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1. INTRODUCTION

Raza Kayani LLP v. Toronto-Dominion Bank ("*Kayani*")[1] is a recent judgment in the chain of cases exposing the problematic interpretation of s. 20(5) of the *Bills of Exchange Act* ("*BEA*").[2] I have addressed relevant issues before,[3] but will use this occasion to tackle them again, in light of new developments and novel reflections. I will proceed to set out the facts of *Kayani* and the conclusion of the judgment, address the cause of action, and critically analyse the evolving interpretation of *BEA* s. 20(5) in Canada and its application in the case. I will then argue that, having reached the correct result, *Kayani* nevertheless misapplied *BEA* s. 20(5). Subsequently, I will revisit the original meaning given by case law to the English counterpart of the provision and endeavour to identify the point where interpretation and good policy divorced. I will conclude with pointing out possible directions for law reform.

2. KAYANI: THE JUDGMENT

Kayani involved actions in negligence and conversion by two real estate lawyers. One was defrauded into issuing a cheque while the other was defrauded into causing the issue of a bank draft. The defendant was a bank into which the two instruments were deposited ("The Bank" or "TD"). According to the judgment,

> [4] Both actions arose out of a fraud perpetrated against the respondents, who are lawyers. The scheme worked as follows.
>
> [5] The respondents were each retained to act on a rush commercial transaction on behalf of a purchaser and a finance company that was providing funding for the transaction. In each transaction, the vendor was identified as Nithiyakalyaani Jewellers, with an address of 1487 Gerrard Street East in Toronto.

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1 2014 ONCA 862, 2014 CarswellOnt 16810, 14 C.C.L.T. (4th) 175, 378 D.L.R. (4th) 729 (Ont. C.A.) [*Kayani*].

2 R.S.C. 1985, c. B-4 [*BEA*].

3 Particularly, first in Benjamin Geva, "The Fictitious Payee and Payroll Padding: Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd." (1978) 2 Can. Bus. L.J. 418; and then in Benjamin Geva, "Conversion of Unissued Cheques and the Fictitious or Non-Existing Payee — Boma v. CIBC" (1997) 28:2 Can. Bus. L.J. 177 [Geva, "Conversion"].

> [6] On the eve of the closing, the finance company provided each respondent with a counterfeit certified cheque to be deposited into their respective trust accounts for the purpose of funding the transaction. The finance company directed the respondents in writing to issue a trust cheque or obtain a bank draft made payable to Nithiyakalyaani Jewellers for the amount of the transaction.
>
> [7] [The two real estate lawyers] respectively released a trust cheque and a bank draft (the "instruments") payable to Nithiyakalyaani Jewellers to their purchaser client, on the understanding that the client would hand deliver it to the vendor as payment for the goods' [sic] being purchased.
>
> [8] The instruments were deposited into an account the Bank maintained under the name Nithiyakalyaani Jewellers. The account had been opened by an individual named Alaudeen Shaik, who provided the Bank with a Master Business Licence issued by the Province of Ontario, indicating that he had registered, as a sole proprietorship, the name Nithiyakalyaani Jewellers.
>
> [9] In essence, the fraud consisted of inducing the respondents to issue a trust cheque or obtain a bank draft on the strength of a counterfeit cheque deposited into their trust accounts. As part of the scheme, the fraudsters had appropriated the descriptive portion of the name and address of a corporation that had previously carried on business but was no longer doing so at the date of the fraud. That company was Nithiyakalyaani Jewellers Ltd., as opposed to the named payee, Nithiyakalyaani Jewellers.

Reversing the decision of the trial judge,[4] the Ontario Court of Appeal concluded that in each case the payee was not the name of any real person known to the drawer. Rather, the payee's name was a creature of the imagination. Hence, each instrument was payable to "a fictitious or non-existing person" so that under *BEA* s. 20(5) it "may be treated as payable to bearer." Accordingly, each instrument was properly paid by the Bank and the loss was allocated to the two lawyers. As part of a critique on the judicial interpretation on *BEA* s. 20(5) and the drawer's cause of action against the collecting bank, this comment rejects the Court of Appeal's statutory interpretation. At the same time, the final result, allocating the loss to the lawyers, is endorsed, albeit for other reasons.

3. THE CAUSE OF ACTION

The lawyers' action against the collecting bank was in negligence and conversion. There was however no discussion as to whether this was a good action. I have explained elsewhere the inappropriateness of conversion as a ground for rendering a collecting bank[5] liable to the drawer for payment over a forged endorsement.[6]

4 *Raza Kayani LLP v. Toronto-Dominion Bank*, 2013 ONSC 7967, 2013 CarswellOnt 18666, 9 C.C.L.T. (4th) 154 (Ont. S.C.J.); reversed 2014 ONCA 862, 2014 CarswellOnt 16810, 14 C.C.L.T. (4th) 175, 378 D.L.R. (4th) 729 (Ont. C.A.) [*Kayani*, Court Below].

5 In this comment "collecting bank" is the bank of deposit, although in practice (where an indirect clearer is involved) it could also be an intermediary bank.

6 See e.g. Geva, "Conversion", *supra* note 3 at 186–192. "Forged" and "forgery" are loosely used throughout this comment to include "unauthorized" or in fact "invalid" signature — or even unauthorized deposit.

Briefly stated, the drawer of a cheque has not been in possession of the cheque as a valuable asset and has not been dispossessed of the cheque *qua* cheque. Nor does the drawer have a claim to enforce the cheque. Rather, the drawer was in possession of an unissued[7] cheque which is a mere piece of paper. Once it left his or her hands, the cheque may represent "an obligation of the drawer rather than a property of the drawer."[8] Hence, there is no basis for the drawer's conversion action. Rather, when a cheque, like any bill,[9] is paid over a forged endorsement, so that the forger or anyone deriving title from the forger is not entitled to give a discharge on the cheque,[10] the drawer's remedy is against the drawee[11] for making an unauthorized payment in breach of their banking contract.[12] For its part, a drawee bank that paid a cheque over a forged endorsement, may recover "from the person to whom [the bill] was paid or from any endorser who has endorsed the bill subsequent to the forged . . . endorsement."[13] The first such endorser is then left to deal with the forger.[14] In a typical setting the drawee bank is thus able to allocate the forged endorsement loss to the collecting bank which received the cheque from the forger.

It is tempting to argue that the allowing the drawer to directly sue the collecting bank will avoid the circuity of action. This however overlooks the possible availability to the drawee bank of defences which are not available to the collecting bank, as for example those arising from the banking contract. Hence, a drawer

7 *BEA*, *supra* note 2, s. 2 defines "*issue*" to mean "the first delivery of a bill or note, complete in form, to a person who takes it as a holder."

8 Official Comment 1 to U.C.C. §3-420 (2002) in the United States.

9 Under *BEA*, *supra* note 2, s. 165 (1), "A cheque is a bill drawn on a bank, payable on demand" so that under *BEA* s. 165(2), in principle, "the provisions of [the *BEA*] applicable to a bill payable on demand apply to a cheque." "Bank" is defined in *BEA* s. 164 by reference to membership in the Canadian Payments Association which includes chartered banks and other specified financial institutions. This comment focuses on cheques but the analysis applies to bills and notes as well.

10 See *BEA*, *ibid.* s. 48(1), under which in principle, "where a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorized signature is wholly inoperative, and no right to retain the bill or to give a discharge therefor or to enforce payment thereof against any party thereto can be acquired through or under that signature unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery . . ."

11 Action is subject to compliance with *BEA*, *ibid.* s. 48(3) which requires the drawer, as a condition to recovering from the drawee, to give "notice in writing of the forgery to the drawee within one year after he has acquired notice of the forgery".

12 Under that contract drawee is required to comply with the drawer's orders each of which is to make payment to the payee or someone deriving title from the payee in lawful possession of the instrument.

13 *BEA*, *supra* note 2, s. 49 which similarly to *BEA*, *supra* note 2, s. 48(3) fastens timely notice requirements.

14 For the loss reduction rationale, see *Mead v. Young* (1790), 4 Term Rep. 28, 100 E.R. 876 (Eng. K.B.). Of course, ultimately it is the forger who is responsible for the loss except that he or she is an "unpromising" defendant and the discussion here is on the loss allocation among innocent parties.

pleading payment over a forged endorsement should first sue the drawee bank. A possible defence available to the drawee bank against its customer the drawer of the cheque is under s. 20(5) of the *BEA* on which the judgment in *Kayani* was based. As indicated, the section states that "Where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer." In the case of a bill payable to bearer, payment to the bearer complies with the drawer's order[15] so as not to be in breach of the drawer-drawee contract. Accordingly, it is the drawer who bears the loss of payment made to a thief or someone deriving title from the thief of a cheque payable to bearer. In effect, when *BEA* s. 20(5) applies, the cheque payable to a fictitious or non-existing person is "transformed" in the eyes of the law from a cheque payable to order to a cheque payable to bearer so that the forged endorsement is overlooked and the loss falls on the drawer.

Arguably, a drawer who is successful in disallowing the drawee bank's defence based on *BEA* s. 20(5) is still exposed to the collecting bank's action for negligence in facilitating the forged endorsement.[16] Similarly, where *BEA* s. 20(5) is held to apply so that between the drawer and the drawee the loss falls on the drawer, the latter should nevertheless be allowed to proceed against the collecting bank in negligence. This is a more sensible approach for the loss allocation than the one premised on the conversion liability of the collecting bank to the drawer. Premised solely on whether the section applies, the absolute liability under conversion does not take into account at all the possible negligence of each of the parties involved.[17]

In principle, only a drawer who, notwithstanding proof of a forged endorsement lost against the drawee bank, should be allowed to proceed against the collecting bank, and only on the basis of the latter's fault. In this day and age of a mass automated cheque collection system a collecting bank may nevertheless be held to a high standard of care in screening customers to whom chequing accounts are made available as well as in accepting cheques for deposit to such accounts. Similarly, only a drawee bank which lost against the drawer due to a forged endorsement ought to be allowed to assert its recourse right against the collecting

15 As long as it is made in good faith it is "payment in due course" discharging the bill. See *BEA*, *supra* note 2, s. 138. Briefly stated, this is so because it is made to the "holder" (as defined in *BEA*, s. 2). For a bill payable to bearer the bearer is the holder. Conversely, someone deriving title through a forged endorsement of a bill payable to order is not a "holder" and hence payment to him or her is not "in due course".

16 Cf. e.g. *Royal Bank v. Société Générale (Canada)*, 2006 CarswellOnt 8091, 31 B.L.R. (4th) 63, 219 O.A.C. 83, [2006] O.J. No. 5081 (Ont. C.A.); additional reasons 2007 ONCA 302, 2007 CarswellOnt 2370, 31 B.L.R. (4th) 83 (Ont. C.A.); leave to appeal refused 2007 CarswellOnt 5676, 2007 CarswellOnt 5677, 376 N.R. 400 (note), 245 O.A.C. 400 (note), [2007] S.C.C.A. No. 87 (S.C.C.); leave to appeal refused 2007 CarswellOnt 5678, 2007 CarswellOnt 5679, 377 N.R. 400 (note), 246 O.A.C. 400 (note) (S.C.C.) in which the Ontario Court of Appeal opened the door to the possibility that a drawer and account holder will be prevented by its negligence from setting up a forged endorsement plea against a collecting bank.

17 For a comprehensive similar (albeit not identical) analysis see Margaret H. Ogilvie, "The Tort of Conversion and the Collecting Bank: Teva Canada Ltd. v. Bank of Nova Scotia" (2014) 91:3 Can. Bar. Rev. 731.

bank, irrespective of the latter's fault, but only to the extent that the drawee bank itself was not at fault.[18]

More specifically, having paid a cheque, a drawee bank, alleging the cheque bears a forged endorsement, may be allowed under clearing rules to return the cheque to the collecting bank.[19] Where the latter either contests the forgery or asserts the drawee bank has a good defence against it, the collecting bank ought to be allowed to return the cheque to the drawee bank which may then debit the drawer's account. The drawer may sue the drawee bank for a wrongful debit in breach of contract. To win and have his or her account re-credited, the drawer will have to prove the forged endorsement. For its part, the drawee bank may successfully meet the drawer's proof of forgery, in whole or in part, establishing either preclusion by the drawer, whether by contract or on the basis of the drawer's negligence,[20] or application of the fictitious payee section. At that point the drawer may reduce or extinguish his or her liability by proving negligence by the drawee bank.

The collecting bank may be joined in this proceeding by both the drawer (alleging the collecting bank's negligence) and the drawee (alleging recourse against the collecting bank as a prior party).[21] Negligence ought thus to be available to the drawer against the collecting bank but only as a contingent claim for what the drawer is liable to the drawee. In effect, the drawer may include in the original statement of claim against the drawee his or her contingent claim against the collecting bank. As well, as a defendant, the drawee bank may bring a third party claim against the collecting bank. Alternatively the collecting bank ought to be entitled to become an intervener in the drawer-drawee litigation at its own initiative. Participating in the litigation, the collecting bank will ensure that the drawee bank is properly defending the drawer's action so as to be released from liability on the basis of which it has recourse against the collecting bank. To that end, the collecting bank may be allowed to subrogate to the drawee's position against the drawer. Ultimately, loss is to be allocated among the drawee, collecting bank and the drawer according to respective fault of each party, with the balance falling on the collecting bank.

In *Kayani*, TD was both the collecting and drawee bank.[22] Hence the lawyers were justified in proceeding directly against it — albeit not in conversion and negligence; rather they should have sued on breach of contract. Conversion should not have been allowed and negligence ought to become available only upon the successful assertion by the Bank of the defence based on *BEA* s. 20(5).

4. BEA S. 20(5) AND CANADIAN CASE LAW PRIOR TO KAYANI

The principal issue addressed by the Ontario Court of Appeal in *Kayani* was whether in each instrument the payee was "a fictitious or non-existing person" so as

18 I speak of "fault" and "negligence" interchangeably, and only where it has contributed to the loss.

19 As in fact provided by Canadian Payments Association Rule A4 — Returned and Redirected Items.

20 *BEA*, *supra* note 2, s. 48(1), as reproduced in note 10, *supra*.

21 *BEA*, *ibid.* s. 49, reproduced in text at note 13, *supra*.

22 See *Kayani*, Court Below, *supra* note 4 at para. 58.

to trigger *BEA* s. 20(5) and have the loss fall on the drawer. To that end, the key was said to be the "four propositions taken from John D. Falconbridge's *Banking and Bills of Exchange*, 6th ed. (Toronto: Canada Law Book, 1956), at pp. 468-69." These propositions were stated to be as follows:[23]

> (1) If the payee is not the name of any real person known to the drawer, but is merely that of a creature of the imagination, the payee is non-existing, and is probably also fictitious.
>
> (2) If the drawer for some purpose of his own inserts as payee the name of a real person who was known to him but whom he knows to be dead, the payee is non-existing, but is not fictitious.
>
> (3) If the payee is the name of a real person known to the drawer, but the drawer names him as payee by way of pretence, not intending that he should receive payment, the payee is fictitious, but is not non-existing.
>
> (4) If the payee is the name of a real person, intended by the drawer to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that the drawer has been induced to draw the bill by the fraud of some other person who has falsely represented to the drawer that there is a transaction in respect of which the payee is entitled to the sum mentioned in the bill.

These four propositions are not entirely clear. Nor do they cover all circumstances, at least explicitly. To begin with, as it relates to a scenario in which "the payee is non-existing, and is probably also fictitious," the first proposition is confusing. Do the two categories (fictitious and non-existing) overlap? Furthermore, for the first proposition to apply, must the payee's name be a creature of the *drawer*'s imagination? Alternatively, let us assume the facts of the fourth proposition except that the payee is the name of an imaginary rather than of a real person. Does the first proposition cover a case in which the payee is the name of an *imaginary* person, intended by the drawer to receive payment, where the drawer has been induced to draw the bill by the fraud of some other person who has falsely represented to the drawer that there is a transaction in respect of which the payee is entitled to the sum mentioned in the bill? If this case does not fall within the first proposition, is it covered by any other?

As well, between the first and third propositions, if a name is fraudulently put as a payee with no intention that this person will receive payment, what difference does it make if the name is the creature of the drawer's imagination (in which case it falls under the first proposition) and if it is the name of a real person known to the drawer (in which case it falls into the third proposition)? Furthermore, if both a payee with an invented name and a payee with the name of a real person could be "fictitious" (first and third propositions respectively), what is the difference between "fictitious" and "non-existing" and why does the distinction matter?

So far as the second proposition is concerned, is a non-existing person only one who was known to the drawer — and at the time the cheque is written — is known by the drawer to be dead, as in the second proposition? What about the name of a real person who is nonetheless not known personally to the drawer? And

23 Technically, they vary from Falconbridge's original where actual names are used for both the drawer and the payee. This is however of no practical significance.

why ought non-existence to be determined from the drawer's — or in fact anyone's — perspective? Isn't "non-existence" an objective fact?

As for the fourth proposition, surely, it cannot be disputed that where "the payee is the name of a real person, intended by the drawer to receive payment," the payee is not non-existing. However, where "the drawer has been induced to draw the bill by the fraud of some other person who has falsely represented to the drawer that there is a transaction in respect of which the payee is entitled to the sum mentioned in the bill," as under that proposition," does it necessarily follow that the drawer is always fault-free so as to be exonerated from any responsibility?

Also, as for the scope of the fourth proposition, three questions arise: (i) Does it apply only where the payee's endorsement signature has been forged? (ii) Ought the real person to be known to the drawer, as in the second proposition? and (iii) As a matter of policy, where "the drawer has been induced to draw the bill by the fraud of some other person who has falsely represented to the drawer that there is a transaction in respect of which the payee is entitled to the sum mentioned in the bill," why does it matter whether the payee's name is real so as to be covered by the fourth proposition, or whether it is imaginary, so as arguably to trigger the first proposition?

By reference to Falconbridge's four propositions, overlooking all such reservations and queries, the court in *Kayani* cited with approval Laskin J.A. in *Rouge Valley Health System v. TD Canada Trust*,[24] ("*Rouge Valley*") stating that

> Two important principles structure these [four Falconbridge's] propositions:
>
> - Whether the payee is non-existing is a simple question of fact not depending on anyone's intention.
> - Whether the payee is fictitious depends upon the intention of the drawer of the . . . cheque . . .

In fact, this rephrases Falconbridge's own two principles[25] which in his text preceded his four propositions. For their part, the four propositions purported to demonstrate the operation of these two principles.

However, the four propositions are not always consistent with the two principles. Thus, the first proposition requires the payee's name to be "a creature of the imagination" rather than of a real person known to the drawer. If it addresses the drawer's imagination, the reference to a non-existing payee is misplaced. Alternatively, if the first proposition addresses a third person's imagination, why does it matter if the drawer knows that person, and why must the payee be non-existing in addition to being fictitious? As well, the drawer's knowledge should not play any role in the second proposition. After all, death is an objective fact, and lack of knowledge of death, or even of the dead person, does not bring the dead person into existence. Nor ought the second proposition to be limited to a person who is dead.

24 2012 ONCA 17, 2012 CarswellOnt 255, 108 O.R. (3d) 561, 287 O.A.C. 241 (Ont. C.A.) at para. 23.

25 In the original language, *supra*, note 23 at 468:

> Whether a named payee is non-existing is a simple question of fact, not depending on anyone's intention. The question whether the payee is fictitious depends upon the intention of the creator of the instrument, that is, the drawer of a bill or cheque or the maker of a note.

Is one who was not born less existing than one who died? Also, for the third proposition to apply, must the drawer think of the person known to him or her in selecting that person's name? In case the drawer has not thought of that person, does the payee become non-existing?

It is also noteworthy that Falconbridge stated the four propositions in relation to an individual drawer. Whether an individual does not intend a cheque to be paid to the person to whom it is written payable, in which case the cheque becomes payable to a fictitious payee, is a question of fact. At the same time, in a case of a corporate drawer, broadly used here to cover any entity other than an individual, the question of the drawer's intention becomes also a question of law. Also, does the fourth proposition equally apply to the inducement by an insider in the drawer's organization as well as to that of an outsider?

Not surprisingly then, whether the payee is fictitious or non-existing within the meaning of *BEA* s. 20(5) has extensively been discussed in case law involving a corporate drawer. The critical issue has evolved around the ascertainment of circumstances in which the drawer's intention rendered the cheque payable to a fictitious person and those in which the cheque was payable to a non-existing person so that the drawer's intention did not matter. Particularly, as indicated, in the absence of the drawer's fraudulent intention, *BEA* s. 20(5) applied only where the payee was non-existing.

Although there are earlier cases,[26] a convenient starting point for an analysis of *BEA* s. 20(5) in Canada is *Royal Bank v. Concrete Column Clamps (1961) Ltd.* (1976)[27] ("*Concrete Column Clamps*"). The scenario under discussion was that of a fraudulent scheme in which the authorized signer is not involved. Nor is the authorized signer cognizant of it. Rather, the authorized signer is deceived by an insider in the corporate drawer to sign corporate cheques payable to payees. The fraudster intends to collect such cheques and divert the collected funds to his or her own use ("payroll padding"). The fraudster either prepares the cheques or is in a position to generate names of people to whom corporate cheques are to be issued. Once signed, the fraudster must be in a position to take possession of them. Typically, named payees are not owed money by the corporate drawer, so that there is no risk of them coming forward to inquire as to why they did not receive cheques.

The majority judgment in *Concrete Column Clamps* was given by Pigeon J. who attributed to the corporate drawer the intention of the actual authorized signer. This is also how the case was understood by the La Forest J. in his dissent in *Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce*[28] ("*Boma*"). According to this original understanding of *Concrete Column Clamps*, the operation of *BEA* s. 20(5) in such a case can be summarized as follows:

1. The provision applies to a corporate drawer only in the case of a cheque signed by an authorized signer;

2. The provision applies where the fraudster is the authorized signer of the cheque in which case the payee is always fictitious, whether his name is of a real or imaginary person;

3. In a "payroll padding" scenario, that is where the fraudster is the one who prepares cheques, or provides the list of payees, and is relied upon by the ultimate signer, no cheque is payable to a fictitious payee. This is so because the authorized signer intended all cheques to be payable to the named payees. However, since "existence" is an objective fact, cheques may be payable to non-existing persons, so as to fall under *BEA* s. 20(5). Stated otherwise,

   (a) Whether the payee is a non-existing person is determined objectively. Hence, *BEA* s. 20(5) applies and the loss falls on the corporate drawer. A cheque payable to a payee who is either [known to be?][29] dead or imaginary falls into this category. A cheque is payable to an imaginary payee when it is payable to the name of a person with no connection to the drawer, particularly, not to a past creditor[30] of the drawer as for example, a past employee. The name of a non-existing person may be that of a literary figure. Alternatively, the name could randomly be picked from the telephone directory or any other source. It could thus be the name of a real person, including a public figure, or even of someone known to the fraudster, who has no connection with the drawer. While a real person who is alive certainly exists, as far as the corporate drawer is concerned,[31] he or she is just a name, and hence "non-existing". Where his or her connection to the drawer has been "non-existing," the cheque payable to him or her thus becomes payable to a "non-existing" person. In the payroll padding scenario, the intent of the honest authorized signer to benefit the payee is irrelevant, since the test for being "non-existing" is determined objectively;

   (b) Conversely, whether the payee is a fictitious person, is determined subjectively, from the viewpoint of the signer. Stated otherwise, a "fictitious" person may be "existing." In fact, he or

26 See e.g. *Zurich Life Insurance Co. v. Royal Bank*, 1973 CarswellBC 298, 36 D.L.R. (3d) 750 (B.C. S.C.); *Banque Royale du Canada v. Manufacturers Life Insurance Co. et Ménard*, [1974] C.A. 462; and *Bromont Inc. v. Banque Canadienne Nationale*, [1973] C.S. 959.

27 (1976), 1976 CarswellQue 45, 1976 CarswellQue 45F, [1977] 2 S.C.R. 456, 74 D.L.R. (3d) 26, 8 N.R. 451 (S.C.C.) [*Concrete Column Clamps*] the issue was characterized at 27 as "a new one for [the SCC] but an old one in the law of negotiable instruments."

28 (1996), 1996 CarswellBC 2314, 1996 CarswellBC 2315, EYB 1996-67134, [1996] 3 S.C.R. 727, 27 B.C.L.R. (3d) 203, 140 D.L.R. (4th) 463, [1997] 2 W.W.R. 153, 82 B.C.A.C. 161, 203 N.R. 321, 133 W.A.C. 161, [1996] S.C.J. No. 111 (S.C.C.).

29 Of course, the bracketed language undermines the objective nature of the test. Also, known to whom?

30 I suppose it could also be a present creditor — as long as there is no intention to use the cheque for payment to him or her. The fraudster will be inclined not to use the name of a present creditor who is likely to complain for not receiving payment and thus expose the fraudulent scheme.

31 This qualification is another drawback to the alleged objective nature of the test.

> she must be "existing"; had that person been "non-existing", the signer's point of view would not have been relevant. This is consistent with the language of *BEA* s. 20(5), so that notwithstanding Falconbridge's first proposition, the categories of "fictitious" and "non-existing" are mutually exclusive. Previous employees/creditors of the drawer are "existing," and from the point of view of the fraudster, are fictitious. However, where the fraudster is not the signer, his or her intention does not matter. Rather, since in the payroll padding scenario, cheques payable to the names of former employees/creditors are intended by the honest authorized signing officer to be paid to them, they cannot be said to be payable to "fictitious" persons. Nor, as discussed, are they payable to non-existing persons. Accordingly, *BEA* s. 20(5) does not apply and the corporate drawer does not bear the loss.

In his dissent in *Concrete Column Clamps*, Laskin CJC found 3(b) to produce an unreasonable result. From a policy perspective, he saw no reason to let the corporate drawer avoid the loss caused by internal fraud. As a matter of statutory interpretation, he thought that there was no point in attributing to the corporate drawer the intention of a signer who mechanically signed cheques submitted for his or her signature. Rather, in Laskin CJC's view, in a "payroll padding" case it is the intention of the fraudulent wrongdoer that should be attributed to the corporate drawer. Accordingly, Laskin CJC thought, cheques payable to names of previous employees/creditors of the corporate drawer were payable to fictitious payees so that *BEA* s. 20(5) operated to allocate the loss to the corporate customer also in that case.

His conclusion was supported by Spence J. In recommending a broad interpretation of *BEA* s. 20(5), Spence J. pointed out the need to make up for the omission in the Canadian *BEA* of a provision, existing in the English *BEA*, under which a drawee bank which pays cheques in good faith on forged endorsement is protected.[32] Taking into account that in the facts of *Concrete Column Clamps* "it would have been quite easy in proper office management to have designed sufficient methods of checking and verifying to have defeated [the fraudster's] scheme" Spence J. invited the Court to "come to the conclusion that the loss should be payable by [the corporate drawer] and not by the bank acting in the ordinary course of business in a manner which could not be criticized."[33]

In *Boma*, speaking for the majority, Iacobucci J. purported to adhere to Falconbridge's four propositions. He did not overrule *Concrete Column Clamps*, but relying on *Fok Fok Cheong Shing Investments Ltd. v. Bank of Nova Scotia*,[34] he thought that the corporate drawer's intention is to be attributed only to its "guiding mind." Indeed, in *Fok Cheong Shing* the fraudster was the corporate drawer's president, and hence, arguably its "guiding mind". However, I do not read in that judgment any limitation to such an authorized signer. Moreover, in *Fok Cheong Shing*

32 *Bills of Exchange Act, 1882* (U.K.), 45 & 46 Vict., c. 61, s. 60 [*Bills of Exchange Act*].

33 *Concrete Column Clamps*, *supra* note 27 at 46.

34 1982 CarswellOnt 735, 1982 CarswellOnt 735F, [1982] 2 S.C.R. 488, 146 D.L.R. (3d) 617, 46 N.R. 181 (S.C.C.).

the president himself, being an authorized signer, signed the cheque, hence the case squarely fell within the four corners of the majority judgment in *Concrete Column Clamps*. At the same time, in *Boma*, Iacobucci J. attributed the intention of the corporate drawer to its "guiding mind," whether or not the "guiding mind" was the actual signer. Effectively then, departing from the majority in *Concrete Column Clamps*, Iacobucci J. went in the opposite direction than that of Laskin CJC's dissent there. Instead of expanding the scope of *BEA* s. 20(5) to cover more instances of internal fraud in a corporate drawer, Iacobucci J. narrowed it down to apply primarily to the case of fraud committed by a "guiding mind" of the corporate drawer. In Iacobucci J.'s view, regardless of who signed the cheque, it is only the intention of the "guiding mind", one of two directors, officers and stock-holders in the facts of the case, that can be attributed to a corporate drawer.

In *Boma*, a junior staffer with a signing authority generated corporate cheques payable to persons not owed by the corporate drawer with the view of collecting those cheques and diverting their proceeds to her use. She signed some cheques but gave others to the "guiding mind" for signature. Some cheques were made payable to names of former employees, others were made payable to an imaginary name. Iacobucci J. held that whether cheques were signed by the junior staffer or the "guiding mind", they were not intended by the "guiding mind" to be payable to a fictitious person. As well, since the "guiding mind" could be said to be reasonably misled as to the identity of the imaginary name, it could not be said that cheques payable to that name were payable to a non-existing person. Accordingly, Falconbridge's fourth proposition was held to apply to the entire case, so as to exclude all fraudulent cheques from the coverage of *BEA* s. 20(5). The "[t]wo important principles [that] structure [Falconbridge's four] propositions"[35] were not discussed.

While in *Boma* it was clear who was the "guiding mind" of the corporate drawer and who was not, the term itself is undefined and hence its boundaries are not clear. This is one problem with Iacobucci's J. judgment. More worrisome is however its policy implication to allocate to a collecting bank losses caused by the drawer's internal fraud.

Originally I read Iacobucci J.'s judgment to mean that for the payee of the cheque to be "existing" so as not to be covered by *BEA* s. 20(5) it suffices for the "guiding mind" to be unfamiliar with the fact that the cheque is not meant to be issued to a real creditor. Not only would this have blurred any distinction between "fictitious" and "non-existing;" it would also have meant that *BEA* s. 20(5) applies *only* — and not *primarily* — when the fraudster is a "guiding mind".[36] However, in the facts of the case the imaginary name was close to that of a real past creditor and it is possible to read Iacobucci J.'s as premised on the "guiding mind's" alleged belief as to that fact.

Accordingly, Crawford understood the law after *Boma* to be that,

> if the name of the payee is a pure invention of the drawer of a cheque . . . the payee may be "non-existing" within the meaning of BEA, s. 20(5), but only if it is also true that the name is of a person having no real connection

35 Falconbridge's four propositions are set out at the beginning of Part 4, above.

36 See Geva, "Conversion", *supra* note 3 at 192-193.

> with the drawer's business, or *semble*, is not a name that *plausibly* might be identified by the drawer as being a real creditor of his business.[37]

I would have replaced the "or *semble*" by "and". In any event, this interpretation came to be known as the "plausibility doctrine." Its effect is to transform an imaginary payee, being otherwise non-existing', into an existing one, as long as the name is similar to a name of a real past creditor, including an employee. Similarity may be in the eye of the beholder, and yet on occasion either similarity or dissimilarity is obvious. Accordingly, the "plausibility doctrine" was followed and *Boma* was distinguished in *Rouge Valley*[38] where the imaginary name to which cheques were made bore no resemblance to the name of any real creditor of the corporate drawer. The fact that the fraudulent invoices for which the cheques were issued bore similarity to invoices previously presented for similar debts owed to a real creditor did not suffice to attribute to the corporate drawer the mistaken belief that the fraudulent cheques were issued to a real creditor. What mattered was that the names of the real and imaginary creditors were completely different. It was thus held that the cheques were payable to a non-existing person so that the loss fell on the corporate drawer.

Accordingly, following *Boma* as understood in *Rouge Valley*, *BEA* s. 20(5) applies to allocate forged endorsement losses to the drawer in two situations:

> 1. Where the drawer writes and signs a cheque payable to a former creditor. This is true however only as long as this former creditor is still alive (or at least not known to the drawer to be dead). For a corporate drawer this applies only by reference to the intention of the "guiding mind" of the corporate debtor not to have the cheque issued to the named payee (and possibly as well as the "guiding mind" does not know of the death of that person). In such cases the payee is existing and hence fictitious; and
>
> 2. Where a cheque is written to an imaginary name other than a living former creditor. In such a case, the application of *BEA* s. 20(5) does not depend on the drawer's intent and the cheque is payable to a non-existing payee. Hence, in the case of a corporate drawer, the intent of the "guiding mind," or in fact of any authorized signer, is irrelevant. However, the provision does not apply where such an imaginary name is close to that of a former creditor so that a "guiding mind" of the drawer might plausibly be led into the mistaken belief that the cheque is payable to a real creditor.

In both cases, a former creditor is that of the drawer. It includes a former employee and possibly anyone with a real connection with the drawer's business. I suppose a present creditor to whom it is not intended to deliver the cheque is also included. Corporate drawer includes any entity other than an individual. As well, in both cases, for a corporate drawer, it does not matter who signed the cheque, as long as the signature is authorized.

37 B. Crawford, *The Law of Banking and Payment in Canada*, vol. 3 looseleaf (Aurora, Ont.: Canada Law Book, 2008–2014) at §22:40.30(9)(b).

38 *Supra* note 24, quoting at para. 30 the above-quotation of Crawford as it was available in 2008.

5. BEA S. 20(5) AND KAYANI

Kayani involved fraud by an outsider, on individuals, and not corporations. Falconbridge's second and third propositions did not apply as they specifically cover fraud practiced by the drawer.[39] In the Ontario Court Appeal Hourigan JA explained,

> [13] The trial judge found that the payee was not fictitious as both [lawyers] made their instruments payable to Nithiyakalyaani Jewellers, which they believed was an existing entity, and which was an existing entity at the time the instruments were negotiated.
>
> [14] The trial judge went on to rely upon *Rouge Valley* . . . for the proposition that a payee will not be found to be non-existing if the payee name is similar to the name of an actual person, such that the drawer of an instrument might plausibly maintain that it believed it was paying a real entity.
>
> [15] The trial judge found that [the two lawyers] honestly believed that the instruments were being made out for an existing obligation to a real company, despite the fact that the name of the payee was not precisely accurate as it did not include the abbreviation "Ltd.". They were fraudulently induced to believe these were real transactions. The trial judge concluded, therefore, that the defence in s. 20(5) of the Act was not available to TD . . .

Specifically, the trial judge concluded that the case came "surely within Falconbridge's fourth proposition."[40] Thereunder, as recalled,[41]

> (4) If the payee is the name of a real person, intended by the drawer to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that the drawer has been induced to draw the bill by the fraud of some other person who has falsely represented to the drawer that there is a transaction in respect of which the payee is entitled to the sum mentioned in the bill.

Stated otherwise, the trial judge held that the payee was a name of a real — and not fictitious — person, "intended by the drawer to receive payment," to whom each lawyer had been fraudulently induced to have the bill issued. However, in the view of Hourigan JA "the trial judge did not conduct a proper analysis of the respondent's knowledge of Nithiyakalyaani Jewellers Ltd. at the time the instruments were drawn."[42] Hourigan JA purported to follow *Rouge Valley*[43] insofar as "resort to the plausibility doctrine does not negate the requirement that the drawer must have knowledge of the payee."[44] Rejecting the existence of any intention by the

39 Falconbridge's four propositions are set out at the beginning of Part 4, above.

40 *Kayani* Court Below, *supra* note 4 at para. 72.

41 Falconbridge's four propositions are set out at the beginning of Part 4, above.

42 *Kayani*, *supra* note 1 at para. 34.

43 *Supra* note 24.

44 *Kayani supra* note 1 at para. 43. For the plausibility doctrine see Part 4 above.

lawyers to make the instruments payable to Nithiyakalyaani Jewellers Ltd.,[45] Hourigan JA observed that:

> [45] This situation [in *Kayani*] is factually distinct from that in *Boma*, where the drawer had an existing business relationship with a party with a name similar to the payee and had actually considered the name of the payee when the instruments were drawn.

Concluding that "[t]he payee [was] not the name of any real person known to the respondents at the time they drew the instruments" Hourigan JA held that the case fit "within Falconbridge's first proposition." Thereunder, as recalled,[46]

> (1) If the payee is not the name of any real person known to the drawer, but is merely that of a creature of the imagination, the payee is non-existing, and is probably also fictitious.

Certainly for the first proposition to apply, to the extent that fictitiousness is determined from the drawer's point of view, the payee could not be fictitious, since the lawyers intended to make payment to whoever the instruments were made out. The payee was thus non-existing. *BEA* s. 20(5) applied and the loss fell on the two lawyers.[47] This of course assumed, albeit without any discussion, that for the first proposition to apply the payee's name could be the creature of the imagination of a third party and not necessarily of the drawer.[48] The inevitable implication is that had the lawyers previously done business with Nithiyakalyaani Jewellers Ltd. it would have been reasonable to assume that they mistook Nithiyakalyaani Jewellers with Nithiyakalyaani Jewellers Ltd. so that the "plausibility doctrine", discussed above in Part 4, would have applied. In such a case the instruments would have been deemed payable to an existing person, and according to Hourigan JA's analysis, loss would have been allocated to the Bank.

Hourigan JA could not find any evidence that the lawyers "knew of the existence of Nithiyakalyaani Jewellers Ltd. at the time the instruments were drafted"[49] so that Falconbridge's fourth proposition did not apply.[50] Furthermore, it seems that in the absence of prior dealings with Nithiyakalyaani Jewellers Ltd, even had both instruments been made payable to Nithiyakalyaani Jewellers Ltd., they would not have been covered by Falconbridge's fourth proposition.

It is noteworthy that in his judgment Hourigan JA overlooked the fact that one of the instruments given by the lawyers was a bank draft. Hence the scenario does not fit squarely into Falconbridge's four propositions and the entire foregoing analysis focusing on the instrument issuer's intention. A bank draft is issued by a bank[51] in which case both the signers and the bank's "guiding minds" are completely indifferent as to the identity of the payee. To fit the bank draft into this framework requires its formulation so as to interpret *BEA* s. 20(5) from the perspective of the remitter, namely the purchaser of the bank draft,[52] who was a fraud victim. No such analysis was carried out by the court.

45 *Kayani ibid.* at para. 45.

46 Falconbridge's four propositions are set out at the beginning of Part 4, above.

47 *Kayani*, *supra* note 1 at para. 47.

48 The point is discussed in Part 4, above.

49 *Kayani*, *supra* note 1 at para. 41.

50 The four propositions are set out at the beginning of Part 4, above.

51 For bank drafts see e.g. Benjamin Geva, "Irrevocability of Bank Drafts, Certified Cheques and Money Orders" (1987) 65:1 Can. Bar. Rev. 107 at 111–122 [Geva "Irrevocability"].

In any event, the principal critique of the Ontario Court of Appeal's judgment is that given the facts of the case, the conclusion that the payee was non-existing is quite startling. After all, Nithiyakalyaani Jewellers was a business name registered as a sole proprietorship[53] under the *Business Names Act*.[54] Indeed, a sole proprietorship is not a legal entity and under *BEA* s. 16(1), a bill not payable to bearer must be made out "to or to the order of a specified person." However, while under s. 35(1) of the *Interpretation Act*[55] "person" is unhelpfully defined to include "a corporation," nowhere is it stated that under *BEA* s. 16(1) the payee must be a legal entity. Elsewhere, for example, under s. 1 in both the *Business Names Act*[56] and the *Limited Partnerships Act*[57] "sole proprietorship" is included in the definition of "person". The *BEA* itself acknowledges in s. 18(3) the possibility that "A bill may be made payable to the holder of an office for the time being." For their part, interpreting the statutory requirement under which "the payee must be named or otherwise indicated therein with reasonable certainty,"[58] *Chalmers and Guest* state that the payee may be indicated by description rather than named.[59] Indeed, instruments payable to "payees, such as partnerships, unincorporated associations, community projects or funds drives that do not have legal entity" ought to be "quite common"[60] and so must be instruments payable to business names including to a sole proprietorship. In recognition of commercial realities, "person" under the *BEA* ought not to be read as limited to a legal entity.[61] Accordingly, as a validly registered sole proprietorship, Nithiyakalyaani Jewellers existed, even without legal personality.

In effect, this reasoning corresponds in part to the analysis of the trial judge who thought that "the Cheque and Draft deposited had an endorsement from a legitimate, albeit misdescribed payee."[62] Nevertheless, departing from this reasoning, she thought that to the extent that Nithiyakalyaani Jewellers was "the name of a

52 See Geva, "Irrevocability", *ibid.* at 111.

53 *Kayani*, *supra* note 1 at para. 8.

54 R.S.O. 1990, c. B.17.

55 R.S.C. 1985, c. I-21.

56 *Supra* note 54.

57 R.S.O. 1990, c. L.16.

58 In Canada, *BEA*, *supra* note 2, s. 20(4).

59 A.G. Guest, *Chalmers and Guest on Bills of Exchange, Cheques, and Promissory Notes* 17th ed. (London: Sweet & Maxwell, 2009) at §2-049.

60 Crawford, *supra* note 37 at §22:40.30(8).

61 I do not disagree with Crawford who finds, *ibid.* that on this point a *BEA* amendment "would appear to be desirable" but am less fearful than him that under the *BEA* as it stands now instruments payable to unincorporated bodies "are of questionable technical validity".

62 *Kayani* Court Below, *supra* note 4 at para. 71.

real person, intended by the drawer to receive payment", the lawyers were exonerated from bearing the loss under Falconbridge's fourth proposition.[63] The trial judge must have assumed then that the fourth proposition, under which the drawer avoids liability, applies even in the case of a legitimate endorsement or deposit by "real person, intended by the drawer to receive payment." This is however not sensible. Indeed, the fourth proposition must be taken to be limited to the situation where notwithstanding his or her belief, the drawer does not deal with the "real person, intended by the drawer to receive payment" and the instrument is not paid to this person so that it is paid over a forged endorsement.

In the final analysis, the trial judge correctly decided that the instruments had been drawn to a "real person." However, since, as she found, the instruments had been endorsed and deposited by that "real person," she erred in triggering Falconbridge's fourth proposition. Rather, she should have allocated the loss to the lawyers. Not only that Nithiyakalyaani Jewellers existed — but this was the commercial entity with which each of the lawyers dealt. As a sole proprietorship Nithiyakalyaani Jewellers had a bank account opened by the fraudster.[64] To this bank account the instruments were properly deposited. The fraudster successfully defrauded each of the two lawyers by obtaining funds from him against a counterfeit, and hence worthless, certified cheque. For sure the fraudster had voidable title to the instruments given to him by the lawyers and yet this sufficed to give him the power to deposit them and withdraw the funds from the account to which he must have been a signatory. Accordingly, the Ontario Court of Appeal was correct in allocating the loss to the lawyers even though *BEA* s. 20(5) did not apply at all to the facts of the case.

Neither *BEA* s. 20(5) nor s. 48(1)[65] would have applied had the lawyers thought they were dealing with Nithiyakalyaani Jewellers Ltd. but ended up giving cheques payable to Nithiyakalyaani Jewellers. The instruments payable to Nithiyakalyaani Jewellers would have been deposited by it to its account so that the lawyers remedy would have been only against the imposter.

The situation would have been different had the instruments been made payable to Nithiyakalyaani Jewellers Ltd but deposited and collected by Nithiyakalyaani Jewellers. Had the fraudster misrepresented himself as acting for Nithiyakalyaani Jewellers Ltd, Falconbridge's fourth proposition would have governed the case. *BEA* s. 20(5) would not have applied and the loss would have fallen on the collecting bank. In principle, inasmuch as the collecting bank would have allowed a cheque payable to Nithiyakalyaani Jewellers Ltd to be deposited to an account belonging to another entity, i.e. Nithiyakalyaani Jewellers, this result would be reasonable. However, this conclusion may be revised if not altogether reversed taking into account the likely negligence of the drawer, and the similarity in names of the payee and account holder. The latter might have been taken into account at least in reducing the collecting bank's negligence. It is noteworthy indeed that in such a case the *American Uniform Commercial Code* allocates the loss to the defrauded

63 Falconbridge's four propositions are set out at the beginning of Part 4, above.

64 *Kayani*, *supra* note 1 at para. 8 reproduced in Part 2, above.

65 The provision is reproduced in note 10, *supra*. Inter alia, it provides for the effect of a forged endorsement not to pass title.

issuer of the cheque.[66] However, a scheme allocating loss according to fault sounds more appropriate. It can be implemented by viewing the drawer and collecting bank owing mutual duties of care to each other.[67]

6. HOW DID WE GET HERE? THE FAILED PROMISE OF THE ENGLISH COUNTERPART OF BEA S. 20(5)

I will endeavour to trace the roots of the troubling case law interpreting *BEA* s. 20(5) by exploring the early history of its counterpart in England. To begin with, Falconbridge's "[t]wo important principles"[68] restate Buckley LJ's proposition in *North & South Wales Bank Ltd v. Macbeth*.[69] In Buckley LJ's view "fictitious" and "non-existent" contemplate "[t]wo different states of facts" each determined according to a different test. On the one hand, "[e]xistence or non-existence of a particular person is a question of fact, not relevant to anybody's mind or intention." Conversely, "A thing can only be fictitious relatively to some one." This proposition underlies the distinction between the objective test for non-existence and the subjective test for fictitiousness.

In distinguishing between "[t]he two . . . states of facts" Buckley LJ purported to refine the principal holding of *Governor & Co. of the Bank of England v. Vagliano Brothers*[70] ("*Vagliano*"), the *locus classicus* for the interpretation of the English counterpart[71] to *BEA* s. 20(5). However, as will be explained, the distinction made by Buckley LJ as to the two tests was unfortunate. Surely, "A thing can only be fictitious relatively to some one." What went wrong has been the identification of that "some one."

In *Vagliano* itself no distinction was made between "fictitious" and "non-existing". Speaking for the majority of the House of Lords, Lord Herschell reached the conclusion that:

> whenever the name inserted as that of the payee is so inserted by way of pretence merely, without any intention that payment shall only be made in conformity therewith, the payee is a fictitious person . . . whether the name be that of an existing person or of one who has no existence.[72]

Does this language suggest that a "fictitious" person may either be existing or non-existing? It is an affirmative answer that must have prompted Chalmers to conclude that "non-existing" in the English counterpart to *BEA* s. 20(5) is "no doubt superfluous."[73] However, a more refined interpretation of the section, which does less violence to its language, is that, to rephrase Lord Herschell's language in *Vag-*

66 U.C.C. §3-404(a) discussed by me in Benjamin Geva, *Bank Collections and Payment Transactions: Comparative Study of Legal Aspects* (Oxford: OUP, 2001) at 505–507.

67 See closing paragraph in Part 2, above.

68 See Part 4, see text accompanying note 24.

69 (1907), [1908] 1 K.B. 13 (Eng. C.A.) at 22; affirmed [1908] A.C. 137 (U.K. H.L.).

70 [1891] A.C. 107 (U.K. H.L.) [*Vagliano*].

71 *Bills of Exchange Act*, *supra* note 32, s. 7(3).

72 *Vagliano*, *supra* note 70 at 153.

73 M. D. Chalmers, "Vagliano's Case" (1891) 7 L.Q.R. 216 at 219. Having conceded that the word may have been added to cover the situation of a deceased payee, *ibid.*, he

liano, to say that the section applies, "whether the [inserted] name be that of an existing person, *in which case the payee is fictitious*, or of one who has no existence, *in which case the payee is non-existing*." In short, Lord Herschell used "fictitious" in a broad sense, so as to cover both cases of "fictitious", narrowly used to refer only to an existing person, and "non-existing". According to Lord Herschell, in both cases — that is whether the payee is existing ("fictitious" in the narrow sense) or non-existing — for the "fictitious payee" (in the broad sense) section to apply, the name must have been "inserted by way of pretence merely, without any intention that payment shall only be made in conformity with" the bill.

Hence, for *BEA* s. 20(5) to apply, what counts is the insertion of a name by way of pretence merely, "without any intention that payment shall only be made in conformity with" the cheque. It does not matter whether the name is of an existing or non-existing person, or to use the statutory language, "fictitious or non-existing."

Vagliano did not identify the person whose insertion of the payee's name by way of pretence triggers the statutory provision. The case itself involved bills of exchange forged by an employee of the acceptor who then successfully submitted purported bills (on which he had forged the drawer's signature) for acceptance and collected them for his own benefit. The drawer's and payee's names were of real entities and the forged bills "mimicked" previous real bills on which by its acceptance the drawee had made itself liable to the payee. The fraudster was an insider in the acceptor's firm; however, there is no reason to have the case limited to an insider's fraud. For *Vagliano* to apply, it should not have mattered who caused the insertion of the payee's name "by way of pretence merely;" rather, what ought to count, is that the name was so fraudulently inserted, no matter by whom.

Vagliano made new law. Fictitious payee cases preceding the enactment of the English arose out of the practice of one firm drawing a bill of exchange on another "friendly" firm and discounting it to raise funds. On maturity, the "friendly" firm would draw a bill on the drawer of the first bill who would discount it to raise funds to repay the first bill. To hide the involvement in this dishonest practice bills were on occasion made out payable to imaginary persons. Pre-English *BEA* case law did not allow a participant in the scheme to avoid liability by relying on the invalidity of the endorsement of the imaginary payee.[74] As stated by Bowen LJ in the Court of Appeal's judgment in *Vagliano*,[75]

> Down, therefore, to the date of the passing of the [English *BEA*] the exception that bills drawn to the order of a fictitious or non-existing payee might be treated as payable to bearer was based uniformly upon the law of estoppel, and applied only against the parties who at the time they became liable on the bill were cognizant of the fictitious character or of the non-existence of the supposed payee.

seemed nevertheless to acknowledge that "only God knows" what was meant by the provision. *Ibid.* at 218.

74 Typically, it was the liquidator of such participant who sought to avoid liability. For a good discussion see e.g. J.S. Rogers, *The Early History of the Law of Bills and Notes* (Cambridge: Cambridge University Press, 1995) at 223–249.

75 *Bank of England v. Vagliano Bros* (1889), 23 Q.B.D. 243 (Eng. C.A.) at 260.

In the House of Lords, having declined to treat the English *BEA* as a "merely a code of the existing law",[76] Lord Herschell focused on the ascertainment of the law "by interpreting the language used" in the statutory provision.[77] On this basis, he could not read the English counterpart of *BEA* 20(5) as limited to circumstances where a person is "fictitious or non-existing" to the knowledge of a party liable on the bill against whom it is sought to enforce the bill.

Vagliano was criticized as focusing on language and as such containing an analysis devoid of any policy rational. "Lord Herschell seems to lay all the emphasis on interpretation, that is in ascertaining the meaning of the words used and almost ignores the broader question of construction."[78] However, by default, departing from the old interpretation, *Vagliano* reflected a strong policy judgment, albeit only implicitly. Its impact has been to expand the fictitious payee rule from one concerned only with fraud committed *by* a party liable on the bill to a rule concerned also with fraud committed *against* such a party. Each such party was to become liable to an innocent party and thus bears the fraud loss. The rule applies whether the party liable is the perpetrator or victim of the fraud.

Unfortunately this policy driven expansion was not appreciated by subsequent case law which preferred literal interpretation of words. Thus, in *Vinden v. Hughes*,[79] a dishonest clerk prepared for the drawer's signature cheques payable to former creditors to whom the drawer was not indebted. The drawer signed the cheques, and the dishonest clerk forged the payees' endorsements and misappropriated the funds. Warrington J. pointed out that in *Vagliano*, there was "no drawer in fact, the use of a name as payee was a mere fiction, although the payee actually existed". Accordingly, the House of Lords was "not dealing with the case of the drawer of the document intending to issue the document, and intending to issue it with the name of the particular payee upon it, that payee not being non-existent."[80] Being able to distinguish *Vagliano* he held that the cheques were paid to existing and not fictitious payees so that the English counterpart of *BEA* s. 20(5) did not apply.

In hindsight this marked the turning point leading to the misunderstanding *Vagliano* and consequently the continuous misapplication of *BEA* s. 20(5). True, in *Vagliano* the bills were forged. At the same time, the acceptances were genuine and what was determined by the Court was whether the acceptances were made payable, rather than the bills drawn payable, to a fictitious or non-existing person. Hence, *Vinden v. Hughes* should have followed rather than incorrectly distinguished *Vagliano*.

Vinden v. Hughes[81] was followed by *Macbeth*[82] so that for an existing person the English counterpart of *BEA* s. 20(5) became limited to a payee who is fictitious from the perspective of the signer of the instrument. It was this interpretation of the

76 *Vagliano, supra* note 70 at 145.

77 *Vagliano, ibid.* at 145.

78 V.H. Kulp, "The Fictitious Payee" (1919-1920) 18 Mich. L. Rev. 296 at 307.

79 [1905] 1 K.B. 795 (Eng. K.B.).

80 *Ibid.* at 801.

81 *Supra* note 79.

82 *Supra* note 69.

provision that was applied in Canada in *Concrete Column Clamps*.[83] As already indicated,[84] in his dissent in this case, Laskin CJC thought that for *BEA* s. 20(5) to apply it did not matter who signed the instrument. This would have reduced the negative impact of *Vinden v. Hughes* and *Macbeth* but only as long as the fraudster was an insider in the drawer's organization.

Pursuing Laskin CJC's line of thinking in *Concrete Column Clamps*, I argue that the insertion of the payee's name "by way of pretence"[85] is not limited even to the case of the physical writing of the payee's name by the fraudster. Rather, following the logic of *Vagliano*, *BEA* s. 20(5) applies whenever a fraudster leads to the insertion on an instrument of the payee's name "by way of pretence merely, without any intention that payment shall only be made in conformity with" the instrument. It does not matter whether the fraudster is an insider or outsider, and as an insider whether he or she is an employee, director, or an agent. Nor does it matter whether the payee is existing so as to be fictitious, or non-existing.

In any event, it is indisputable that the fraudulent employee in *Vagliano* was not the "guiding mind" of the firm and nevertheless the corresponding provision to *BEA* s. 20(5) was held to apply. In an explicit departure from case law that preceded the English *BEA*, *Vagliano* held that for a bill to be covered by the English counterpart to *BEA* s. 20(5), it is not required that the insertion by pretence of the payee's name has occurred to the knowledge of the party liable on the bill. Hence, requiring fictitiousness to be determined from the point of view of the drawer's "guiding mind", as in *Boma*,[86] is contrary to *Vagliano*. *Boma* has thus taken us full circle to pre-Act English case law, that with the demise of its rationale, was specifically held not to survive the passage of the English *BEA*.

7. CONCLUSION: WHERE DO WE GO FROM HERE?

In following *Vinden v. Hughes*,[87] *Macbeth*[88] formalized the distinction between "fictitious" and "non-existing"[89] and led to the conclusion that fictitiousness is to be determined from the signer's viewpoint. In sticking to the letter of the distinction *Concrete Column Clamps*[90] carried this position to the case of a corporate drawer. A final blow to a broad understanding of *Vagliano*[91] was given by *Boma*,[92] requiring fictitiousness to be determined from the viewpoint of a "guiding mind" in the drawer company. With the view of providing solutions to cover all possible situations, Falconbridge formulated four propositions governed by two principles. However, the scheme he came up with has not been complete, has internal contradictions, and above all, has not been designed to reflect desired policies in loss allocation. Not surprisingly, against this background, and even as it ultimately properly allocated the loss, *Kayani*, in both instances, generated confusing and unsatisfactory analysis.

83 *Supra* note 27.

84 See Part 4, text between notes 31 and 32, above.

85 See text accompanying note 72 (quoting from *Vagliano*).

86 *Supra* note 28.

87 *Supra* note 79.

88 *Supra* note 69.

89 See first paragraph in Part 4, above.

90 *Supra* note 27.

91 *Supra* note 70.

92 *Supra* note 28.

So far as policy is concerned, assuming no negligence on the part of the collecting bank, as for example in opening the account for the fraudster, in allocating the entire loss on the givers of the instruments, *Kayani* reached the correct result. However, *Kayani* misapplied *BEA* s. 20(5) and piled another layer of uncertainty on the heap of confusing case law interpreting the provision. To that end, particularly, a re-examination of *Boma* with the view of reversing it is badly needed.

I have not been alone in criticizing *Boma*.[93] Scholarly opinion has been overwhelmingly against the judgment.[94] It is not too late for the Supreme Court of Canada to readdress the issue, restore the original meaning of *Vagliano*, and reinterpret *BEA* s. 20(5) in a way that will implement desired policies. The Supreme Court may further recognize mutual duties of care among the various participants in the process of the collection and payment of cheques, thereby bringing Canadian law into line with other major legal systems that in one way or another take into account fault in assigning responsibility for forgery and fraud losses in the cheque collection system.[95] Alternatively, Parliament may provide for such duties by statute, and in the process may well repeal *BEA* s. 20(5) altogether.

In the final analysis, as a matter of policy, between a defrauded bank customer who writes and signs a properly payable cheque and a non-negligent collecting bank, loss should fall on the former. Mutual duties of care between the defrauded bank customer and the collecting bank are thus the key to a proper allocation of the

93 Geva, "Conversion", *supra* note 3.

94 In her commentary on *Teva v. BNS*, *supra*, note 17 at 734 note 6, Ogilvie cites, besides, mine, the following unfavourable discussions: Margaret H. Ogilvie, "Should the Collecting Banker Be The Drawer's Insurer?: *Boma Manufacturing Ltd v Canadian Imperial Bank of Commerce*" (1994) 9 B.F.L.R. 227; Nicholas Rafferty & Jonnette Watson Hamilton, "Forged Payees' endorsements: The Liability of Collecting Banks to Drawers and the effect of Section 40(4) of the *Bills of Exchange Act*" (1998) 13 B.F.L.R. 271; Nicholas Rafferty & Jonnette Watson Hamilton, "The Liability in Conversion of a Collecting Bank to the Payee: Is An Endorsement Required to Pass Title to a Cheque?" (2002) 17 B.F.L.R. 395, Nicholas Rafferty & Jonnette Watson Hamilton, "The Liability in Conversion"; Nicholas Rafferty & Jonnette Watson Hamilton. "The Collecting Bank's Liability for Conversion of Cheques" (2003) 19 B.F.L.R. 77; Nicholas Rafferty & Jonnette Watson Hamilton, "Is the Collecting Bank now the Insurer of a Cheque's Drawer against Losses Caused by the Fraud of the Drawer's Own employee?" (2005) 20 B.F.L.R. 427; Margaret H. Ogilvie, "If *Boma* is Wrong, Is the Bank Always Right? *373409 Alberta Ltd v Bank of Montreal*" (2003) 39 Can. Bus. L.J. 138; Munaf Mohamed & Jordan McJannet, "The employer, the Bank, and the Fraudster: Vicarious Liability and *Boma Manufacturing Ltd v CIBC*" (2005) 20 B.F.L.R. 465. She also refers to Bradley Crawford, *supra* note 37 for criticisms of *Boma* throughout but especially in chs. 10 and 22.

95 For a comparative study including this element, covering England, the United States and civil law countries see Geva, *Bank Collections and Payment Transactions*, *supra* note 66, Chapter 4.

loss. Focusing on the meaning of the words in *BEA* s. 20(5) is not an effective tool for the allocation of fraud losses.