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The Issuing Bank’s Defences Against the Payee of a Bank Draft - Addendum to “The Autonomy of the Banker’s Obligation on Bank Drafts and Certified Cheques”*

Benjamin Geva**

Ricky Yan v. Post Office Bank,1 a recent decision of the New Zealand Court of Appeal, allowed a bona fide for value payee of a bank draft to recover from the issuing bank notwithstanding the latter’s defences against the remitter (namely the bank customer who procured the issue of the bank draft). The decision came to my attention too late to be referred to in the above-captioned article. Nonetheless, it merits attention. The ensuing discussion will critically examine the reasoning of the judgment. I will argue that the Court gave wrong reasons for the right result.2

Contrary to the analysis of Part I of the above-captioned article, and having only briefly discussed the issue, the Court held that a payee of a bank draft could not be a holder in due course. Specifically citing R.E. Jones Ltd. v. Waring and Gillow Ltd.,3 the Court concluded that the instrument had not been “negotiated” to the payee, thereby disqualifying him from becoming a holder in due course, notwithstanding his compliance with the other statutory requirements, including taking the instrument in good faith, without notice and for value. Acknowledging that by giving the remitter valuable consideration for the instrument, the payee satisfied the holder for value statutory requirements,4 the Court nevertheless correctly concluded that “a holder for value has no special rights unless he is also a holder in due course, and [the payee] does not come within that category”. Ultimately, however, the payee won by virtue of the dismissal of the issuing bank’s defence of failure of consideration as well as on the basis of common law estoppel.

As for the failure of consideration, the Court highlighted the distinctiveness of the contract between the issuing bank and the remitter from the issuing bank’s engagement to the payee. This, however, overlooks the derivative title of the payee to the instrument. The bank draft is not a letter of credit generating a

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2 In fact, in the facts of the case, even the result may not be right, inasmuch as the instrument was crossed and marked “not negotiable”. No such practice is prevalent in Canada and this aspect of the case will not be further considered. See p. 28 of the above-captioned article.
4 Particularly, under the corresponding provisions to ss. 52(1) and 53(1) of the Canadian Bills of Exchange Act, R.S.C. 1985, c. B-4 (ss. 27(1) and (2) of the English Act, 45 & 46 Vict., c. 61 as am.) under which “[v]aluable consideration for [an instrument] may be constituted by...any consideration sufficient to support a simple contract; or...an antecedent debt or liability”, and “[w]here value has, at any time, been given for [an instrument], the holder is deemed to be a holder for value as regards...all parties to the [instrument] who became parties prior to that time”. The latter is referred to below as “the holder for value provision”.

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separate engagement to the beneficiary; at the inception of the bank draft, the issuing bank was liable thereon to the remitter, and it is the remitter's right which was transferred to the payee. The Court thus failed to explain how the payee, who takes the instrument from its original owner, the remitter, holds it free from defences available to the issuing bank against that predecessor in title.²

Moreover, inasmuch as it purported to base the payee's elevated status on the value given by the payee to the remitter, the Court relied on the "holder for value" provision,⁶ deeming a holder to be a holder for value on the basis of any value given for the instrument. This, however, was the very section which had not been considered by the Court to be adequate to protect the payee-holder!¹⁷ Indeed, in relying on the "holder for value" provision, the Court specifically cited *Diamond v. Graham*,⁸ a judgment of the English Court of Appeal. In that case, Graham made out a cheque payable to Diamond and delivered it to Herman for consideration that subsequently failed. Herman delivered the cheque to Diamond for good consideration.⁹ As against Diamond, Graham purported to dishonour the cheque (drawn by him to Diamond's order) on the basis of the failure of Herman's consideration on the contract under which the cheque had been delivered by Graham to Herman. Finding that the case "turns upon the construction of [the 'holder for value' provision]"¹⁰ a unanimous Court of Appeal¹¹ held that Diamond "clearly...falls within all requirements of the section"¹² and decided in his favour.

Elsewhere,¹³ I argued that the "holder for value" provision was totally irrelevant in resolving *Diamond v. Graham*. In fact, payee Diamond should have prevailed as a holder in due course. Indeed, it is overwhelmingly accepted that by merely giving value, or taking an instrument for which value has been given, a holder for value does not have an indefeasible right on the instrument.¹⁴ As indicated elsewhere,¹⁵ I maintain that by stating that "[w]here value has, at any time, been given for [an instrument], the holder is deemed to be a holder for value...", the "holder for value" provision¹⁶ means only that absence for consideration

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² For the remitter's original title and the payee's derivative title, see particularly, pp. 30-31 of the above-captioned article. The issuing bank and the payee of a bank draft are remote and not immediate parties.

⁶ See *supra* footnote 4.

⁷ See text *supra* footnote 4.


⁹ The consideration from Herman to Graham (that failed) was a cheque payable by Herman to Graham. Likewise, the consideration from Diamond to Herman (that did not fail) was Diamond's cheque payable to Herman.

¹⁰ *Supra* footnote 8 at 1064 *per* Diplock L.J.

¹¹ Danckwerts, Diplock, and Sachs L.JJ.

¹² *Supra* footnote 8 at 1065 *per* Diplock L.J.


¹⁵ See *supra* footnote 13 at 140-151 (particularly 148-149).

¹⁶ *Supra* footnote 3.
is not an equity as to ownership; that is, one who acquired an instrument by way of a gift, without giving value, may recover from prior parties liable on the instrument, though subject to their defences. I further argued that the confusing distinction between a “mere holder” and a “holder for value” ought to be simply understood to say that an instrument for which no value has been given by anyone is unenforceable. Obviously, it does not follow that by giving value, never mind by sheltering under a predecessor who gave value, a holder becomes entitled to enforce an instrument free of defences of parties liable thereon.

I should add that under both the German Civil Code and the Swiss Code of Obligations, the acceptance of an order to pay generates an independent and separate undertaking of the acceptor to the payee, unrelated to and free from defences arising from the contractual relationship between the giver of the order and the drawee/acceptor. This may be quite similar to the reasoning of the New Zealand Court of Appeal. Nonetheless, the common law does not contain such a rule, at least as a matter of first impression; without the benefit of a further extensive analysis, not undertaken in Ricky Yan v. Post Office Bank, one cannot assume that such a rule is well founded as a matter of common law.

Alternatively, the New Zealand Court of Appeal rationalized its decision in the payee’s favour on the basis of common law estoppel:

“[The issuing bank] must be taken to be aware of the fact that bank [drafts] are commonly relied upon in commercial transactions as being almost equivalent to cash, and that the purpose of obtaining a bank [draft], rather than the customer proffering his own cheque, is to enable the payee to have the added assurance of payment. This would be futile if the bank’s [draft] were to be no better than the customer’s cheque against which it was issued”.

This reasoning is subject to two major flaws. First, it purports to recognize a commercial custom or usage merely on the basis of judicial notice and without evidence. Second, compared to the personal cheque, the obligation of the issuing bank is undoubtedly an added feature of the bank draft; whether such an obligation is absolute and free of defences may be an entirely different question.

In the final analysis, the bank draft is a negotiable instrument governed by the Bills of Exchange Act. Certainty and consistency are enhanced where the defence-free position of the payee is determined within the framework of this piece of legislation, as a matter of a correct application of principles of law and statutory interpretation. If only for this reason, the defence-free position of the payee of a bank draft ought better be explained on the basis of the holder in due course doctrine, as set out in Part I of the above-captioned article, rather than as held in Ricky Yan v. Post Office Bank.

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18 See BGB §784 (Germany), and CO art. 468 (Switzerland).
20 Supra footnote 4.