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COMMENTARY

THE FICTITIOUS PAYEE AND PAYROLL PADDING: ROYAL BANK OF CANADA v. CONCRETE COLUMN CLAMPS (1961) LTD.

I

In Royal Bank of Canada v. Concrete Column Clamps (1961) Ltd. (hereafter Royal Bank), the Supreme Court of Canada was faced with an issue, characterized as "a new one for this Court but an old one in the law of negotiable instruments." A payroll clerk, whose normal duty is to prepare wage or salary cheques for employees of a company, perpetrates a fraud by including among the cheques presented to the authorized signing officer of the company a number of cheques payable to persons who were not owed any wages, some being former employees and the other such payees having names which may or may not be those of existing persons. The fraudulent clerk abstracts these cheques, forges the endorsements and obtains payment from the company's bank which debits the company's account accordingly. Who, as between the company and the bank should bear the loss?

The general rule with respect to a forged or an unauthorized signature on a bill is contained in s. 49(1) of the Bills of Exchange Act (the "Act"). Such a 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". The effect of this section is to

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3 Royal Bank, supra, footnote 1 at p. 27, per Laskin, C.J.C. A more detailed account of the facts appears in the decision of Spence, J., at pp. 44-5. See also the account of Pigeon, J., at p. 47.
4 A cheque is a type of a bill, and "the provisions of this Act applicable to a bill of exchange payable on demand apply to a cheque": s. 165 of the Act (cited and defined in footnote 5 and text, infra).
6 Under s. 49(1) itself, this rule is subject to an exception where "the party against whom it
force a bank that has paid a cheque and debited the account of the drawee, based on a forged or unauthorized endorsement, to recredit the account and to bear the loss.\(^8\)

An exception to this general rule lies in the fictitious payee section. Thus, under s. 21(5) of the Act,\(^9\) "where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer" (hereafter referred to as the rule of the fictitious payee). In debiting the account of its customer with the sum of a cheque paid to the order of a fictitious payee, the bank is protected under this section and the loss is thrown upon the drawer.\(^10\)

The issue for the court in *Royal Bank* was whether the case fell within the general rule under s. 49(1) of the Act, or within the exception thereto under s. 21(5). More specifically, the general rule under s. 49(1) being quite clear, the precise issue was the applicability of s. 21(5) of the Act to the facts of the case.\(^11\)

With regard to named payees who were not former employees, it was held by the trial judge\(^12\) and the Quebec Court of Appeal\(^13\) that as they were non-existing\(^14\) they fell within s. 21(5) of the Act. No issue with respect to these cheques was raised in the Supreme Court.\(^15\) At the same time, with regard to named payees who were former employees, it was held, by the trial judge,\(^16\) the Quebec Court of Appeal\(^17\) and the majority of the Supreme Court,\(^18\) that

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\(^7\) In England (unlike in Canada) the parallel section (s. 24 of the English Act) does not apply to payment of a drawee bank on a forged endorsement. See section III, infra, and s. 60 of the English Act.

\(^8\) Provided the drawer will give "notice in writing of such forgery to the drawee within one year after he has acquired notice of such forgery"; s. 49(3) of the Act. This requirement was met by the drawer in *Royal Bank* (supra, footnote 1, at p. 47), of course, the bank (or the customer if he fails in his claim under s. 49 of the Act) has a cause of action against the wrongdoer.

\(^9\) Section 7(3) of the English Act.


\(^11\) Cf. sections III, IV, infra; the superimposition of negligence concepts on s. 49(1) of the Act in general.

\(^12\) Cited in *Royal Bank*, supra, footnote 1, at p. 28, per Laskin, C.J.C.


\(^14\) But see footnotes 24-5 and text, infra.

\(^15\) *Royal Bank*, supra, footnote 1 at p. 28.

\(^16\) *Supra*, footnote 12.

\(^17\) *Supra*, footnote 13.

\(^18\) The majority opinion was delivered by Pigeon, J. (*Royal Bank*, supra, footnote 1 at p. 46).
these payees could not be described as "fictitious or non-existing" within the meaning of s. 21(5) of the Act. Consequently, the drawee bank could not debit the account of the company for the value of these cheques.

In holding the bank liable for the cheques drawn to the order of named former employees, though not for the other cheques, the majority of the Supreme Court purported to apply the established rule in the English law under which the intention of the drawer (or more specifically the one who actually signs the bill as the drawer) determines whether the payee is fictitious, but not whether he is non-existing. Only in the latter situation is the objective fact of the existence or non-existence, rather than the intention of the drawer, decisive.19 Thus, according to the majority of the Royal Bank court, the officer who drew the cheques, being misled by the dishonest clerk, did not intend those cheques to be payable to the order of fictitious or non-existing persons. Therefore, only cheques drawn to the order of non-existing persons, i.e., to the order of those who were not former employees, fell within the statutory exception of s. 21(5) of the Act. Cheques drawn to the order of named former employees remained covered by the general rule of s. 49(1) of the Act, and the drawee bank could not debit the account of the drawer with the sums thereof.

Undoubtedly, in reading the words "to the knowledge of the drawer" after "fictitious" but not after "non-existing" in s. 21(5) of the Act,20 the majority of the Royal Bank court followed the unanimous opinion of all major textbook writers21 and restated the rule that emerges from the leading cases.22 However, whatever the difference between "fictitious" and "non-existing",23 the distinction

with whom Martland, Judson, Ritchie, Beetz and de Grandpré JJ., concurred. Dissenting opinions were given by Laskin, C.J.C. (at p. 27), with whom Dickson, J., concurred and Spence, J. (at p. 43).


20 Cf. Royal Bank, supra, footnote 1 at p. 47, per Pigeon, J.


22 See e.g., Vinden v. Hughes, [1905] 1 K.B. 795; North & South Wales Bank, Ltd. v. Macbeth, [1908] A.C. 137. The rule was followed in recent Canadian cases cited in Royal Bank, supra, footnote 1, at p. 47, per Pigeon, J.

23 The term "non-existing" was originally regarded by Chalmers as "no doubt
between former employees and others, in the circumstances of this case, seems quite unintelligible. Where, as here, the selection of the names of the payees by the dishonest clerk was casual and not an essential component in the fraudulent scheme, a person whose name is taken from a telephone directory is no more “non-existing” or less “fictitious” than a person whose name is taken out of a list of former employees. In either case, it is impossible to conceive of any specific intention on the part of the signing officer who mechanically signs a large number of cheques payable to names he does not know at all.

For these reasons, a powerful dissent was delivered by Chief Justice Laskin. He concluded that in the facts of the case the named former employees were “fictitious” persons under s. 21(5) of the Act and that the intention of the dishonest clerk should be attributed to the drawer-company. Thus, while only slightly modifying the accepted interpretation of s. 21(5) of the Act, Las-kin C.J.C., found for the drawee bank.

While supporting the position of the Chief Justice, Mr. Justice Spence also added in his dissent that the bank was faultless and that “it would have been quite easy in proper office management to have designed sufficient methods of checking and verifying to have defeated ... [the dishonest clerk’s] scheme.”

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24 superfluous”; Chalmers, “Vagliano’s Case”, 7 L.Q.R. 216 (1891), at p. 219 (hereafter cited as: Chalmers Vagliano); See also Vagliano Brothers v. The Bank of England (1889), 23 Q.B.D. 243 at p. 260, per Bowen, L.J. None the less, later cases distinguished between “fictitious” and “non-existing” by saying that while “[e]xistence or non-existence of a particular person is a question of fact, not relevant to anybody’s mind or intention ... A thing can only be fictitious relatively to some one.” North & South Wales Bank, Ltd. v. Macbeth, [1908] 1 K.B. 13 at p. 22, per Lord Buckley. See footnotes 19-20 and text, supra.

25 For the former is no more “imaginary” or less “real person” than the latter within the words of Laskin, C.J.C., in Royal Bank, supra, footnote 1, at p. 32. On the other hand, “[k]nowledge, at least in the sense of awareness of the existence of the payee and who he was, existed” in the cases setting forth the distinction between “fictitious” and “non-existing” (ibid., at p. 36).

26 A point that is stressed by Laskin, C.J.C., at p. 38, and emerges from the account of the facts by Spence, J., at p. 44.

27 Ibid., at pp. 38-43.

28 Cf. footnotes 19-22 and text, supra.

29 Royal Bank, supra, footnote 1, at pp. 45-6.

30 Ibid., at p. 46. The point is also mentioned by Laskin, C.J.C., at p. 43. The cheques were in small amounts and were duly signed by an authorized signing officer of the drawer.

31 Ibid., at p. 46.
Their opinion did not prevail. The majority preferred the accepted interpretation of s. 21(5) of the Act and in dealing with the cheques drawn to the order of named former employees held for the drawer company. In so doing, the majority decision gives rise to basic questions underlying the construction of the Act in relation to liability for cheques drawn to the order of a fictitious or non-existing person. Is liability dependent only on the literal meaning of “fictitious or non-existent person”? Does it depend on the construction of the fictitious payee section in light of the rules of common law concerning the subject? Or rather, does the rule of the fictitious payee merely constitute one manifestation of a broader principle of law? If it does, then neither the literal meaning of the term, nor the rules of the common law, should be decisive but instead the policies behind the principle should determine the issue.

This comment is designed to examine the issue presented in Royal Bank in light of these questions and thereby demonstrate that they reflect complementary rather than alternative techniques in the construction of the Act and the interpretation of its terms. It will be argued that the meaning of s. 21(5) of the Act in general, and in its application to the facts of Royal Bank in particular, though depending on each of these three facets of inquiry should, primarily, be determined in light of the duty of care of the drawer of a cheque.

II

The canon for construing a codifying statute in general, and the English Bills of Exchange Act in particular, was given by Lord Herschell in the leading case of Bank of England v. Vagliano, at pp. 47-8 per Pigeon, J.

The possibility of determining the existence or the scope of such a duty under the Quebec Civil Code will not be considered in this comment. It will rather be assumed in the following discussion that the rules dealing with the duty of care of the drawer of a cheque constitute part of “the law of bills and notes in the strict sense” (for this expression, see Falconbridge, supra, footnote 10, at p. 456). This assumption is based on the effect of the nature of a bill and the process of payment thereof, as well as of the provisions of the Act, on the existence, content and limits of that duty of care in the law of bills and notes (for this effect see sections III and IV, infra). But see Lepage, “La banque et le faux endossement”, 9 Rev. Jur. Themis 411 (1974), at p. 429, arguing for the applicability of s. 1053 of the Quebec Civil Code to the facts of Royal Bank.

Cited at footnote 5, supra. The Act in Canada is “the adoption . . . with some modification” of the English Act, Falconbridge, supra, footnote 10, at p. 425.
Brothers: \(^{35}\)

…the proper way to deal with such a statute as the Bills of Exchange Act, which was intended to be a code of the law relating to negotiable instruments. … is in the first instance to examine the language of the statute and to ask what is its natural meaning, uninfluenced by any considerations derived from the previous state of the law. \(^{36}\)

Applying this canon to the fictitious payee section, Lord Herschell declined to read it as refined by any rule “derived from the previous state of the law.” \(^{37}\) To do so would be to confine the application of the rule of the fictitious payee only as against a party with knowledge of the fraud. \(^{38}\) It seemed to Lord Herschell that adding this limitation or condition to the language of the fictitious payee section would be “doing violence to the language of the statute”, and he could find “no warrant in the statute itself for inserting any limitation or condition.” \(^{39}\) He therefore turned to the interpretation of the word “fictitious” in Dr. Johnson’s Dictionary and concluded that:

… where 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 within the meaning of the statute, whether the name be that of an existing person, or of one who has no existence. \(^{40}\)

From this last passage of Lord Herschell’s opinion it was later concluded in Vinden v. Hughes \(^{41}\) that whether an existing person qualifies as a fictitious payee depends solely on the intention of the drawer. When the drawer is induced by his dishonest clerk to draw cheques payable to existing customers these customers are intended by the drawer to be paid, and it cannot therefore be said that their names are inserted by way of pretence only. \(^{42}\) This holding underlies the Royal Bank decision. \(^{43}\)

To argue that the addition of “to the knowledge of the drawer”

\(^{36}\) Ibid., at p. 144.
\(^{37}\) Ibid.
\(^{38}\) A summary of the pre-Act authorities appears in the decision of the Court of Appeal in Vagliano where the majority held that the rule survived the passage of the English Act: Vagliano Brothers v. The Bank of England (1889), 23 Q.B.D. 243 (C.A.), at pp. 255 et seq., per Bowen, L.J.
\(^{39}\) Vagliano, supra, footnote 35 at p. 146.
\(^{40}\) Ibid., at p. 153.
\(^{41}\) [1905] 1 K.B. 795.
\(^{42}\) Cf., footnotes 19-22 and text, supra.
\(^{43}\) See footnotes 12-22 and text, supra.
after "fictitious" in the fictitious payee section is an interpretation of the word "fictitious", and not the insertion of a limitation or condition into the language of the section, is hardly plausible. Ironically, those who purported to follow Lord Herschell, while faithfully declining to introduce the pre-Act limitation or condition into the fictitious payee section, understood him to insert a limitation or condition of his own into its language.

Whether or not this limitation actually reflects the view of Lord Herschell is beside the present issue. For one thing, the circumstances wherein the rule of the fictitious payee operates cannot be ascertained by reference to the meaning given to the word "fictitious" in the language. The question of the meaning to be given the rule of the fictitious payee is one which should be answered in the context of the construction of the Act. As was correctly noted with respect to Lord Herschell's canon,\(^4\) he "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."\(^5\) Whether an existing person can be "fictitious" within the meaning of the section, is a question of statutory interpretation to be answered according to the "natural meaning"\(^6\) of the word "fictitious" in the language. When or in what circumstances an existing person can be "fictitious" within the meaning of a given statutory rule depends on the construction of the applicable section in the context of the meaning of the statute as a whole. Lord Herschell's failure to express this distinction has resulted in giving the decision in Vagliano a meaning which undermines the principle upon which it appeared to be based.

In the context of the broader question of the construction of the Act, attention should have been given to s. 97(2) of the English Act (s. 10 of the Canadian Act). The section provides that "[t]he rules of common law, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to ... cheques". Since no "express provisions of this Act" appear to deal with the scope of the rule of the fictitious payee, consideration of "[t]he rules of the common law, including the law merchant" seems to have been warranted.

\(^4\) Text and footnote 36, supra.


\(^6\) In the sense of Lord Herschell's canon, text and footnote 36, supra.
Yet Lord Herschell’s failure to read the pre-Act limitation into the scope of the rule of the fictitious payee is excusable. “The rules of common law ... [that] continue to apply”\(^{48}\) are not necessarily those in their static form as they preceded the Act. Rather, they may well refer to the dynamic and continuing process of law-making in the common law, or more specifically to the potential of a newly-recognized policy to affect the reading of the language of a section by providing a different rationale.

Also, the construction of a statute can by no means be performed mechanically. What the “express provisions of this Act”\(^{49}\) provide depends, to a great extent, on what one is prepared to read into them. This, in turn, other than being determined by the meaning of the specific words in the language, is a function of the policies underlying a given statutory rule, whether as of itself or as part of the statute as a whole. The “express provisions” of a section may mean more than its language appears to say, once it is read in the light of the underlying policy thereof. When the language of a section is too meagre to provide for a comprehensive guideline to the scope of the rule embodied therein, as it is in the case with the fictitious payee section, the injection of policy considerations into the “express provisions” is a must.\(^{50}\)

The pre-Act rationale of the rule of the fictitious payee was understood to be estoppel against a party with knowledge of the fraud.\(^{51}\) This rationale was inapplicable to the facts of *Vagliano*. They involved purported bills of exchange on which a clerk of the acceptor forged the drawer’s signature, obtained the acceptor’s signature by fraud, and then, by forging also the payee’s signature, obtained payment at the acceptor’s bank. “In the House of Lords the negligence of each party was strongly relied on ... [the acceptor-customer] not discovering that bills to a huge amount, which represented no commercial transactions, were being drawn on him, and the bank having paid these sums across the counter to a stranger”.\(^{52}\) Thus, by extending the rule of the fictitious payee

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\(^{48}\) Under s. 97(2) of the English Act.

\(^{49}\) Ibid.

\(^{50}\) Cf. Kulp, supra, footnote 45, at pp. 307-13. Note that in drafting s. 7(3) of the English Act, the draftsmen were probably not sure of what they were doing: Chalmers Vagliano, supra, footnote 23, at p. 218.

\(^{51}\) See summary of Bowen, L.J., in the decision of the Court of Appeal in *Vagliano*, cited in footnote 38, supra.

\(^{52}\) Byles, supra, footnote 19, at p. 24, n. 97. *Vagliano* stands also for the proposition that the
also to the case of a negligent party\footnote{43} without knowledge of the fraud, the \textit{Vagliano} majority rejected the pre-Act estoppel rationale of the rule, and displaced it with the broader principle of negligence. Negligence of the customer was either read into the language of the fictitious payee section, or superimposed on it as one of “[t]he rules of common law ... [that] continue to apply”.\footnote{54}

Subsequent cases failed to read \textit{Vagliano} in this light but instead focused on the linguistic argument of Lord Herschell. New fact situations were put into the straitjacket of Lord Herschell’s language rather than measured in the light of a guiding principle. This construction technique has led to the holding in \textit{Royal Bank}.

III

The authority of a drawee bank to debit the account of the drawer for the full amount of a cheque that was so negligently drawn as to permit its subsequent alteration by the insertion of words and figures without erasures was established in England in the leading case of \textit{Young v. Grote}.\footnote{55} For a period, the real meaning,\footnote{56} and even the authority,\footnote{57} of the case were doubted, until fully re-established by the House of Lords in \textit{London Joint Stock Bank v. MacMillan}\footnote{58} where it was said that the “sole ground upon which \textit{Young v. Grote} was decided ... was that Young was a customer of the bank owing to the bank the duty of drawing his che-

\footnote{43} Four of the Law Lords (Halsbury, L.C., Earl of Selborne and Lords Watson and Macnaghten) referred specifically to the conduct of the parties. Most explicit in pointing at negligence of the customer as the rationale for his decision was Earl of Selborne. Though “unusual”, the conduct of the bank was found by him irrelevant in determining liability. \textit{Vagliano, supra}, footnote 35, at pp. 127-8.  
\footnote{54} Under s. 97(2) of the English Act.  
\footnote{55} (1827), 4 Bing 253, 130 E.R. 764.  
\footnote{56} It had been questioned whether the case stood for apparent authority, duty of care in favour of all takers of a negotiable instrument, or a contractual duty to take care owed by a depositor to his bank with respect to cheques: Note, “Careless Spaces in Negotiable Instruments”, 31 Harv. L. Rev. 779 (1918).  
\footnote{57} \textit{Young} was treated by the Privy Council as no longer law, in \textit{Colonial Bank of Australasia v. Marshall}, [1906] A.C. 559. This view was convincingly challenged by Beven. \textit{supra}, footnote 52, \textit{passim}.  
que with reasonable care”. 59
Whether the improper office management which enables a dishonest clerk to procure cheques and to forge the endorsements thereon, constitutes a breach of the duty of care of the customer to the drawee bank has never been an issue in England. This is because s. 60 of the English Act creates an important exception to the rule that a forged signature is “wholly inoperative”. 60 The section protects a drawee bank that pays a cheque with a forged endorsement61 in good faith and in the ordinary course of business by providing in effect that it is entitled to debit the drawer’s account.62

Being broader in its operation than negligence, the effect of the section is that the existence of a duty of care on the part of the customer is irrelevant in dealing with the authority of the drawee bank to debit the drawer’s account with value of cheques paid on forged endorsements.63 As it is general in its application to all

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59 [1918] A.C. 777, (H.L.), at p. 793 per Lord Finlay, L.C., emphasis added. It has been still questioned whether the negligence of the customer entitles the bank to sue him under the tort of negligence, or whether it merely triggers estoppel by negligence against the customer when he sues the bank; see e.g., O’Hare, Comment, 1 Australian Bus. Law Rev. 335 (1972), at p. 336. Note however that estoppel by negligence presupposes the existence of a duty of care: *Swan v. North British Australasian Co.* (1863), 2 H. & C. 175 at p. 182, 159 E.R. 73 (Ex.Ct.), per Blackburn, J. See in general; Pickering, “Estoppel by Conduct”, 55 L.Q. Rev. 400 (1939), at pp. 411-16: Kadirgamar, “The Problem Promissory Note: A Question of Estoppel”, 22 Mod. L. Rev. 146 (1959); M. A. Millner, *Negligence in Modern Law* (1967), pp. 142-8.

60 This is the rule under s. 24 of the English Act; s. 49(1) of the Act in Canada. See footnotes 5-6 and text, supra.

61 It has been questioned whether or not the provision covers the case of the forger signing the name of the payee on the back of the cheque at the time of receiving payment from the payor, see Byles, supra, footnote 19, at p. 254, nn. 17-19 and text.

62 Section 60 of the English Act reads as follows:

*Whenever a bank pays a bill in due course under the terms of this provision, it is entitled to debit the drawer’s account: Charles v. Blackwell (1876), 1 C.P.D. 548, affd 2 C.P.D. 151 (C.A.).*

63 The bank will prevail under s. 60 of the English Act regardless of negligence on the part of either itself or the customer, provided payment was made “in good faith and in the ordinary course of business”. Byles, supra, footnote 19, at pp. 253-4. A concise history of s. 60 (together with a rationale thereto) appears in Kessler, “Forged Endorsements”, 47 Yale L. J. 863 (1938), at pp. 868-71.
cases of forged endorsements, the effect of s. 60 of the English Act is also to exclude the drawee bank and customer relation from the coverage of the fictitious payee section.\(^6\) The cumulative effect is then to exclude the rule of the fictitious payee from falling within the ambit of the duty of care of a customer to the drawee bank.

The reason Vagliano was not covered by s. 60 of the English Act was that the bank there, though dealing with his customer, was not the drawee.\(^6\) The operation of the fictitious payee section, as well as the duty of care of a customer to his banker, could thus be considered in the case. Yet, Vagliano involved an unusual fact situation, never to recur in a reported case. Consequently, its message of construing the fictitious payee section on the basis of the duty of care of the customer to his banker went unnoticed in the case law to come.\(^6\)

In Canada, a drawee bank does not enjoy the protection embodied in s. 60 of the English Act\(^6\) and upon paying a cheque on a forged endorsement is bound under s. 49(1) of the Canadian Act to re-credit the account of the drawer.\(^6\) The fictitious payee section provides an exception to that general rule.\(^6\) Whether liability of the drawee bank under the general rule of s. 49(1) of the Act is subject to a duty of care of the customer, and whether the fictitious payee section is a codification of one aspect of the duty of care of the customer to the drawee bank, are questions that cannot be answered by reference to specific rules of the English law where s. 60 makes them superfluous. At the same time, a fresh look at Vagliano seems to have been warranted.\(^7\)

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\(^6\) The leading English cases construing the fictitious payee section, with the notable exception of Vagliano (see the following footnote and text), involved contests between the drawer and purchasers of the instrument: Royal Bank, supra, footnote 1 at p. 31, per Laskin, C.J.C.

\(^6\) The bills were payable at the acceptor’s bank, rather than drawn on the bank; cf. footnote 52, supra.

\(^6\) Cf. last paragraph of section II, at p. 426, supra.

\(^6\) Falconbridge, supra, footnote 10, at p. 566.

\(^6\) See footnotes 4-8 and text, supra.

\(^6\) See footnotes 9-10 and text, supra.

\(^7\) Indeed, Vagliano was originally understood in Canada also to apply to a fact situation where the drawer had been induced by a dishonest clerk to draw cheques to an actual customer to whom no debt had been owed: London Life Assurance Co. v. Molsons Bank (1904), 8 O.L.R. 238 (C.A.). Where “[t]he distinction between such a case and one where the payees were never intended by the drawer to receive the money was not overlooked, but … [t]here being no corresponding provision in the Canadian Bills of Exchange Act to s. 60 of the … [English Act], the bank would have been otherwise without a defence as against
It is noteworthy that in the American jurisdictions, the statute which in the past governed bills and notes, the *Uniform Negotiable Instrument Law* (hereafter N.I.L.),\(^{71}\) did not contain a parallel provision to s. 60 of the English Act.\(^{72}\) Wherever the failure of a customer to use reasonable care enabled the committing of a forged endorsement, courts were faced with the task of deciding a customer's duty of care to his banker.\(^{73}\) However, the fictitious payee section of the N.I.L., s. 9(3), provided in its original form that an "instrument is payable to bearer when it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable".\(^{74}\) As such, its construction did not require the application of principles of negligence. Unless the drawer or the signing officer thereof\(^{75}\) knew personally of the fraud the section was inapplicable.

Against this background, a "bankers' amendment" to s. 9(3) of the N.I.L. was introduced. The amendment was designed to enlarge the scope of the original section to the case where a dishonest employee or agent supplied the name of the fictitious payee.\(^{76}\) Also being specific in its applicability, the construction of the amended version did not require the rationalization of negligence. As a result, the American experience with construing s. 9(3) of the N.I.L. cannot be employed in the search for a guideline to the construction of the fictitious payee section in the Canadian Act.

\(^{71}\) The statute was promulgated in 1896 and was the first major project of the National Conference of Commissioners on Uniform State Laws. Up to 1924, when it was last enacted, it was adopted by 48 states: Braucher, "The Legislative History of the Uniform Commercial Code", 58 Col. L. Rev. 798 (1958), at p. 799.

\(^{72}\) See in general, Kessler, *supra*, footnote 63, at pp. 878-9.


\(^{75}\) *Mueller & Martin v. Liberty Ins. Bank*, 218 S.W. 465 (Ky. 1920).

\(^{76}\) The amendment added to s. 9(3) (footnote 74 and text, *supra*) the following phrase: "or known to his employee or other agent who supplies the name of such payee"; see in general, Broadman, "Proper Construction of the So-Called 'Bankers' Amendment' to Sec-
The same is also true with respect to the present American Uniform Commercial Code. In dealing with the rule of the fictitious payee in s. 3-405, it explicitly covers the padded payroll cases as a separate category. Since the Canadian Act contains no corresponding provisions, the Royal Bank majority rejected "the argument of... [the bank], based on references to legislation in other countries." However, in so doing, the Royal Bank majority overlooked the place of s. 3-405 in the scheme of allocation of forgery losses under the U.C.C. Like the Canadian Act, the U.C.C. does not have a counterpart to s. 60 of the English Act and, under the Code provisions, the duty of care of a customer may affect his liability for cheques paid on forged endorsements. Likewise, under the U.C.C., as is true under the Canadian Act, the fictitious payee section applies to the customer-drawer bank relationship. In this framework, U.C.C., s. 3-405 is explained by negligence, and apart from its specific provisions, it is viewed as a codification of "the proposition that certain behavior is negligent and thus renders signatures resulting from that behavior effective against the negligent party." It is the adoption of that broad principle that should

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77 The U.C.C. deals with negotiable instruments in Article 3 (Commercial Paper) and Article 4 (Bank Deposits and Collections). These Articles are in force in all 50 states. Currently there are two official texts of the U.C.C.: from 1962 and from 1972. The 1972 Official Text did not introduce any change in Articles 3 and 4.

78 The Official Comment to the section specifies the uniqueness of its legislative technique as follows: "The words 'fictitious or nonexisting person' have been eliminated [from the section] since the existence or nonexistence of the named payee is not decisive and is important only as it may bear on the intent that... [the payee] shall have no interest. The instrument is not made payable to bearer and endorsements [by any person in the name of the named payee] are still necessary to negotiation". In general with respect to s. 3-405 of the U.C.C., see Comment, "The Fictitious Payee and the UCC — The Demise of A Ghost", 18 U. Chic. L. Rev. 281 (1951).

79 Section 3-405 (1)(c) reads as follows:

(1) An indorsement by any person in the name of a named payee is effective if...
(c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.

80 Cf. footnotes 60-70 and text supra.

81 J. White and R. Summers, Handbook of the Law Under the Uniform Commercial Code (1972), p. 542. In dealing with the underlying policy of s. 3-405(c) (footnote 79, supra), Official Comment (4) states also that "the loss should fall upon the employer as a risk of his business" and that the employer is "in a better position to cover the loss by fidelity insurance": cf. also Royal Bank, supra, footnote 1, at p. 32, per Laskin, C.J.C. Neverthe-
have been considered by the court in *Royal Bank*. Being warranted under *Vagliano* and formulated under a statute whose scheme of allocation of forgery losses is analogous to the one under the Act in Canada, this broad principle of negligence provides a clear rationale to the fictitious payee section, free from the traps of the linguistic argument of Lord Herschell.

However, unlike the U.C.C. which, explicitly provides in s. 3-406 that a person “who by his negligence substantially contributes to ... the making of an unauthorized signature is precluded from asserting the ... lack of authority”, the scope of the duty of care under *Young* has been understood in English law to be confined only to acts or omissions in regard to the drawing and signing of cheques. As between banker and customer, the customer is under no duty to exercise reasonable care in the general course of carrying on business.

Admittedly, a customer’s duty of care in preventing forged endorsements hardly fits into this framework. Nevertheless, it should always be kept in mind that the existence of s. 60 of the English Act has resulted in the absence of any thorough discussion with respect to the effect of negligence on liability for payment of cheques on forged endorsements. Therefore, the limits of the duty of care of the customer as understood under the English Act do not necessarily apply to the construction of the Canadian Act. Furthermore, *Vagliano*, as already indicated, is an exception

83 Footnotes 52-4 and text, supra.
84 In general for the allocation of forgery losses in American law, see Comment, “Allocation of Losses”, supra, footnote 73, passim.
85 The theory of the section is estoppel by negligence rather than the tort of negligence. Official Comment (5) to s. 3-406 of the U.C.C.: cf. footnote 59, supra. The applicability of the section to negligence contributing to a forgery of the signature of another is explicitly referred to in Official Comment (7).
86 Footnotes 55-59 and text, supra.
87 Chalmers, supra, footnote 21, at p. 206; Falconbridge, supra, footnote 10, at pp. 564-565. This view was recently affirmed in *National Bank of New Zealand Ltd. v. Walpole and Patterson Ltd.*, [1975] 2 N.Z.L.R. 7, at pp. 17 et seq.
87a Negligence in the padded payroll cases refers to choosing and supervising employees in sensitive positions (White and Summers, supra, footnote 82, at p. 542), as well as to the failure to set proper procedure of verification before mailing the cheques, and after they are returned by the bank together with a statement of account: cf. footnote 31 and text, supra.
88 Footnotes 52-54 and text, supra.
to the narrow understanding of the duty of care in English law and can justify the extension thereof to situations (and jurisdictions) where s. 60 of the English Act is inapplicable.

Unfortunately, the opportunity to deal with the rule of the fictitious payee in the broad context of the duty of care of the customer was missed in *Royal Bank*. Such analysis is warranted under *Vagliano*, seems justified under the Act in light of the absence of a counterpart to s. 60 of the English Act, and could have led to a better quality of justice.

IV

The duty of care of a drawer in issuing cheques has traditionally been regarded in English law as owed only to his banker. While it was originally questioned whether *Young* could be authority for the broader proposition “that the person putting in circulation a bill of exchange does, by the law merchant, owe a duty to *all parties to the bill* to take reasonable precautions”, the view prevailed that the basis for liability in *Young* was the contract between the customer and the banker, and the duty had therefore been confined to that relation. The drawer of a bill or the maker of a note owes no duty to the public at large, “if a person is careless of his property, and it is stolen in consequence, and the thief sells it to an innocent purchaser, the true owner can recover it from the innocent purchaser, notwithstanding his negligence... *there is no legal duty to the public on the part of the owner to keep his own property safe from theft*”.

The vindication of negligence as the underlying policy of the fictitious payee section can hardly be reconciled with this restrictive view of the drawer’s duty of care. The effect of the section as

89 But cf. footnote 31 and text, *supra.*
92 But see *Stone & Webster Engineering Corp. v. First National Bank & Trust Co.*, 184 N.E. 2d 358 (Mass. 1962): a cheque in the hands of a drawer, prior to the delivery thereof to the payee, is not “valuable property” in his hands. The case is not convincing.
it is worded,94 as well as its application in the cases,95 is clearly to make the drawer also liable to a subsequent purchaser of the bill. Thus, while the doctrine of Young could provide a just solution in Royal Bank irrespective of the fictitious payee section,96 the section itself appears to require the existence of a broader rationale than the present understanding of Young.

Indeed, many American courts tended to prefer a broader interpretation of Young and extended it to cases arising between parties other than the drawer and drawee.97 Their view was adopted by the draftsmen of the U.C.C. who noted that "[b]y drawing the instrument and 'setting it afloat upon a sea of strangers' the maker or drawer voluntarily enters into a relation with later holders which justifies his responsibility".98 Accordingly, it was provided in s. 3-406 of the U.C.C. that the substantial contribution to the making of an unauthorized signature by way of negligence results in the preclusion from "asserting the . . . lack of authority against a holder in due course" or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business." This section was construed to apply to the claim of a collecting bank against a drawer of a cheque, who, by sending it negligently to the wrong person substantially contributed to the making of a forged endorsement thereon.102 Its underlying princi-

94 Footnotes 9-10 and text, supra.
95 Cited by Laskin, C.J.C., Royal Bank, supra, footnote 1, at p. 31.
96 Cf. ibid., at p. 39, where Laskin, C.J.C., stated that he could not "read s. 49(1) otherwise than as obliging the bank which pays on a forged endorsement to establish on a balance of probabilities some valid ground for avoiding the liability that would otherwise rest on it".
97 See in general, Note, "Careless Spaces", supra, footnote 56, at p. 781 and n. 13. But under one view this is a "misunderstanding" of Young, Note, 4 Cor. L.Q. 46 (1919), at p. 47, and n. 7. Cf. also Britton, supra, footnote 74, at p. 668, where the author finds it difficult "to justify the broader rule which assumes a duty . . . to subsequent holders".
98 Section 3-406 of the U.C.C., Official Comment (2).
99 See footnote 85 and text, supra.
100 Emphasis added. Note that a purchaser of a cheque bearing a forged endorsement is not a holder, and therefore he is not a holder in due course; but cf. footnote 101, infra.
101 In applying the section to a collecting bank that could not be a holder (supra, footnote 100), the court either extended the principle of the section, or presupposed the genuineness of the endorsement by virtue of the preclusion from asserting "the . . . lack of authority".
ple would also provide an explanation to another case which found that the negligence of a payee who contributed to the forging of his own endorsement precluded him, under s. 3-404, from denying to the collecting bank the effect of the endorsement. 103 This section provides in subsec. (1) that “[a]ny unauthorized signature is wholly inoperative as that of the person whose name is signed unless he … is precluded from denying it”. 104

Though s. 3-406 of the U.C.C. does not have a counterpart in the Act, and although its Official Comment (2) explicitly speaks of the extension of the doctrine of Young “to the protection of a holder in due course and of payors who may not technically be drawees”, the introduction of the principle embodied in the section does not require the intervention of the Legislature. The lawmaking process of defining new relationships that give rise to a duty of care is a continuing one and those relationships that have already been defined by decided cases are not exhaustive. 105 It is also well established that a negligent performance by A of his contract with B may give an independent cause of action to C who “derives his rights [against A] not from the contract but from the circumstances that the nature of A’s contractual duties to B ought reasonably to put him in mind that third persons, such as C, might be in jeopardy should A be negligent in the performance of his contract with B”. 106 Thus, the contractual roots of the duty under Young should not constitute a bar to its extension by courts toward third parties.

In addition, U.C.C., s. 3-404(1) 107 has a parallel in the Act. Section 49(1), after providing that a forged signature “is wholly inoperative”, explicitly exempts from the coverage of that general rule circumstances where “the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority”. 108 The American case which construed U.C.C., s. 3-404(1) to mean that negligence precluded a drawer from denying to the collecting bank the effect of a forged endorsement signed by him precluded him from asserting the forged endorsement thereon against a collecting bank.

104 Section 3-404(1) of the U.C.C.
106 Millner, supra, footnote 59, at p. 129.
107Footnote 104 and text, supra.
108 Cf. footnotes 5-8 and text, supra.
endorsement, relied explicitly on the Official Comment to the section, and implicitly on s. 3-406's general principle. Nevertheless, that court's interpretation of the s. 3-404 preclusion clause could be adopted by Canadian courts as a means to superimpose negligence principles on s. 49(1) of the Act.

It may well be that the "assault upon the citadel" of the contract as the basis to the contours of the doctrine of Young has already started in England. Thus, in Saunders v. Anglia Building Society, a party who had not exercised reasonable care in signing a document was not allowed to set a plea of non est factum against a bona fide third party who had relied on the signature. Though the House of Lords explicitly rejected the existence of a duty of care on the part of the signer, it is hard to find a better rationale for the decision. The proposition that "this is . . . an illustration of the principle that no man can take advantage of his own wrong" is too vague and is therefore far from being convincing.

V

Being concerned only with the relationship between the drawer and the drawee, the fact situation in Royal Bank did not raise the problem of extending the duty under Young towards the purchaser of an instrument. Likewise, not involving negligent conduct of the bank, the case did not raise the further question of the effect of

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109 Footnote 103, supra.
110 Official Comment (4) explicitly recognizes "the negligence which precludes a denial of the signature", emphasis added.
111 Negligence of the customer (though not in the context of forged endorsement) is discussed by Falconbridge as affecting liability under s. 49(1) of the Act: Falconbridge, supra, footnote 10, at pp. 555, 562.
113 Ibid., at p. 966 per Lord Hodson, at p. 982 per Lord Pearson.
114 Cf. Anson, "Carlisle and Cumberland Banking Co. v. Bragg", 28 L.Q.R. 190 (1912), where the author would prefer to discuss an analogous situation under estoppel by negligence rather than under the tort of negligence: ibid. at p. 194. None the less, the existence of a duty of care is essential in asserting estoppel by negligence: see footnote 59, supra.
116 In this context compare the simplistic proposition that "wherever one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it": Lickbarrow v. Mason (1787), 2 T.R. 63, at p. 70, per Ashburst, J. This maxim cannot be taken at face value: Kadrigamar, supra, footnote 59, at p. 146.
117 See footnote 30 and text, supra.
contributory negligence on the liability of the drawer. Unfettered by such complications, the case could have been used as an opportunity for presenting the basic proposition of superimposing negligence concepts on the scheme of s. 49(1) of the Act, and its application to the reading of s. 21(5) thereof.

Though the enactment of statutory provisions modelled on s. 3-405(1)(c) of the U.C.C.118 will solve the particular issue of Royal Bank, reliance on the intervention of the Legislature suffers from limitations. In construing detailed statutory provisions, courts tend to focus on the scope of the letter of the statute, thereby losing sight of the guiding principle that also may apply to border cases that fall outside the provisions themselves.119 No matter how far the Legislature goes in providing specific fact situations that fall within the fictitious payee rule, the existence of a guiding principle to be applied beyond those statutory provisions should be clearly pronounced. The interpretation of the term “fictitious”, and the examination of the common law rules are steps in the right direction; yet without an underlying principle they will lead to inconsistency and injustice.

The pronouncement of such a guiding principle should not await the intervention of the Legislature. By the 18th century, at a time when there was no s. 3-406 or a Bills of Exchange Act, Lord Mansfield stated that the loss caused by forgery should fall “on him who is most in fault”.120 In working its way out of the statutory maze of the Bills of Exchange Act, the Royal Bank majority lost sight of this simple truth.

Benjamin Geva*

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118 Footnote 79, supra.
119 Cf. Snug Harbour Realty Co. v. First National Bank of Toms River, 253 A. 2d 581 (N.J. 1969), a situation on the borderline of s. 3-405(1)(c) of the U.C.C.
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