing of a cheque does not, usually, give rise to an estoppel. Parke B. in *Bank of Ireland v. Evans' Trustees,* which related to the negligent keeping of a seal, expressed to the House of Lords the unanimous opinion of the judges: 'If there was negligence in the custody of the seal, it was very remotely connected with the act of transfer'. The learned judge went on to explain that:

> If such negligence could disentitle the Plaintiffs, to what extent is it to go? If a man should lose his cheque-book, or neglect to lock the desk in which it is kept, and a servant or stranger should take it up, it is impossible in our opinion to contend that a banker paying his forged cheque would be entitled to charge his customer with that payment. Would it be contended that if he kept his goods so negligently that a servant took them and sold them, he must be considered as having concurred in the sale, and so be disentitled to sue for their conversion on a demand and refusal?[17]

In *Lewes Sanitary Steam Laundry Co. Ltd. v. Barclay & Co. Ltd.*[18] the secretary of a company who, to the knowledge of the chairman of the board of directors, had been convicted of forgery, was made a joint signatory and was entrusted with keeping the company's cheque book and pass book. It was held that the company's bankers were not

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15 [1918] A.C. 777, 789. The quoted passage bases the customer's liability on negligence but the effect is the same as if he were precluded from suing.

16 [1931] 2 K.B. 588, affirmed [1932] 1 K.B. 544.

17 (1855) 5 H.L.C. 389, 410-411; 10 E.R. 950, 959. See also Welch v. Bank of England [1955] Ch. 508.

18 (1906) 95 L.T. 444. See also Kepitigalla Rubber Estates v. National Bank of India [1909] 2 K.B. 1010.

entitled to debit the account with the amount of a cheque on which the secretary forged the signature of one of the directors, and that the company was not estopped from alleging the forgery. Thus, while a customer must be careful not to facilitate fraud when drawing cheques, he is not under a duty to his banker to take reasonable care in organising his business so as to prevent opportunties for others to forge his cheques.

This is a serious limitation of the estoppel and negligence doctrine. It is difficult to see why it applies only in cases where the customer's negligence is directly connected with the drawing of a cheque. It seems unreasonable that a customer, who facilitates a fraud by entrusting a forger with his cheque book, can recoup from the paying banker a loss resulting from the forger's activities. This is particularly so in cases like the *Lewes Sanitary Steam Laundry* case where the directors failed to inspect the cheque book from time to time.

(iii) *Ratification*

The paying banker, it will be recollected, is the agent of the customer. It follows that the customer can ratify the act of a banker who pays a cheque which he is not authorised to honour. In so far as the customer's act of ratification is done voluntarily, and is not due to pressure by the banker, it should be valid.

A question of some difficulty is whether the customer can ratify the payment by a banker of a forged cheque. There is authority for the proposition that a person cannot ratify a forgery of his signature.[19] The basis of this doctrine is that the forgery constitutes an illegal act which the forger does not purport to execute as an agent. The principal, therefore, cannot adopt it.[20] However, if a cheque is drawn by an agent who fraudulently exceeds his authority, the principal can, probably, ratify his act.[21]

On this basis, it is arguable that the customer may ratify the act of a banker who pays a forged cheque. The banker who pays such a cheque, without discovering the forgery of the customer's signature,

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19 Ex p. Edwards (1841) 2 Mon. D. & D. 241; Williams v. Bayley (1866) L.R. 1 H.L. 200; Brook v. Hook (1871) L.R. 6 Ex. 89; M'Kenzie v. British Linen Co. (1881) 6 App.Cas. 82; Imperial Bank of Canada v. Begley [1936] 2 All E.R. 367; Stoney Stanton Supplies (Coventry) Ltd. v. Midland Bank Ltd. [1966] 2 Lloyd's Rep. 373.

20 CHITTY, para. 21.

21 Braidwood v. Turner & Forrest (1908) 10 W.A.L.R. 105 (the facts, unfortunately, are not clearly stated). Note that it is doubtful whether a signature made by an agent in excess of his authority is a forgery: PAGET, 442-443; CHITTY, para. 285.

purports to pay it on behalf of the customer. Moreover, he does not commit an illegal act. It is submitted that the banker's payment of the forged cheque may, therefore, be ratified. It should be noted that by ratifying the banker's act, the customer does not ratify the forged signature.

(iv) *Payment in the ordinary course of business*

As pointed out above, if the banker pays an order cheque to a person who holds it under a forged indorsement of the payee, he does not pay it in due course. Neither is it payment in compliance with the customer's instructions. But if the payee is not one of the paying banker's customers, the banker is not familiar with his signature and cannot verify his indorsement. Section 60 of the Bills of Exchange Act gives some defence to bankers who pay cheques with such forged indorsements. The section reads:[22]

> Where a bill payable to order on demand is drawn on a banker, and the banker on whom it is drawn pays the bill in good faith and in the ordinary course of business, it is not incumbent on the banker to show that the indorsement of the payee or any subsequent indorsement was made by or under the authority of the person whose indorsement it purports to be, and the banker is deemed to have paid the bill in due course, although such indorsement has been forged or made without authority.

Thus, when the cheque is paid in the ordinary course of business, the banker does not have to show that the payee's indorsement is genuine. It follows that the customer cannot bring an action based solely on the forgery of the indorsement.

It is important to stress that this section applies only in cases concerning forgeries of indorsements. It does not apply if the forged signature of the payee, on the back of the cheque, is just a receipt and not made for the purpose of negotiating the cheque. In *Smith v. Commercial Banking Co.*[23] the appellant, who was about to sail from England to Sydney, obtained a draft payable to his own order on the respondents, a firm of bankers. The draft was issued in two parts. The appellant retained the first part [or exchange] and sent the second to himself c/o the G.P.O., Sydney. The second copy was stolen by a thief who presented it for payment to the respondents. He was asked to sign his name on the back of the bill and, after comparing his

22 In Australia section 65 (1). Sub-section (2), which extends the application of the section to drafts drawn by one branch of a bank on another, appears in the Australian and New Zealand Acts, but not in the English Act.

23 (1910) 11 C.L.R. 667.

signature with a specimen signature of the appellant, the draft was paid to the thief. The High Court of Australia gave judgment for the appellant, the payee. It was held that the respondents, the paying bankers, could not rely on section 60 as the signature of the thief was not an indorsement. O'Connor J. said:

> The reason of the protection conferred by the section is the obligation of the banker to pay on indorsements which come to him in the ordinary course of business under circumstances in which it is in most cases impossible to test their genuineness. Where payment is made to the holder, as holder, and not as indorsee, where he is not bound to indorse before obtaining payment, and he is asked to put his name on the back merely as a receipt, or as test of identity, the reason for the protection is at an end. In such a case the bank pays because it is satisfied as to the identity of the payee, and not because it is satisfied as to the genuineness of the indorsement.[24]

The most important question concerning section 60 is the meaning of the words "in the ordinary course of business". The phrase probably means the mode of transacting business which is adopted by the banking community at large.[25]

It is not certain whether a banker, who acts negligently when paying a cheque, may nevertheless be considered as paying it in the ordinary course of business. In *Carpenters' Co. v. British Mutual Banking Co.*[26] Greer L.J. expressed the view that, when a banker acts negligently, he cannot be regarded as paying a cheque in the ordinary course of business. Slesser J., who concurred with Greer L.J.'s judgment on other grounds, thought that a banker may be acting in the ordinary course of business despite his negligence. His view was supported by MacKinnon L.J., who delivered a dissenting judgment.

The question whether negligence is compatible with the ordinary course of business is complicated by the existence of section 80 [section 86 Australia]. Under this section, if a banker pays a crossed cheque (a) in conformity with the tenor of the crossing, (b) in good faith, and (c) "without negligence", he is placed in the same position as if he had paid the cheque to the true owner. Unlike section 60, section 80 is not specifically confined to cases of cheques bearing forged indorsements of the payee. But section 80 is not likely to apply in other cases. The reason for this is that if a banker pays a cheque bearing a genuine indorsement, this will in most cases be payment in

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24 Id. at 678.
25 PAGET, 113.
26 [1938] 1 K.B. 511.

compliance with the banker's authority. The banker therefore does not have to rely on the defence of section 80. Thus, section 60 and section 80 have a similar scope of application, except that section 80 applies solely to the payment of crossed cheques while section 60 relates to crossed as well as to uncrossed cheques.

However, while section 60 uses the phrase "in the ordinary course of business", section 80 uses the phrase "without negligence". At first glance it could be assumed that the use of different phrases indicates an intention of the legislature to employ different standards. Indeed, if section 80 appeared immediately before or after section 60 this would be an inescapable conclusion. But section 60 appears in the part of the Act on "discharge". This part relates to all types of bills of exchange, including the species of cheques. Section 80, on the other hand, appears in the part relating to crossed cheques. Its inclusion in this part of the Act, despite the obvious overlap between it and section 60, can be explained by its history. Section 80 reproduces section 9 of the Crossed Cheques Act 1876. Other provisions of this Act were reproduced in the part of the Bills of Exchange Act relating to crossed cheques. It is therefore likely that section 80 was incorporated in the Bills of Exchange Act because the draftsman overlooked the overlap between it and section 60. Indeed, the need to include section 80 in the Act has been questioned.[27]

Thus, it may be concluded that the difference between the terminology of section 60 and that of section 80 is accidental. In section 60 the legislature provides that a banker is protected if he pays a cheque in accordance with ordinary business practice. This ordinary business practice of bankers aims at their exercising reasonable care to protect their customers. Section 80 says, specifically, that the banker is protected only in so far as he acts without negligence. In other words, he is protected only if he exercises due care and skill in order to protect his customer's interest.

Authorities confirm that the two tests lead to similar results. If a banker pays a crossed cheque over the counter,[28] or honours a cheque bearing an irregular indorsement[29] he does not pay it in the ordinary course of business. It seems obvious that a banker who pays a crossed

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27 HOLDEN, HISTORY OF NEGOTIABLE INSTRUMENTS IN ENGLISH LAW 229 (London 1955); CHALMERS, 268.

28 Smith v. Union Bank (1875) L.R. 10 Q.B. 291, 296, affirmed (1876) 1 Q.B.D. 31, 35.

29 Charles v. Blackwell (1877) 2 C.P.D. 151, 159-160; Slingsby v. District Bank [1931] 2 K.B. 588, affirmed [1932] 1 K.B. 544. But see *infra* as regards the position after the Cheques Act.

cheque over the counter acts negligently. As regards irregular indorsements, it has been held that if a banker *collects* a cheque with such an indorsement, he does not act "without negligence".[30] *A fortiori* if a banker *pays* an irregularly indorsed cheque he must be regarded as acting with negligence. The reason for this is that the banker is authorised to pay the cheque only at the order of the payee and, if the indorsement is irregular, the banker cannot be certain that it is that of the true payee.

Thus, in most cases where a banker does not act in the ordinary course of business, his departure from established practice is, by itself, an indication of negligence. Similarly, if a banker acts with negligence, his carelessness, it is submitted, involves some departure from sound business practice or from the "ordinary course of business".

As pointed out above, both section 60 and section 80 protect the banker if he pays a cheque bearing a forged indorsement. But neither of the two applies if the indorsement (whether genuine or forged) is executed in a way which renders it irregular on its face. The indorsement of the payee is irregular whenever it differs materially from the name by which he is described by the drawer of the cheque. If a cheque is payable to "John Williams" and indorsed "J. Williams", the indorsement is not irregular. But where the payee is described on the face of the cheque by the wrong name (e.g. W. Williams) and then indorses it in his true name, (e.g. John Williams) the discrepancy between the front and back of the cheque renders the indorsement irregular, even though it may be effective for the purpose of negotiation. Similarly, if a company indorses the cheque without adding the word "company" or "Ltd.", which forms part of its description as payee of the cheque, the indorsement is irregular.[31]

It is obvious that cheques are indorsed in an irregular manner on many occasions. Rejection of cheques irregularly indorsed would, frequently, be a disservice to the customer. If the customer misspelt the payee's name, and the banker dishonoured the cheque because the indorsement in the payee's true name was irregular due to this misnomer, the rejection could cause embarrassment to the customer.

In England and New Zealand the problem has been solved by the Cheques Act. Section 1 [section 2 N.Z.] protects a banker who, in good faith and in the ordinary course of business, pays a cheque which is not indorsed or is irregularly indorsed. It provides that a banker who pays such a cheque is deemed to have paid it in due course

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30 Bavins Junr. & Sims v. London and South Western Bank [1900] 1 Q.B. 270.
31 Arab Bank Ltd. v. Ross [1952] 2 Q.B. 216.

within the meaning of section 59 of the Bills of Exchange Act 1882, and that he does not assume any liability by reason only of the absence of or an irregularity in indorsement.

However, the Committee of London Clearing Bankers has taken the view that the public interest would best be served by retaining the need for indorsements in certain circumstances. These circumstances are set out in a circular of September 23, 1957 forwarded by that Committee to Clearing Bank Managers. The procedure laid down in this Circular may, no doubt, be taken as establishing "the ordinary course of business". A banker who disregards it may lose the protection of section 1. This is especially so because section 1 provides that the banker does not incur liability by "reason only of" the irregular indorsement. If the banker pays an irregularly indorsed cheque in circumstances where this contravenes the provisions of the Circular, he becomes liable not by reason of the missing indorsement but because of the disregard of standard banking practice.

In so far as this Circular relates to the paying banker, it provides that indorsements continue to be required where cheques are cashed over the counter, but that otherwise the paying banker need not concern himself with indorsements unless the instruments are combined cheques and receipt forms marked "R.", travellers' cheques, bills of exchange (other than cheques) and promissory notes. When a cheque is not marked "R." the banker must concern himself with indorsements only if it is presented for payment over the counter and not through a collecting bank. A similar circular was issued by the bankers in New Zealand on November 17, 1960.

In Australia, where there is no Act corresponding to the Cheques Act, the law continues to be governed by the provisions of the Bills of Exchange Act. A banker who pays an order cheque bearing an irregular indorsement, does so at his own peril. A reform has been suggested by the Australian Bills of Exchange Committee.[32] Clause 65(1) of the draft bill, attached to the Committee's report, absolves the paying banker from the duty to concern himself with indorsements when the cheque is presented by a collecting banker. But under clause 65(2) a banker will have to continue checking the indorsements when a cheque is presented for payment over the counter. In the last type of case the paying banker is the first bank to handle the cheque and, in the Committee's view, a greater degree of care can be expected from the banker in such a situation than when a cheque reaches him, together with others, through ordinary banking channels.

32 Paras. 139-145.

C. BANKER'S DUTY TO CONSIDER VALIDITY OF INSTRUCTIONS

Is the banker obliged to consider the validity of instructions given to him by a customer? Should he do any more than satisfy himself that the signature of the customer is genuine? This problem arises mainly in connection with trust accounts, accounts of companies and partnerships and ordinary accounts operated upon by the customer's relation or agent under a power of attorney. A typical example is that in which directors of a company draw a cheque payable to a well-known gambler or racketeer, or draw a cheque for a large amount payable to one of them. Should the banker question the validity of the cheque, or does he perform his duty by simply verifying the signature and satisfying himself that the cheque is signed by an authorised person?

It is important to stress that, if the banker pays a cheque of the type described above, he acts within the apparent scope of his mandate, and that such payment does not constitute "wrongful payment" in the sense discussed in the foregoing part of this article. The problem in the type of case here under discussion is whether the banker owes the customer any duty of care or of trust beyond ascertaining that cheques are paid in compliance with the general instructions, as to signing and of drawing, given to the banker when the account is opened.

Two doctrines are relevant as regards this problem:

(a) constructive trust, and

(b) negligence.

The question of constructive trust arises when a banker knows that a cheque is drawn on the customer's account by a person who abuses his authority to do so. A recent case on this problem, as well as on the question of negligence, is the decision of Ungoed-Thomas J. in *Selangor United Rubber Estates Ltd. v. Craddock.*[33] The plaintiff company which had sold all its estates in Malaya, became a "shell" company, that is, a company which has liquidated assets but no business enterprise. It appears that such companies are of specific value for tax avoidance purposes. Investors, who purchase the shares in such a company, "inject into" it (i.e. sell it) some of their properties or enterprises at an amount lower than the market value. As a result of this "injection" process the value of the shares of the shell company

[33] [1968] 2 Lloyd's Rep. 289. For a general statement see State of New South Wales v. Commonwealth of Australia (1932) 46 C.L.R. 246, 265; PAGET, 74-75.

increases. The investor sells these shares, and it is thought in some quarters that the profit so made by the investor is not subject to tax.

In the *Selangor United Rubber Estates* case an investor, Craddock, offered to purchase the majority of the plaintiff's (the shell company's) shares from its shareholders for an amount of £195,000. He did not have the necessary liquidated funds and the transaction was therefore arranged in a rather complicated way. The plaintiff opened an account with the branch of the District Bank at which Craddock kept his own account, and paid into this new account an amount of £232,764. The plaintiff agreed to lend an amount of £232,500 (out of this balance) to a finance company at 8% p.a., and the finance company agreed to lend this amount to Craddock at 9% p.a. Craddock agreed to pay this amount into his account with the District Bank. The latter agreed to issue against the credit balance so acquired a draft for £195,000 payable to a middleman, who was to use the proceeds for paying the price of the shares sold to Craddock by the shareholders of the plaintiff. The entire transaction was carried out in one meeting, attended by the directors of the plaintiff, the representative of the finance company, the middleman, an employee of the District Bank and by Craddock. The directors of the plaintiff drew a cheque on the new account with the District Bank and made it payable to the finance company. The representative of the finance company there and then indorsed the cheque to Craddock, who immediately delivered it to the employee of the District Bank. The latter thereupon gave the bank draft for the amount of £195,000 to the middleman.

It is clear that in this manner the amount standing to the credit of the plaintiff with the District Bank was used in order to enable Craddock to pay for his shares in the plaintiff. The transaction, therefore, involved a contravention of the provision which prohibits the use of a company's funds for the payment or purchase of its own shares. When the plaintiff went into liquidation, the Official Receiver brought an action to recover the amounts paid from the directors, the finance company, the middleman, Craddock and from the District Bank. The action against the District Bank was for breach of duty as constructive trustee and, alternatively, in negligence for a breach of duty of care owed by the Bank to its customer, the plaintiff.

Ungoed-Thomas J. gave judgment against the District Bank on both counts. He held that the District Bank had knowledge, or ought to have known, that the plaintiff's money was used for the purchase of its own shares by Craddock. As the District Bank was aware of

the breach of trust committed by the directors of the plaintiff, it became a constructive trustee and, by issuing the draft, it committed a breach of the duty imposed on it in equity. His Lordship said:

> The knowledge required to hold a stranger liable as constructive trustee in a dishonest and fraudulent design is knowledge of circumstances which would indicate to an honest, reasonable man that such a design was being committed or would put him on inquiry, which the stranger failed to make, whether it was being committed. Acts in the circumstances normal in the honest conduct of affairs do not indicate such a misapplication, though compatible with it; and answers to inquiries are *prima facie* to be presumed to be honest . . .[34]

Ungoed-Thomas J. stressed that, in his view, actual knowledge of the fraudulent design was not necessary in order to constitute the banker a constructive trustee. He felt that there may be circumstances which give rise to a duty to inquire and that if the banker fails to make inquiries he must be deemed to have knowledge of the facts. He felt that, in the case before him, there were such circumstances. It should be borne in mind that in this case the employee of the District Bank attended the meeting in which the scheme was put into operation and was familiar with the details of the transaction. It is therefore clear that the District Bank had actual knowledge of the nature of the transaction.

Ungoed-Thomas J. then turned to the question of negligence. He came to the conclusion that a banker owes a duty of care to his customer, which goes beyond the duty of verifying the genuineness of the signature and the regularity of the cheque. His Lordship referred to two types of cases. First, he considered authorities relating to situations where bankers acted negligently when paying cheques, and arrived at the conclusion that these cases establish that the banker owes a general duty of care under his contract with his customer. His Lordship reinforced his view by citing the second type of cases, namely those relating to actions by true owners of cheques against collecting bankers. He thought that these cases, although not relating to the relationship of paying banker and customer, indicate the type of careless acts for which any banker is liable. Ungoed-Thomas J. then said:

> To my mind . . . a bank has a duty under its contract with its customer, to exercise "reasonable care and skill" in carrying out its part with regard to operations within its contract with its customer. The standard of that reasonable care and skill is an objective standard applicable to bankers. Whether or not it has

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34 [1968] 2 Lloyd's Rep. 289, 313.

> been attained in any particular case has to be decided in the light of all the relevant facts, which can vary almost infinitely. The relevant considerations include the *prima facie* assumption that men are honest, the practice of bankers, the very limited time in which banks have to decide what course to take with regard to a cheque presented for payment without risking liability for delay, and the extent to which an operation is unusual or out of the ordinary course of business. An operation which is reasonably consonant with the normal conduct of business (such as payment by a stockbroker into his account of proceeds of sale of his client's shares) of necessity does not suggest that it is out of the ordinary course of business. If "reasonable care and skill" is brought to the consideration of such an operation, it clearly does not call for any intervention by the bank. What intervention is appropriate in that exercise of reasonable care and skill again depends on circumstances. Where it is to inquire, then failure to make inquiry is not excused by the conviction that the inquiry would be futile, or that the answer would be false.[35]

Three objections may be raised against this conclusion. First, the authorities cited by Ungoed-Thomas J. do not support the wide conclusion which he bases on them. The cases relating to the negligence of the collecting banker are hardly in point. A collecting banker does not owe an independent duty of care to the true owner of a cheque. The collecting banker has to prove that he has acted "without negligence" solely for the purpose of relying on a defence given to him by the Cheques Act against his strict liability to the owner of a converted cheque.[36] But where no action in conversion lies against the collecting banker, the true owner cannot sue him in negligence for the breach of a duty of care. The cases cited by Ungoed-Thomas J. as regards the duty of care of a paying banker, are all cases in which bankers exceeded their actual mandate. Thus, in *Westminster Bank v. Hilton*[37] a banker paid a cheque which had been countermanded by an ambiguous letter of his customer. The court examined whether a reasonable banker, acting carefully, would have stopped the cheque on the basis of this instruction. In *Curtice v. London City and Midland Bank*,[38] due to an oversight, a cable countermanding a cheque was not collected on time from the banker's letter box. The court considered whether the banker acted negligently when paying the cheque. Likewise, in the remaining cases cited by his Lordship,

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35 Id. at 324.

36 Discussed post p. 132. The Acts substitute, in effect, a duty to act carefully for a strict liability in tort.

37 (1926) 43 T.L.R. 124.

38 [1908] 1 K.B. 293.

the question of the banker's duty of care to his customer was discussed in connection with the banker's failure to observe specific instructions. There does not appear to be a single case in which a banker was held negligent because he failed to examine the validity of instructions given to him by an authorised person.

The second objection to the rule formulated by Ungoed-Thomas J. is based on the relationship between the banker and the customer. This, it will be recollected, is a relationship of debtor and creditor, as well as that of agent and principal. Normally, the banker is not a trustee of the customer and, while he is under a duty to obey instructions, he does not appear to be in a fiduciary position.[39] It is therefore difficult to see why the banker should concern himself with anything apart from his instructions. It is to be doubted whether the banker should disobey his instructions and dishonour a cheque drawn on the customer's account by authorised persons because he fears that the signatories commit a breach of trust. Indeed, if a banker dishonours a cheque on such grounds, he may find himself in deep waters. If the suspicions are unfounded, the dishonour of a cheque may cause his customer considerable damage and the banker himself may be sued for breach of contract. It is one thing to say that a banker, who *knows* of a fraud committed by his customer's agent, may be liable as constructive trustee if he participates in the transaction. To impose on a banker a general duty of care, which requires him to assess more than the apparent validity of instructions given to him, is, it is submitted, far-fetched and unreasonable.

The third and last objection to the principle of Ungoed-Thomas J. is based on the business exigencies of the banking world. Cheques have to be honoured or rejected promptly. This is the basis on which the clearing houses function. Of course, if a banker is aware that his customer is being defrauded, he should dishonour the fraudulently drawn cheque. This object is achieved by the constructive trust principle as applied by the learned judge. But it is submitted that the banker does not have the time, nor necessarily the experience, to enable him to inquire into or investigate the regularity of acts of agents appointed by the customer. Thus, in the *Selangor United Rubber Estates* case the employee of the District Bank, who attended the relevant meeting, had no experience in "take-overs" of companies. Neither, in fact, did the branch manager. This ignorance was largely the cause of their failure to realise the irregularity of the transaction.

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[39] Foley v. Hill (1848) 2 H.L.C. 28, 9 E.R. 1002; Joachimson v. Swiss Bank Corporation [1921] 3 K.B. 110.

But did this ignorance constitute negligence? His Lordship held that it did. But it is difficult to agree with a proposition that may involve bankers in an obligation to familiarize themselves with the details of transactions or with the type of business carried on by their customers. Their main function is to collect cheques, to receive deposits of money and to pay cheques drawn by their customers.[40] To put bankers under a duty to assist in securing that the customer is not defrauded by those trusted and appointed by him, seems to put on them an unjustifiably onerous burden.

Actually, that the customer should not expect too much from his banker, is a point stressed by Ungoed-Thomas J. It arose in connection with a second transaction in the case before him. Craddock, the original investor and purchaser, agreed to sell his shares in the plaintiff company to one of its directors. For this purpose the account of the plaintiff was transferred to a branch of the Bank of Nova Scotia with which the director concerned had his own account. The sale of the shares was effected by a process of drawing three cheques and, in the end, by debiting and crediting the accounts of the director and of the plaintiff with similar amounts. As in the first transaction this process was used to enable the director to purchase the shares with the money of the plaintiff. An employee of the branch of the Bank of Nova Scotia, who in point of fact made no inquiry, was told that the process was for 'internal accounting purposes'. Ungoed-Thomas J. held that the Bank of Nova Scotia was not liable in negligence or as a constructive trustee. While the information given to its employee might not have satisfied a lawyer, a banker (or his clerk) was entitled to treat it as a satisfactory explanation. The employee of the bank saw that, at the end of the three cheques operation, the balance in the accounts would be exactly the same as before. There was, thus, nothing to raise his suspicion. It is important to note that, in this second transaction, the employee of the Bank of Nova Scotia did not attend a meeting concerning the transaction and was, in fact, not familiar with its details.

Thus, even in the view of Ungoed-Thomas J. the negligence principle propounded by him has a very narrow scope of application. It is difficult to see what purpose is served by it. If the banker knows (or, in view of the facts, ought to know) of a fraud or misapplication

40 Commissioners of the State Savings Bank of Victoria v. Permewan, Wright & Co. Ltd. (1915) 19 C.L.R. 457, 470-471; Bank of Chetinad Ltd. v. Commissioner of Income Tax, Colombo [1948] A.C. 378, 383; United Dominions Trust Ltd. v. Kirkwood [1966] 2 Q.B. 431.

of funds, the constructive trust principle comes into operation. As the negligence principle does not appear to be more extensive, there is really no need for it.

Finally, it may perhaps be doubted whether a paying banker should be liable as a constructive trustee because he "ought to have known" of the fraud or irregularity committed by the customer's agent. The cases cited by Ungoed-Thomas J. appear to base the banker's liability as constructive trustees on actual knowledge of the agent's act. A similar view was taken by the Supreme Court of N.S.W. in *Dixon v. Bank of New South Wales.*[41]

D. RIGHTS OF TRUE OWNER AGAINST PAYING BANKER

(i) *Establishing the cause of action*

Can the "true owner" of a cheque, which has been paid to a person without a title, sue the paying banker in conversion? While textbook writers answer this question in the affirmative,[42] an attempt will be made to show that this may not be so. It will be convenient to discuss first who is the "true owner" of a cheque and then whether he may establish a cause of action in conversion against the paying banker.

The phrase "true owner" of a cheque is not defined in the Bills of Exchange Act, but it is mentioned in section 79 (2) and 80 (2) [sections 85 (2) and 86 (2) Australia].[43] It is important to note that the person who has the physical possession of a cheque is not necessarily its owner. For example, an order cheque may be stolen from the payee's desk while unindorsed. As no title can be transferred without a genuine indorsement of the payee, it follows that the payee remains its true owner. On the other hand, if a cheque payable to bearer is stolen and transferred to an innocent purchaser for value,

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41 (1896) 17 L.R. (N.S.W.) Eq. 355. See also Gray v. Johnston (1868) L.R. 3 H.L. 1; Gray v. Lewis (1869) L.R. 8 Eq. 526 (for further proceedings in this case see (1873) L.R. 8 Ch.App. 1035); Backhouse v. Charlton (1878) 8 Ch.D. 444; Lawson v. Commercial Bank of South Australia (1888) 22 S.A.L.R. 74; Thomson v. Clydesdale Bank [1893] A.C. 282; Coleman v. Bucks and Oxon. Union Bank [1897] 2 Ch. 243; McMahon v. Brewer (1897) 18 L.R. (N.S.W.) Eq. 88; Bank of New South Wales v. Goulburn Valley Butter Co. [1902] A.C. 543; Quistclose Investments Ltd. v. Rolls Razor Ltd. [1968] 3 W.L.R. 1097, 1105. Most of the English cases are cited by Ungoed-Thomas J. in the Selangor United Rubber Estates case, but appear to require actual knowledge in order to make the banker liable as constructive trustee.

42 BYLES, BILLS OF EXCHANGE 267 (22nd ed.); PAGET, 310-311.

43 See also the Cheques Act 1960, s. 4 [N.Z. s. 5] and the Australian Bills of Exchange Act, s. 88.

the latter becomes a holder in due course. As such, he becomes the true owner of the cheque.[44]

An Australian authority throws further light on this point. In *Channon v. English, Scottish and Australian Bank*[45] the plaintiff, who owed some money to a firm, posted to it a crossed cheque drawn on the defendants (his bankers). The cheque was stolen from the post by a thief, who obliterated the crossing and obtained payment by presenting the cheque at the defendant's counter. The Supreme Court of N.S.W. held that the plaintiff's (customer's) right to sue the defendants (his bankers) in conversion, depended on whether he was the true owner of the cheque. If he was asked by the firm to post the cheque, then the post office would be the firm's agent for delivery and the firm (the payee) would, when the cheque was posted, become the "true owner". If, on the other hand, the plaintiff was not asked to post a cheque, then the post office would be his agent, and he would remain the true owner of the cheque. As there was no direct evidence on this point, a new trial was ordered.

Thus, the true owner of a cheque is the person who, under the provisions of the Bills of Exchange Act, must be regarded as having the property in the instrument. He is the last person, including a holder in due course, to whom the property in the cheque is validly transferred.

That the true owner of a cheque can bring an action for its conversion, follows from the well established principle by which cheques, bills of exchange and other types of negotiable instruments are treated as a species of personal property.[46] The principle is too well established to be disputed. But the question remains as to whether the paying banker commits an act of conversion by paying a cheque to a person who is not entitled to it.

It must be conceded that authorities suggest that the paying banker can be sued in conversion if he pays a cheque to a person other than the true owner. In *Smith v. Union Bank*[47] a debtor of the plaintiff sent him a cheque and crossed it to his own bankers. The cheque was stolen and, eventually, came into the hands of a holder in due course.

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44 Smith v. Union Bank (1876) 1 Q.B.D. 31, 35-36.

45 (1918) 18 S.R. (N.S.W.) 30. See also London Bank of Australia v. Kendall (1920) 28 C.L.R. 401, 409.

46 Morison v. London County and Westminster Bank [1914] 3 K.B. 356; Underwood (A.L.) Ltd. v. Barclays Bank [1924] 1 K.B. 775; Lloyds Bank v. Savory & Co. [1933] A.C. 201; Bute (Marquess of) v. Barclays Bank [1955] 1 Q.B. 202; Marfani & Co. Ltd. v. Midland Bank [1968] 1 W.L.R. 956.

47 (1875) L.R. 10 Q.B. 291, affirmed (1876) 1 Q.B.D. 31.

The defendant bank paid the cheque, although the bankers who presented it for payment on behalf of the holder were not the bankers on whom it was specially crossed. Blackburn J. dismissed the action. He held that as the person to whom the cheque was paid was a holder in due course, the plaintiff was not its true owner and could, therefore, not sue in conversion. But his Lordship explained that 'if the cheque be crossed to a particular banker, and [the paying banker] pays it, however bona fide, to another banker to whom it is not crossed, then [the paying banker] is not protected, and trover would lie against him at the suit of the true holder'.[48] Therefore, if the cheque had been paid to a person holding it under a forged indorsement, who could not be a holder in due course, the plaintiff would have succeeded. This dictum was approved in the Court of Appeal by Cairns L.C.[49] A similar view was expressed, though also *obiter,* by the High Court of Australia.[50]

However, two objections may be raised against treating the paying banker, who honours a cheque, as a person who commits an act of conversion. First, it is to be doubted whether the banker who pays a cheque, makes a "disposition" over it. He retains the cheque mainly as evidence of his payment to the holder, and does not transfer it to any further party.

Some support for this submission can be found in the decision of Cockburn C.J. in *Charles v. Blackwell.*[51] The defendant drew a cheque and sent it to the plaintiffs in order to settle a debt due to them. The plaintiffs' clerk executed an unauthorised indorsement on the cheque and obtained payment from the drawee bank. The bank eventually returned the cancelled cheque to the defendant. The plaintiffs' action in conversion was dismissed. It was held that the bank was authorised to pay the cheque and that the plaintiffs were precluded from assailing the validity of the indorsement by the clerk. Cockburn C.J. also observed:[52]

> A cheque taken in payment remains the property of the payee only so long as it remains unpaid. When paid the banker is entitled to keep it as a voucher till his account with his customer is settled. After that, the drawer is entitled to it as a voucher between him and the payee. If the cheque was duly paid, so as to deprive the payees of a right of action, either on it or in respect

48 (1875) L.R. 10 Q.B. 291, 296.
49 (1876) 1 Q.B.D. 31, 35.
50 Smith v. Commercial Banking Co. (1910) 11 C.L.R. 667.
51 (1877) 2 C.P.D. 151.
52 Id. at 162-163.

> of the goods in payment for which it was given, they no longer have any property in it.

This observation shows that in his Lordship's opinion the property in a cheque is transferred from the "true owner" when it is paid. This point may be doubted. Property in a cheque is normally transferred by valid negotiation. But the other observation is, it is submitted, good law. The banker retains the cheque as a voucher, or as evidence of payment. This tends to indicate that he does not really make a disposition which constitutes trover or conversion.

As regards the second objection to treating the paying banker as liable in conversion in cases of wrongful payment of a cheque, it is important to note that the paying banker acts under instructions of the customer. If the cheque is paid in accordance with these instructions the "true owner" may be deemed to have consented to such payment. The reason for this is that the true owner takes the cheque as it is. If it includes an instruction to the banker to pay to "bearer", the true owner can hardly complain if the paying banker pays it in this manner.[53] Thus, even if the true owner has a right to sue the paying banker in conversion, this right can be exercised only if the cheque is paid otherwise than in compliance with the customer's mandate.

This argument is likely to apply if a cheque, payable to "X or order", is indorsed in blank by the payee and then lost and paid to a bearer. The drawer has instructed the banker to pay the cheque at the payee's (X's) order. The payee has ordered that it be paid to bearer.[54] Therefore, the payee as "true owner" must be taken to consent to the payment of the cheque to a bearer.

It follows that an action in conversion by a true owner can, in any event, be brought mainly in two types of cases. The first is where a cheque payable to order has been stolen and paid to a person holding under a forged indorsement. The second is where the cheque has been materially altered. Such an alteration avoids the cheque,[55] and the banker is not authorised to pay it. As some authorities indicate

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53 It is important to note that not every "bearer" is the "true owner". If a bearer cheque is stolen from the true owner and given by the thief to another person as a present, the donee becomes a "bearer". Payment to him is made in due course. But the original true owner appears to retain the title. The same is true whenever the "bearer" cannot plead to be a "holder in due course", e.g. if the cheque is not regular on its face due to a missing detail.

54 As to the effect of a blank indorsement, see ante p. 106.

55 Section 64 (1) of the Bills of Exchange Act; [Australia section 69 (1)].

that in such cases the true owner can sue the paying banker in conversion, it is important to consider how far the banker may be able to rely on the specific defences of the Bills of Exchange Act against such actions.

(ii) *Defences available to paying banker against true owner under the Bills of Exchange Act*

Three defences were discussed as regards the protection given to a paying banker under the Act against actions by the customer. These were "payment in due course", "payment in the ordinary course of business" and "payment without negligence". It is important to consider whether a paying banker, who pays a cheque under circumstances that would entitle him to rely on one of these defences against the customer's action, is likewise protected against an action by the "true owner". It will also be important to consider the problem of irregular indorsements.

As has been pointed out, the effect of "payment in due course" is to discharge the bill. It protects the paying banker against an action by the customer only if such payment is made within the scope of the banker's mandate. It has been shown that in such a case it will, also, protect the paying banker against an action by the true owner. The latter must be treated as consenting to payment of the cheque if made within the scope of the banker's authority.

But if "payment in due course" is not made within the scope of the paying banker's mandate, it is to be doubted if it protects him against an action by the true owner. The reason for this is that payment in due course only has the effect of discharging the bill or cheque; it does not have the effect of discharging the paying banker. In point of fact, the undue discharge of the bill is the very thing of which the true owner complains. It is important to note that the action of the true owner is not based on the cheque. He does not sue to enforce it, but complains of its conversion. It follows that the discharge of the cheque is not, by itself, a defence.

It will be recollected that payment in the "ordinary course of business" protects a banker who has paid an order cheque, with a forged indorsement of the payee, against an action of the customer. But it is to be doubted whether section 60 is wide enough to protect the paying banker against an action by the true owner. The section provides that where a banker pays a cheque in the ordinary course of business, he is deemed to have paid in due course and does not have to prove the genuineness of an indorsement. But payment in due course does not,

by itself, protect the paying banker against an action by the true owner. Similarly, the fact that the paying banker does not have to prove that an indorsement is genuine is not, by itself, significant. If the true owner can establish his title to the cheque, he can bring an action in conversion; the fact that the banker does not have to prove the genuineness of an indorsement, does not defeat this action.[56]

It is interesting to note that section 1 of the Cheques Act can in certain circumstances protect the paying banker against an action in conversion by the true owner. Under this section the banker does not incur 'any liability by reason only of the absence of, or irregularity in, indorsement, and he shall be deemed to have paid it in due course'. Of course, payment in due course does not, by itself, protect the paying banker against an action in conversion by a true owner. But the fact that the banker does not incur liability by reason only of the absence of or irregularity in an indorsement is of some value. In many cases a person to whom the banker pays the cheque may not be a holder in due course by reason only of the irregularity in or absence of an indorsement.[57] If the paying banker pays the cheque to such a person he should perhaps be deemed to be in the same position as if he had paid the cheque to a holder in due course.[58] If this were so, then the banker would be protected: Payment to a holder in due course defeats an action by a person claiming to be a "true owner" because, as shown above, the holder in due course is regarded as the actual "true owner" of the cheque.

In a way, these conclusions lead to an unexpected result. It has been shown that the banker is not protected against the true owner if he pays the cheque, in the ordinary course of business, to a person holding it under a forged indorsement of the payee. It seems strange that the banker may be protected if, in the ordinary course of business, he pays a cheque which does not bear an indorsement at all, or which bears an irregular one. From the banker's point of view it is much easier to detect the irregularity in or the absence of an indorsement than the forgery of an apparently regular one.

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56 However, the defence succeeds against the customer. It may perhaps be argued that, as the customer cannot sue the paying banker, who paid a cheque with a forged indorsement of the payee, the payee or true owner must likewise be precluded from suing and be deemed to have consented to such payment.

57 See post pp. 139, 140.

58 Support for this argument may be derived from authorities interpreting s. 2 of the Cheques Act 1957 [N.Z. s. 3], as to which see post p. 140.

An even more haphazard result follows from the wording of section 80. Under this section, if a banker pays a crossed cheque in good faith, without negligence and according to the tenor of its crossing, he is 'entitled to the same rights and be placed in the same position as if payment of the cheque had been made to the true owner thereof'. Obviously, if the banker is deemed to have paid the cheque to the true owner, the latter cannot sue him in conversion even if a cheque payable to order has been paid to a person holding it under a forged indorsement of the payee.

It is to be doubted whether the legislature had the intention of putting the paying banker in such an anomalous position *vis-à-vis* the "true owner". The difference between, on the one hand, the language of section 60 of the Bills of Exchange Act as well as section 1 of the Cheques Act and, on the other hand, the wording of section 80 of the Bills of Exchange Act, stems basically from historical reasons.[59] It is irrational to make the paying banker's position dependent on whether the cheque is crossed or uncrossed. Moreover, it is most surprising that the banker is in a better position when paying an unindorsed cheque than if he pays an uncrossed cheque bearing a forged indorsement of the payee.

It seems obvious that this position results from the fact that, when passing the Bills of Exchange Act, the legislature did not bear in mind the possibility of an action in conversion by the true owner against the paying banker. The reason for this oversight is, probably, due to the fact that the Bills of Exchange Act is mainly concerned with the rights of parties seeking to enforce a negotiable instrument. Apart from the position of the collecting banker, the Act did not make comprehensive provisions for regulating the rights of the true owner against persons liable in conversion.

An attempt to rationalise the position was made before the enactment of the Bills of Exchange Act. It was suggested in *Charles v. Blackwell*[60] that when a banker paid a cheque under circumstances that would entitle him to protection against his customer, he could not be sued by the true owner of the cheque. Unfortunately, there is nothing to indicate that this view was adopted by the draftsman of the Act. Admittedly, under section 97(2) of the Bills of Exchange Act 1882 [Australia section 5 (2); New Zealand section 98 (2)], the rules of the common law and law merchant, except when inconsistent with the express provisions of the Act, continue to apply to cheques

59 See ante p. 112.

60 (1876) 1 C.P.D. 548, 555, affirmed (1877) 2 C.P.D. 151, 162-163.

and bills. But apart from the dictum in *Charles v. Blackwell,* it is not at all clear what the position was before the 1882 Act.

(iii) *The plea of contributory negligence*

Can the paying banker raise a plea of contributory negligence against the true owner of a cheque who sues him in conversion? It is obvious that in many cases where a cheque is lost or stolen, the carelessness of the true owner starts the chain of events ending in the conversion of the cheque. But it is important to note that the true owner and the paying banker are strangers and that the true owner cannot be regarded as owing a duty of care to the banker.

At the same time, the wording of section 1 (1) of the Law Reform (Contributory Negligence) Act 1945, of the United Kingdom[61] may be wide enough to enable the banker to raise a plea of contributory negligence. The section reads:

> Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage . . .

The question is whether the defence available under the Act can be raised against a plaintiff suing in conversion. In New Zealand the Court of Appeal has given an affirmative answer. In *Helson v. McKenzies (Cuba Street) Ltd.*[62] the plaintiff forgot her bag in the department store of the defendants. Within a few minutes it was claimed from the defendants' employee by a thief, who described it accurately. It was thereupon handed to him. The Court of Appeal held the defendants liable in conversion, but allowed the plea of contributory negligence. It was further held that the plaintiff contributed to the loss to a greater degree than the defendants and the proportion was fixed at three-fourths on her part and one-fourth on the part of the defendants.

It is important to stress that all three judges in the Court of Appeal held that the defence of contributory negligence may be raised not only against a plaintiff who sues a defendant in negligence but also against a plaintiff relying on other causes of action in tort. The Court

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61 s. 3 (1) of the Law Reform (Contributory Negligence) Act 1947 of New Zealand; *W.A.*: Law Reform (Contributory Negligence and Tortfeasors Contribution) Act, 1947, s. 4.

62 [1950] N.Z.L.R. 878.

was also unanimous in that the "fault" of the defendant need not be a breach of duty owed by him to the plaintiff. Gresson J. explained this point most clearly: 'to constitute contributory negligence under the Act, it is not necessary that the conduct should have been a breach of any duty owed, but it is sufficient if it amounted to lack of reasonable care for safety of person or property'.[63]

On this basis, Gresson and Northcroft JJ. reached the conclusion that the plaintiff's fault constituted contributory negligence. Finlay J. dissented as he thought that the fault of the plaintiff did not cause or contribute to the loss. In his opinion 'there is a clear line to be drawn between the negligence of the [plaintiff] and the negligence of the [defendants] . . .'[64] He held, therefore, that there was no room for a plea of contributory negligence.

This difference of opinion between the majority of the Court and Finlay J. may prove of relevance to most cases concerning the conversion of cheques. Normally, such cases arise when the true owner loses the cheque or, by carelessly leaving it around, enables a rogue to steal it. In the view of the majority of the Court such a negligent act can contribute to the eventual conversion of the cheque by the paying banker; Finlay J.'s judgment takes the opposite view.

It is submitted that the view of the majority of the Court of Appeal is the better one. It is difficult to see how the "fault" of the plaintiff in the *Helson* case could be separated from the conversion of the bag. It seems clear that her carelessness made the conversion possible. To say that the defendants had the "last opportunity" and that, therefore, the plaintiff's fault did not contribute to the loss, is a dubious argument. On this basis a plaintiff is likely to be exonerated from any contributory negligence whenever the final negligent act is committed by the defendant.

The availability of the defence of contributory negligence is of major importance to a paying banker who is sued in conversion by the true owner of the cheque. As there is no proximity between these two parties, the true owner's negligence cannot preclude him from suing the paying banker, to whom he does not owe a duty of care. However, under the doctrine of contributory negligence the court may take into account the blameworthiness of the true owner and reduce the damages.

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63 Id. at 920. See also Davies v. Swan Motors (Swansea) Ltd. [1949] 2 K.B. 291, 309. CLERK AND LINDSELL, TORTS, para. 810 (12th ed.).

64 [1950] N.Z.L.R. 878, 913.

E. CONCLUSIONS CONCERNING THE POSITION OF THE PAYING BANKER

It is submitted that the law relating to the protection of the paying banker against actions by the customer (drawer) and by the true owner in cases of wrongful payment of cheques, leaves much to be desired. It has been shown that there are certain inconsistencies as regards the defences available to the banker against actions by the customer and that others prevail as regards defences to actions by true owners. For example, too much depends on whether the cheque is crossed or uncrossed.

But the most disturbing result is that, in some cases, the banker has a more adequate protection against actions by his own customer than against actions by the true owner. Thus, the customer's negligence in drawing a cheque may preclude him from suing the paying banker. Negligence of the true owner, on the other hand, can at best enable the banker to plead contributory negligence. Moreover, as against the customer, the banker is protected if he pays a cheque "in the ordinary course of business" or if he pays a crossed cheque "without negligence". The second defence is also available against the true owner but, apparently, not the first one.

From a commercial point of view this position is objectionable. The banker is employed by the customer and is willing to assume a contractual duty of care towards him. But the banker knows nothing about the true owner and has no relationship of contract with him. It seems, therefore, strange that at law the banker may be liable to this unknown third party even in situations where he is protected against his own customer.

The position of the paying banker is, in a business sense, different from that of an agent who handles chattels or goods at the authority of his principal. It is well understood by the business community that goods are not negotiable and that a person who disposes of them without due inquiry as to the title of the principal or transferor assumes a calculated risk. Negotiable instruments, on the other hand, are meant to be readily transferable. It seems irrational to expect a banker, who is appointed the paymaster of such an instrument, to verify more than that the customer's signature is genuine and that the cheque is regular on its face. To make him liable to a third party because, for example, an indorsement turns out to be forged, is unjustifiable from any practical point of view.

A reform has been suggested by the Australian Bills of Exchange Committee. Clause 65 of the draft bill attached to the report absolves the paying banker from liability towards the true owner in all cases

where the banker is not liable to the customer. The question is whether such a reform is adequate. Before considering this matter further it will be convenient to consider the position of collecting and discounting bankers.

III. COLLECTING AND DISCOUNTING BANKERS

A. DISTINCTION BETWEEN COLLECTING AND DISCOUNTING BANKER

When a banker receives a cheque payable to his customer and presents it for payment to the paying banker, he may act either as a collecting banker or as a discounting banker. In both cases, if it turns out that the customer's title to the cheque is defective, the discounting or collecting banker can be sued in conversion by the true owner. However, it will be shown that the defences available to the two types of bankers are not always the same. It is therefore important to distinguish between them.

The distinction between a discounting banker and a collecting banker is that the former gives the customer value for the cheque before its clearance. He therefore becomes a holder of the instrument. The collecting banker, on the other hand, acts merely as an agent of the customer and does not become a holder of the cheque. Whether the banker acts, in a specific case, as a collecting banker or as a discounting banker depends on the facts. At one time it was thought that whenever the banker credits the amount of the cheque to the customer's account before clearance, he becomes a discounting banker.[65] But on this view any collecting banker is a discounter: the crediting of cheques to customers' accounts before clearance is a matter of accountancy practice, which is used even if the banker is not prepared to allow the customer to utilise the proceeds before clearance. At present, it is well established that the banker becomes a discounter only if, apart from crediting the cheque to the customer's account before its clearance, he agrees to grant an overdraft or actually permits the customer to draw against it.[66] The banker becomes a discounter also by reducing a revolving overdraft by the amount of the cheque before its clearance.[67]

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65 Capital and Counties Bank Ltd. v. Gordon [1903] A.C. 240. Cf., Bank of New South Wales v. Barlex Investments Pty. Ltd. [1964-5] N.S.W.R. 546, 549-550.

66 Re Farrows Bank [1923] 1 Ch. 41; Underwood (A.L.) Ltd. v. Barclays Bank [1924] 1 K.B. 775; Westminster Bank Ltd. v. Zang [1966] A.C. 182.

67 M'Lean v. Clydesdale Banking Co. (1883) 9 App.Cas. 95.

It should be added that in many cases the banker does not make a specific decision as to whether he is willing to act solely as a collecting banker or whether he is prepared to discount a cheque payable to his customer. Obviously, if the customer's account is in sufficient credit for meeting outstanding cheques drawn by him, then the question of his being allowed to draw against uncleared cheques payable to him (and credited to his account) does not arise. If the customer's balance is insufficient for meeting some cheques and he is of good standing with his bankers, they will (at least in New Zealand) allow him to draw against uncleared cheques without raising many questions, and in most cases even if no specific arrangement has been made.

Thus, while from a legal point of view there is a clear distinction between the position of a collecting banker and a discounting banker, it is often a purely accidental matter whether a banker acts in the one capacity or in the other.

B. DEFENCES OF THE COLLECTING BANKER

A defence available to the collecting banker against an action in conversion by the true owner of the cheque is provided by section 4 of the Cheques Act 1957 [section 5 N.Z.]. This section replaced section 82 of the Bills of Exchange Act 1882. In Australia, where there is no counterpart to the Cheques Act, section 82 (as amended by the Bills of Exchange (Crossed Cheques) Act 1906) still applies: it is section 88 of the Bills of Exchange Act 1909-1958.[68] The distinction between section 88 of the Australian Act and section 4 of the Cheques Act is, however, of importance mainly as regards the position of the discounting banker. In the case of the collecting banker, it is of consequence only where a cheque is irregularly indorsed.

Under section 4 a banker is not liable to the true owner of the cheque despite any defect in the customer's title, if the banker has received payment of it for a customer, in good faith and without negligence. The position is similar under section 88 of the Australian Act. In most cases the banker has no difficulty in proving that he has acted for a customer and in good faith. A customer is a person in whose name the banker has either opened or agreed to open a current or a deposit account.[69]

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68 As regards the recommendations of the Bills of Exchange Committee see post p. 137.

69 Lacave & Co. v. Crédit Lyonnais [1897] 1 Q.B. 148 (by opening an account); Great Western Ry. v. London and County Banking Co. [1901] A.C. 414 (do.);

The crucial question in most cases concerning sections 4 and 88 is whether the banker has acted "without negligence". The type of situation in which a collecting banker is regarded as not having acted "without negligence" can be divided into cases where the banker is careless when opening a customer's account and cases in which the carelessness is directly connected with the cheque received for collection.

The banker is considered as acting negligently when opening the account, if he does so without making due inquiries about his customer. Thus, the banker is negligent if he fails to take up references,[70] or if he fails to ascertain the occupation of his prospective customer and, if it turns out that he is an employee, the name of his employer.[71] But the banker is not obliged to ascertain from time to time whether his customer has changed his employment.[72] Moreover, if the prospective customer is introduced to the banker by another well-known customer, who also acts as referee, the banker is not negligent by reason only of his failure to require that the prospective customer produce a document of identification.[73]

The banker may be considered negligent in connection with specific cheques received for collection in several types of case. First, if an employee, official or agent wishes to pay into his private account cheques payable to, or in some cases drawn by, the employer, the banker should not permit this without making some inquiry.[74] The fact that an inquiry is not likely to disclose that a fraud is involved,

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Ladbroke v. Todd (1914) 30 T.L.R. 433 (do.); Commissioners of Taxation v. English Scottish and Australian Bank [1920] A.C. 683, 20 S.R. (N.S.W.) 401 (do.); Woods v. Martins Bank [1959] 1 Q.B. 55 (by agreeing to open the account). The habitual performance of some services for a person who does not have an account with the banker does not constitute him a customer: Robinson v. Oriental Bank (1872) 3 V.R. (L.) 177; Great Western Ry. v. London and County Banking Co., supra; Commissioners of Taxation v. English and Scottish and Australian Bank, supra.

70 Ladbroke v. Todd (1914) 30 T.L.R. 433; Hampstead Guardians v. Barclays Bank (1923) 39 T.L.R. 229; London Bank of Australia v. Kendall (1920) 28 C.L.R. 401.

71 Lloyds Bank v. Savory & Co. [1933] A.C. 201.

72 Orbit Mining and Trading Co. v. Westminster Bank [1963] 1 Q.B. 794.

73 Marfani & Co. Ltd. v. Midland Bank Ltd. [1968] 1 W.L.R. 956.

74 Morison v. London County and Westminster Bank Ltd. [1914] 3 K.B. 356; Ross v. London County and Westminster Bank [1919] 1 K.B. 678; Souchette Ltd. v. London County and Westminster Bank (1920) 36 T.L.R. 195; Underwood (A.L.) Ltd. v. Bank of Liverpool [1924] 1 K.B. 775; Bennet & Fisher Ltd. v. Commercial Bank of Australia [1930] S.A.S.R. 26; Lloyds Bank v. Savory & Co. [1933] A.C. 201.

does not excuse the banker's failure to investigate.[75] However, if an explanation or an inquiry indicates that business efficacy requires the collection of some cheques payable to an employer through the account of an employee or agent, the banker is not considered negligent because he permits such collection.[76]

Secondly, a banker is considered negligent if, without making due inquiry, he credits to the private account of an agent a cheque payable to him in his representative capacity.[77] Third, the banker acts negligently if he collects a cheque crossed "A/C payee only" for a person other than the ostensible payee.[78] Finally, a banker is negligent if he collects, without inquiry, a cheque for an amount clearly out of proportion to the known position in life of the customer.[79]

At the same time, the banker is not required to play the role of the amateur detective and he does not have to be unduly suspicious.[80] Thus, the banker is not considered negligent merely because he fails to compare the signature of the drawer with an indorsement, and as a result does not discover that the customer is not only the payee but also the drawer of a company's cheque paid into his private account.[81] Actually, the standard of care by which the absence or presence of negligence is to be determined must be ascertained by reference to the practice of reasonable men carrying on the business of bankers and endeavouring to do so in such manner as may be calculated to protect themselves and others against fraud.[82]

This principle is extremely well illustrated by the recent decision of the English Court of Appeal in *Marfani & Co. Ltd. v. Midland Bank Ltd.*[83] The plaintiffs, a Manchester importing firm, had a client

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75 Underwood (A.L.) Ltd. v. Bank of Liverpool [1924] 1 K.B. 775, 789.

76 Australia and New Zealand Bank Ltd. v. Ateliers de Constructions Electriques de Charlroi [1967] 1 A.C. 86, [1966] 1 N.S.W.R. 19.

77 Bute (Marquess of) v. Barclays Bank [1955] 1 Q.B. 202.

78 Bevan v. National Bank (1906) 23 T.L.R. 65; House Property Co. of London v. London County and Westminster Bank (1915) 31 T.L.R. 479; Universal Guarantee Pty. Ltd. v. National Bank of Australasia Ltd. [1965] N.S.W.R. 342, [1965] 1 W.L.R. 691. As regards a cheque payable to "tax or bearer" and collected for a private account of drawer's employee see Commercial Bank of Australia Ltd. v. Flannagan (1932) 47 C.L.R. 461.

79 Lloyds Bank v. Chartered Bank of India [1929] 1 K.B. 40.

80 Penmount Estates Ltd. v. National Provincial Bank (1945) 173 L.T. 344, 346. Cf., Gippsland and Northern Co-operative Co. Ltd. v. English Scottish and Australian Bank Ltd. [1922] V.L.R. 670.

81 Orbit Mining and Trading Co. v. Westminster Bank [1963] 1 Q.B. 794.

82 Lloyds Bank v. Savory & Co. [1933] A.C. 201, 221.

83 [1968] 1 W.L.R. 956. Cf., Union Bank of Australia Ltd. v. McClintock [1922] 1 A.C. 240, 22 S.R. (N.S.W.) 293.

called Eliaszade. A clerk of the plaintiffs, whose true name was K., introduced himself as "Eliazade" to a respectable customer of the defendant bank. This customer introduced the clerk, K., to the defendant bank as "Eliaszade" and, by giving him in good faith a favourable reference, induced the defendant bank to open an account for K. under the assumed name of "Eliaszade". K. first paid £160 in cash into this account. After a few days, K. stole a cheque for £6,000 drawn by his employers, the plaintiffs, and payable to the true "Eliaszade". The defendant bank collected this cheque, credited the proceeds to the "Eliaszade" (K's) account, and permitted K. to withdraw the proceeds.

It was held that the defendant bank acted without negligence and was, therefore, entitled to plead the defence of section 4. Diplock L.J. said that the section substituted for the banker's strict liability in conversion, a duty to act without negligence. The phrase, in his Lordship's opinion, must be interpreted with regard to current banking practice. The fact that a mode of conduct by a banker may have been regarded as negligent under authorities decided thirty years ago is not necessarily conclusive. Banking facilities were at that period much less widespread than today and the required standard of care may have changed. Diplock L.J. held that, whether a banker acted without negligence, should be determined according to the following test:

> were the circumstances such as would cause a reasonable banker possessed of such information about his customer as a reasonable banker would possess, to suspect that his customer was not the true owner of the cheque?[84]

If the answer is negative, then the banker has acted in accordance with established banking practice: in his Lordship's opinion a court should be hesitant before condemning as negligent a practice generally adopted by the banking world.

However, Cairns J., who delivered a concurring judgment, indicated that bankers should not, in reliance on this decision, relax the practice applying to the collection of cheques. He thought that while 'the defendant bank here exercised sufficient care, it was . . . only just sufficient'.[85]

This case shows that, generally, a banker discharges his duty of acting "without negligence" by adhering to established banking practice. A major development as regards the nature of banking practice was achieved by the Cheques Act 1957.

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[84] [1968] 1 W.L.R. 956, 973.
[85] Id. at 982.

Before the Act it was held that if a banker collected a cheque bearing an irregular indorsement, he acted negligently and was, therefore, not protected by section 82 of the Bills of Exchange Act 1882.[86] At present this is the position in Australia. Under section 88 of the Australian Bills of Exchange Act, an irregular indorsement may put the banker on inquiry even if it is executed on a cheque payable to "X or bearer". It is true that such a cheque is transferred by delivery and that X's indorsement is, therefore, not necessary.[87] For that reason, a *paying* banker may be protected if he honours such a cheque: it is arguable that he pays it in compliance with his mandate.[88] The defence of the collecting banker against the true owner of a converted cheque, on the other hand, is based on his having acted without negligence. Ordinary banking practice, where the Cheques Act is not applicable, requires the collecting banker to check the regularity of indorsements. If he fails to do so he is careless, and the fact that the cheque is payable to bearer and could have been transferred by delivery, does not necessarily protect the collecting banker against the true owner's action.[89]

It is, however, obvious that the need to check the regularity of indorsements is a most cumbersome task, especially in view of the large number of cheques handled by bankers every day. In England, section 4 (3) of the Cheques Act 1957 [section 5 (3) N.Z.] provides that a banker is not negligent by reason only of his failure to concern himself with the absence of or the irregularity in indorsements. However, the Committee of London Clearing Bankers felt that in certain cases bankers should continue to require indorsements. Under the Circular of September 23, 1957 the collecting banker should require indorsements in any cheque:

(i) which is tendered for an account other than that of the ostensible payee (in such a case the banker must look for the indorsement of the payee and of all subsequent indorsees other than that of the customer for whose account it is to be collected),

(ii) on which the payee's name is misspelt, or the payee is incorrectly designated, and the surrounding circumstances are suspicious, or

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86 Bavins Junr. & Sims v. London and South Western Bank [1900] 1 Q.B. 270. As to when an indorsement is irregular see ante p. 113.

87 See ante p. 105.

88 See ante pp. 106, 124, which show that this may protect him against an action by the true owner.

89 A bearer does not necessarily have the title, which may remain vested in the "true owner". See ante p. 124 and n. 53.

(iii) which is payable to joint payees and tendered for an account to which not all are parties.

Similar requirements apply in New Zealand under a Circular of the Bankers Institute dated 17 November 1960. If a banker collects a cheque mentioned in the Circular despite its being unindorsed or bearing an irregular indorsement, he must be considered as having acted "with negligence". This argument is based on the wording of section 4, which emphasises that the banker is not to be considered negligent "by reason only" of the defective or absent indorsement. If he disregards the provisions of the Circular he is negligent not "by reason only" of the irregular indorsement but because he ignores established banking practice.

The reform recommended by the Australian Bills of Exchange Committee is similar to the principles adopted by the English Circular. Under clause 63 of the draft bill a collecting banker must concern himself with indorsements where a cheque is collected for an account other than that of the ostensible payee and also where the description of the payee by the drawer of the cheque does not reasonably identify him as the customer for whom the cheque is presented. Whether the payee is sufficiently identified or whether a misnomer is such as to render the identification doubtful is a matter of fact.

If a collecting banker is not entitled to rely on the defence of section 4, he will not, usually, have any valid defence against the true owner of a converted cheque. The true owner's negligence does not preclude him from suing the collecting banker. The true owner cannot be regarded as owing a duty of care to the collecting banker. However, the collecting banker may probably raise a plea of contributory negligence, based on the true owner's "fault".

C. DEFENCES AVAILABLE TO DISCOUNTING BANKERS

(i) *Is the protection of a collecting banker available to a discounting banker?*

Some textbook writers suggest that the defence of section 4 of the Cheques Act 1957 [section 5 N.Z.] is not available to a discounting banker.[90] Some support for this view can, perhaps, be found in the marginal note (or section heading) which refers to "protection of bankers collecting payment of cheques, etc." But the language of section 4 (1) (b) leads to a different conclusion. Under this sub-

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90 PAGET, 415; BYLES, 288; CHALMERS, 311. CHORLEY, LAW OF BANKING 117-120 (5th ed.). See also Report of the Australian Bills of Exchange Committees, paras. 130-133.

section the banker is protected if 'having credited the customer's account with the amount of the instrument [he] receives payment thereof for himself'.

The key to the meaning of section 4 is to be found in its historical background. Indeed, the defence available under the original section 82 of the Bills of Exchange Act 1882 could be claimed only if the collecting banker received payment of the cheque for his customer. In 1903 it was held in *Capital and Counties Bank v. Gordon*[91] that if a banker credited a cheque to the customer's account before its clearance, he received payment for himself and not for the customer. He was therefore not entitled to rely on the defence of section 82. It is important to note that *Gordon's* case did not draw a distinction between a discounting banker on the one hand and a collecting banker on the other hand. It proceeded on the presumption that any banker —whether he acts as a discounter or as an agent—who credits a customer's account with uncleared cheques, collects them for himself. As the crediting of cheques to a customer's account before clearance is a mere matter of accountancy practice, and does not indicate an intention to permit drawing against them, this conclusion is a hard one to swallow.

The law was remedied by the Bills of Exchange (Crossed Cheques) Act 1906 which stipulated that '[a] banker receives payment of a crossed cheque for a customer . . . notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof'. It is important to note that this section did not purport to extend the protection of section 82 to a banker who received payment of a cheque for himself. It only stated that by crediting the account before clearance, a banker was not deemed to receive payment of the cheque for himself. Where a banker in fact collected a cheque for himself, that is, where he discounted it, the 1906 Act did not extend him the protection of section 82. Thus, between 1906 and 1957 the defence of section 82 was open only to a collecting banker and not to a discounting banker. This is still the position in Australia, where section 88 of the Bills of Exchange Act 1909-1958 adopts the language of the 1906 Act.[92]

It is submitted that the effect of section 4 (1) (b) of the Cheques Act 1957, the language of which has been adopted by the Australian Bills of Exchange Committee in clause 63(1) (b) of the draft bill, is to extend the defence originally provided by section 82 of the Bills of

91 [1903] A.C. 240.

92 RILEY, BILLS OF EXCHANGE IN AUSTRALIA 273-274 (2nd ed.).

Exchange Act to a discounting banker. As pointed out above, under this sub-section a banker is protected (provided he acts in good faith and without negligence) even if, having credited the customer's account, he *receives payment for himself*. This is exactly what is done by a discounting banker. As he grants the customer an overdraft or cash against the uncleared cheque he really receives payment of it to reimburse himself. Actually, the departure in the Cheques Act 1957 from the language of the 1906 Act is evidence of the intention to amend the law. If the intention had been to retain the law prevailing before 1957, this could have been done easily by adopting the language of the 1906 Act in section 4 of the Cheques Act.

However, it is important to bear in mind that even a discounting banker can rely on the defence of section 4 only if the cheque has gone through the customer's account. It is clear from the language of the sub-section (1) (b) that the banker cannot rely on the section if he has, for example, paid the customer cash against the cheque without crediting it to his account.

(ii) *The defence of being a holder in due course*

A second defence which may, on occasions, be open to the discounting banker is to rely on his position as the holder in due course of a cheque. If he can bring himself within the definition of a holder in due course, he is to be regarded as the true owner of the cheque and an action in conversion against him will fail.[93]

In order to be considered a holder in due course, the banker must be able to prove that he took the cheque in good faith and for value and that the cheque was, at that time, complete and regular on its face: this follows from section 29 (1) of the Bills of Exchange Act 1882 [section 34 (1) Australia]. Usually the discounting banker has no difficulty in proving that he has acted in good faith and that he has given value for the cheque. Indeed, if he has not given value for it he is a collecting banker and not a discounting banker.

But the requirement of "completeness and regularity on the face of the cheque" can frequently prove a pitfall. A cheque is considered incomplete if any material detail, such as the name of the payee or the amount payable, is missing.[94] A cheque is considered irregular whenever anything can give rise to doubts or suspicion: for example,

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93 See s. 38 (2) of the Bills of Exchange Act 1882 [Australia s. 43 (1) (*b*)] and ante pp. 121, 122.

94 Whistler v. Forster (1863) 14 C.B. (N.S.) 248, 258, 143 E.R. 441, 445; Slingsby v. District Bank [1931] 2 K.B. 588, affirmed [1932] 1 K.B. 544.

if there is a discrepancy between the words and figures denoting the amount, or if the cheque is pasted together after having been torn.[95]

Moreover, the word "face" in section 29 includes the back of the cheque. Thus, a cheque is considered irregular on its face if it is payable to order and is not indorsed, or is irregularly indorsed by the payee.[96] However, in England and in New Zealand this requirement has been mitigated, in so far as a discounting banker is concerned, by section 2 of the Cheques Act 1957 [section 3 N.Z. and clause 63 (5) of the draft bill attached to the report of the Australian Bills of Exchange Committee]. This section confers on a banker who gives value for a cheque payable to order, which the holder delivers to him for collection without indorsing it, such rights as he would have had if it had been indorsed in blank.

Two cases show that a discounting banker may rely on this section in order to establish that he is a holder in due course of an unindorsed cheque. In *Midland Bank Ltd. v. R. V. Harris Ltd.*[97] a customer of the plaintiffs paid into his account with them two cheques drawn by the defendant on Lloyds Bank and payable to the customer's firm. The cheques were dishonoured by Lloyds Bank and the plaintiffs brought an action claiming to be holders in due course of the cheques. It was proved that the customer was allowed to draw against the cheques before their clearance. Although the cheques did not bear an indorsement, it was held that, by section 2, the plaintiffs should be treated as holders in due course of the cheques despite the absence of an indorsement.

In *Westminster Bank v. Zang*[98] a customer of the plaintiffs paid into the account of a company of which he was a director an unindorsed cheque, drawn by the defendant and payable to the customer's order. The defendant stopped the cheque and it was dishonoured by the drawee bank. The plaintiffs brought an action to enforce payment, claiming to be holders in due course. As it was proved that the plaintiffs did not give value for the cheque it was held that they were

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95 Scholey v. Ramsbottom (1810) 2 Camp. 485, 170 E.R. 1227; Ingham v. Primrose (1859) 7 C.B. (N.S.) 82, 141 E.R. 745; Cf., Redmayne v. Burton Lloyd & Co. (1860) 2 L.T. 324.

96 Whistler v. Forster (1863) 14 C.B. (N.S.) 248, 143 E.R. 441; Slingsby v. District Bank [1931] 2 K.B. 588, affirmed [1932] 1 K.B. 544; Arab Bank Ltd. v. Ross [1952] 2 Q.B. 216, 226. As to when an indorsement is irregular see ante p. 113. (Note that an irregularly indorsed cheque payable to "X or bearer" is probably regular on its face. The position differs from that raised at p. 136 ante because here the regularity is required for negotiation.)

97 [1963] 1 W.L.R. 1021.

98 [1966] A.C. 182.

not holders in due course or for value, and could not enforce payment. The House of Lords held, however, that if they had given value for the cheque, they would have been holders in due course despite the missing indorsement. It was further held that the fact that the cheque was not collected for the original payee was of no relevance. Thus, a banker may be considered to be a holder in due course in circumstances in which an ordinary member of the public—who is less familiar with negotiable instruments than a banker—would not be so considered.[99]

D. COMPARISON OF POSITION OF COLLECTING AND DISCOUNTING BANKER

The discounting banker is in a better position than the collecting banker. Apart from being able to plead the defence available to the collecting banker under section 4 as well as contributory negligence, the discounting banker can on occasions rely on his position as holder in due course of the cheque.

This additional defence is of value especially when the discounting banker is unable to prove that he has acted "without negligence". Unlike the collecting banker, who thereupon is without adequate defence, the discounting banker may be able to prove that he is a holder in due course: a person may be a holder in due course even if he has acted carelessly in giving value for a cheque, provided he has acted in good faith. Of course, the cheque must have been complete and regular on its face when negotiated to the discounting banker. But this is a narrower requirement than that of having acted without negligence within the meaning of section 4.

The following two examples illustrate this point. If the discounting banker's negligence has been his failure to observe an irregularity in the cheque (such as a discrepancy between the amount denoted by the words and the figures) he is unable to rely on section 4 because of this carelessness and is equally unable to plead that he is a holder in due course because of the irregularity on the face of the cheque. If the banker's negligence arises at the time of the opening of the account or by agreeing to credit a cheque payable to a principal to his agent's account, the defence of section 4 is unavailable but the

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99 The Australian Bills of Exchange Committee felt that when a banker gives value for a cheque and thus becomes a discounter he should be treated as any other holder for value of a cheque and should not be given a special defence, such as that of section 4 of the Cheques Act, (report paras. 130-133). The adoption of sections 4 (1) (b) and 2 of the Cheques Act in clause 63 of the draft bill is, therefore, puzzling.

discounting banker may be able to prove that he is a holder in due course.

Moreover, the discounting banker may be in a better position than a collecting banker when a required indorsement is missing. It has been shown that if an order cheque does not bear an indorsement of the payee, the discounting banker may nevertheless be a holder in due course. But if this cheque is of a type in which an indorsement is required by the Circular, the absence of the required indorsement prevents the banker from pleading that he has acted without negligence.

In effect, the discounting banker has the best of both worlds. If he has failed to act without negligence, he may be able to defeat an action of the "true owner" by relying on his own position as holder in due course. If he cannot prove that he is a holder in due course, he may still be able to escape liability by proving that he has acted without negligence within the meaning of section 4.

It is to be doubted whether, from a commercial point of view, there is any justification for the difference in the defences available to the two types of banker. As pointed out at the beginning of this part of the article, it is frequently an accidental matter whether a banker acts as a collecting banker or as a discounting banker. It is, therefore, artificial to base the defences available to the banker on the particular role assumed by him. Under the present state of the law, a banker reduces his liability to the "true owner" of a cheque by granting his customer an overdraft against it. But from a commercial point of view, if the granting of an overdraft to a customer against uncleared cheques is to influence the rights available to the banker against the true owner, it should put him under a more stringent duty of care. Basically, acts done for a customer who does not require an overdraft, appear to be more regular than those done for a customer who hurries to realise the proceeds of cheques before their clearance.

IV. NEED FOR A REFORM

It appears to be clear that the existing law concerning the defences available to paying, collecting and discounting bankers leaves much to be desired. It has been shown that the paying banker may be under a more stringent liability to the true owner of a cheque than to his own customer. Moreover, too much depends, as regards the paying banker, on whether the cheque is crossed or uncrossed and on the specific type of irregularity which prohibits payment.

It is, of course, inevitable that the liability of a discounting banker and of a collecting banker is generally different from that of a paying banker. The commercial roles assumed by these bankers are of a different nature. It is desirable to discuss these roles briefly and, on their basis, suggest some tests for suitable defences.

The paying banker, it should be recollected, acts as an agent of his customer. When a cheque is presented through the clearing house, the paying banker is mainly concerned with two questions. First, is the amount standing to the credit of the customer's account sufficient for meeting the cheque? Second, is the cheque regular on its face? If it is signed by the customer or by a person authorised by him and does not appear to be irregular then, in accordance with standard banking practice, it must be honoured. There is no room for detailed inquiries and prolonged investigation. In point of fact, the Cheques Act and the Circular confirm that under modern practice the banker cannot even be expected to check the regularity of indorsements, except in certain types of case, including that in which a cheque is presented for payment over the counter.

Usually it is unreasonable to expect the paying banker to do more than verify that payment is effected within the scope of his authority and in conformity with ordinary banking practice. The large volume of cheques handled every day makes it impossible to expect a banker to examine in each case whether the directors of a company abuse their authority by drawing a specific cheque or whether a trustee commits a breach of trust. It is wrong to say, as has been done by Ungoed-Thomas J. in the *Selangor United Rubber Estates* case, that a banker is liable as constructive trustee or in negligence if he "ought to have known" of a fraud or abuse of authority by the fiduciary agents of his customer. It is easy to be wise after an event! But if a banker were to dishonour a cheque drawn on a company's account due to an alleged breach of trust by the directors, he could in the end find himself involved in an action for wrongful dishonour or for defamation of character. In any event, it is unreasonable to expect the paying banker, who is not a trustee of the customer, to exercise control over the acts of the latter's agent.

Finally, as regards the paying banker, it appears unreasonable to make him liable in conversion to the true owner of a cheque which has been wrongfully paid. The banker pays the cheque because it is drawn by his customer, who is entitled to make such a demand. In the normal course of events the paying banker cannot discover whether a cheque is collected for the true owner or for a thief. Moreover, the

true owner has a right of action in conversion against the collecting or discounting banker, who is in a much better position than the paying banker to discover who is the owner of the cheque. The present state of the law, which gives the collecting banker the defence of section 4 but denies a similar defence against the true owner to a paying banker, is absurd.[100]

The commercial role assumed by the collecting or discounting banker differs from that of a paying banker. The collecting (or discounting) banker receives the cheque from the person in possession and puts it into transmission for clearing. He is in a better position for asking any questions than the paying banker; the latter, in fact, has to assume that it is presented by the collecting banker for the true owner. The collecting banker should, therefore, be liable for a careless act to the true owner of the cheque. Section 4 of the Cheques Acts 1957 appears to adopt a suitable standard. The banker is protected as long as he acts in good faith, without negligence and for a customer. In other words, he is protected as long as he acts in accordance with ordinary banking practice. The abrogation of the banker's defence in cases where a cheque is collected for a person other than the ostensible payee and the other limitations provided by the Circular and proposed by the Australian Bills of Exchange Committee are, it is submitted, sound and useful for protecting the public.

But, from a commercial point of view, there is no justification for the additional defence available to a discounting banker. The object of section 29(1) of the Bills of Exchange Act 1882 is to protect the ordinary transferee of a cheque, who should be allowed to rely on its negotiable character when seeking to enforce it against the drawer. A banker who discounts or collects cheques can be expected to be more careful than any other holder or transferee of a cheque. The reason for this is that the banker's main business is concerned with cheques: he can therefore be expected to act in a manner aimed at protecting the general interests of the public. Probably, the solution is to provide that a discounting banker is prevented from setting up his rights as true owner (or holder in due course) against a person suing for the conversion of a cheque, unless the banker has obtained it in the ordinary course of business.

It is further submitted that the standard of acting "in the ordinary course of business" is preferable to that of acting "without negligence". The former phrase provides a guideline assisting in the determination

100 However, a greater degree of care can be expected from the paying banker when a cheque is presented for payment over the counter: see ante p. 114.

of the degree of care which must be assumed by the collecting banker.

Finally, there appears to be no need to provide an elaborate definition of the "ordinary course of business". First, the practice may vary from time to time. Secondly, the banking community itself is inclined to set up a standard aimed at protecting the interests of the public. It is typical that when the Cheques Act purported to exempt bankers from any duty to check indorsements, the banking community mitigated this wide exemption. This was not done for any philanthropical reason. Banking business depends on the reliance of the public on the banker's care in handling money and cheques. To maintain this trust the banker has to observe a high standard of care in order to protect his customers. It is felt that the determination of what constitutes the "ordinary course of business" may be left in the hands of the banking world.

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