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Conversion of Unissued Cheques and the Fictitious or Non-Existing Payee—Boma v. CIBC

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CONVERSION OF UNISSUED CHEQUES AND THE FICTITIOUS OR NON-EXISTING PAYEE — BOMA v. CIBC

Benjamin Geva*

I. INTRODUCTION

In Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce1 (“Boma”), the Supreme Court of Canada dealt with important questions of doctrine, statutory interpretation of the Bills of Exchange Act2 (“BEA” or “the Act”), and policy considerations. The question of doctrine concerned the availability of the action of conversion to the drawer of an unissued cheque. The statutory interpretation focused on BEA s. 20(5) dealing with the fictitious or non-existing payee as well as on s. 165(3) of the Act covering the collecting bank as a holder in due course. The discussion raised policy questions relating to the allocation of cheque losses incurred because of the fraud of the customer’s own signing officer and bookkeeper. The case was concerned with loss allocation among the customer, the drawee, and the collecting bank to which the fraudulent bookkeeper/signing officer delivered the cheques for collection to her account. In my view, except on one point which is the interpretation of s. 165(3) of the Act, the majority decision of the Supreme Court is mistaken as a matter of doctrine and statutory interpretation, as well as of policy. On the ultimate loss allocation the dissenting opinion is more persuasive. However, on the availability of the conversion action to the drawer of an unissued cheque the dissent did not challenge the disappointing majority decision.3

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3 Several issues were settled by the lower courts and were thus not discussed by the Supreme Court. They concerned negligence, the notice under BEA s. 49, and the non-applicability of the verification agreement to payment over a forged endorsement. These aspects are not discussed in this article.
I have previously stated my position on the contested issues elsewhere, particularly in an article published around 15 years ago. It seems that the article was not considered in the course of the various stages of the Boma litigation. In any event, I may not have expressed myself clearly and in a sufficiently detailed manner. I believe therefore that the result in Boma, and the unfortunate law it has produced, justify a restatement and further elaboration and substantiation of my position in the context of a critical review of the judgments.

II. THE FACTS

Boma involved a fraudulent bookkeeper, Donna Alm ("Alm") who was employed by two associated companies ("the companies") and who defrauded her employers over the course of five years. Alm's responsibilities included the preparation of payrolls and cheques, the handling of accounts receivable and payable, and the reconciliation of bank statements. She was not an officer, director, or shareholder of the companies. She was, however, a duly authorized signing officer on the companies' bank accounts with the Royal Bank of Canada ("the drawee"). Cheques drawn on these accounts required only one authorized signature. In the course of her employment by the companies, Alm managed to appropriate the proceeds of 155 cheques, drawn by the companies and made payable to various payees, by collecting them through her bank account with the Canadian Imperial Bank of Commerce ("the collecting bank").

None of the 155 cheques was issued in satisfaction of a genuine debt owed by the companies. They were all fraudulently prepared by Alm with a view to misappropriating the proceeds. She herself signed 146 of the 155 cheques and induced her supervisor, Boris Mange, one of the two shareholders, directors and officers of the

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5 In fact, the "Fictitious" commentary was mentioned by Iacobucci J. in para. 44, but in another context.
companies who had a signing authority ("the shareholder/officer"), to sign the other nine. Altogether, 41 cheques were drawn payable to names of persons connected with the companies, such as shareholders and employees ("cheques payable to existing employees"). Of these, 38 cheques were signed by Alm and three by the shareholder/officer. The remaining 114 cheques were made payable to an imaginary person° conjured up by Alm as part of her fraudulent design ("cheques payable to the imaginary person"). She signed 108 such cheques, while the shareholder/officer signed six. Out of the 114 cheques payable to the imaginary person, 107 were deposited to Alm's account unendorsed, contrary to the collecting bank's policy. This departure may be explained by the fact that Alm was a well-established customer of the collecting bank who was considered to be reliable. Apparently, the tellers assumed that the payee on each such cheque was Alm's first husband. 103 of the 107 unendorsed cheques were signed by Alm. All 41 cheques payable to existing employees, as well as seven cheques payable to the imaginary person (consisting of five cheques signed by Alm and two by the shareholder/officer), were deposited by Alm at her account with the collecting bank bearing a forged endorsement by Alm of the named payee.

All of the 155 cheques were genuine cheques of the companies, totaling $91,289.54, written on the drawee's pre-printed cheque forms, and signed by a duly authorized signing officer. They thus fell into the following four broad categories:

1. 108 cheques payable to the imaginary person and signed by Alm, of which 103 cheques were deposited by her to her account with the collecting bank unendorsed;
2. 38 cheques payable to existing employees signed by Alm;
3. six cheques payable to the imaginary person on which the shareholder/officer was induced to sign, of which four were deposited by Alm at her account with the collecting bank unendorsed; and
4. three cheques, payable to existing employees, on which the shareholder/officer was induced to sign.

° These cheques were made out payable either to "J. Lam" or "J.R. Lam". In fact, the companies had some dealings with one Van Sang Lang. As well, Alm's first husband was J. Alm or J.R. Alm. This may explain the apparent legitimacy of the cheques payable to the imaginary person in the eyes of both the shareholder/officer and the collecting bank.
III. JUDGMENTS OF THE LOWER COURTS

At trial, Macdonald J. held that since Alm never intended any named payee to receive payment, all 146 cheques signed by her were payable to a fictitious payee, and therefore could be treated as payable to bearer under s. 20(5) of the Act. However, in his view, this only provided a full defence to the drawee and not to the collecting bank, which remained responsible for the genuineness of the endorsement or as their guarantor. The claim against the drawee was thus upheld only with respect to the nine cheques signed by the shareholder/officer. Even in respect of these cheques, the drawee had recourse against the collecting bank, which thus was liable to the companies for the entire amount of the 155 fraudulent cheques.

In the course of his judgment, Macdonald J. did not distinguish between cheques payable to a "fictitious" or a "non-existing" payee. Nor did he analyze the companies’ causes of actions against the banks, except to indicate that they arose under the Act. However, he specifically rejected the position that a collecting bank holding a cheque through a forged endorsement may have rights of a holder in due course under BEA s. 165(3).

In the Court of Appeal, the companies’ action was treated as lying in conversion. Speaking for the majority, Southin J.A. agreed with the trial judge that BEA s. 165(3) does not confer a holder in due course status on a collecting bank which derives title to the cheque through a forged endorsement. Nevertheless, she dismissed the companies’ conversion action against the collecting bank for the 146 cheques signed by Alm. She reasoned that "[t]he [collecting bank] was not a wrongful dispossessor of these instruments because Alm, who had the authority not only to sign but to deliver the instruments, gave possession of them to the [collecting bank] fully intending to receive the proceeds herself". In her view, therefore, the conversion action against the collecting bank failed without even invoking BEA s. 20(5).

However, Southin J.A. upheld the judgment for the companies with respect to the nine cheques signed by the shareholder/officer on the basis of her interpretation of BEA s. 20(5). In her view,

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9 Ibid., at p. 447.
"[w]hether someone is 'fictitious or non-existing' within the meaning of s. 20(5) must ... depend on the intention of the drawer of the cheque, not the intention of the person who fills in the cheque". She also opined that “[t]he drawer was the company but ... the intention of the company is found in the intention of [the shareholder/officer], not in the intention of Alm”. She did not distinguish between cheques payable to “fictitious” or “non-existing” payees.

Hutcheon J.A. dissented regarding the 103 cheques signed by Alm and deposited by her unendorsed. He thought that the collecting bank was also liable to the companies with respect to them, and not only with regard to the 9 cheques signed by the shareholder/officer. He stated that “the cheques accepted by [the collecting bank for deposit] without any endorsement ... were patently irregular on their face”. Accordingly, he believed that “before the provisions of s. 20(5) are applicable the person claiming to enforce payment of the cheque must be its ‘lawful holder’”. Being neither the payee nor the endorsee of the cheque, nor “the person in possession of a cheque that was payable to bearer”, the collecting bank was not the holder, as defined in s. 2 of the Act. In Hutcheon J.A.'s view, “[n]o policy reason exists for extending s. 20(5) beyond its express letter to protect a collecting bank that received and paid the unendorsed cheques contrary to its own internal rules”.

It is, however, noteworthy that he cited no authority to support these views. On both counts, the reverse seems to be true. Section 165(3) was enacted in part in order to protect a collecting bank against the absence of endorsement. As well, by turning an instrument payable to a fictitious or non-existing person into an instrument payable to bearer, BEA s. 20(5) has turned its possessor into a holder, as defined in s. 2.

IV. IN THE SUPREME COURT

In the Supreme Court, the sole adversaries were the companies and the collecting bank. A unanimous court agreed that a drawer, as true owner of a cheque payable to order, may bring an action in conversion against a collecting bank that collected the cheque over a forged endorsement. It was further universally agreed that

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10 Ibid., at p. 451.
11 Ibid., at p. 455.
12 Ibid., at p. 456.
s. 165(3) of the Act does not provide the collecting bank with a defence against such an action. This is so provided the cheque is not payable to a fictitious or non-existing payee so as to be treated under BEA s. 20(5) as payable to bearer. The court, however, split in its interpretation of this provision.\textsuperscript{13}

I will first set out the points of agreement. As for conversion, Iacobucci J. endorsed Crawford's definition,\textsuperscript{14} according to which it "is the remedy of the lawful possessor of chattels to have their value paid to him by a wrongful dispossessor". In the case of a cheque, the converted chattel is "the instrument itself, that is . . . the piece of paper in respect of which the payment is made". In other words, "a bank that collects a sum of money under an instrument for a person not entitled to it is treated as having converted the instrument"\textsuperscript{15}. Iacobucci J. added that "[t]he tort is one of strict liability, and accordingly, it is no defence that the wrongful act was committed in all innocence". In turn, "[t]he fact that liability for the tort of conversion is strict suggests" that no defence of contributory negligence ought to be made available to one liable in conversion.\textsuperscript{16} Iacobucci J. had no difficulty in holding that a drawer of an unissued cheque, who has been dispossessed of the cheque and is thus "still the owner of the cheque", may bring an action of conversion against a collecting bank that collected the cheque for an unlawful possessor.\textsuperscript{17}

However, an action of conversion is not available against a person who has acquired ownership in the converted chattel. This describes the position of the holder in due course of a cheque, who is therefore not liable to the previous owner in conversion. This result follows, because under s. 73(b) of the Act, the holder in due course holds the cheque "free from any defect of title of prior parties". Under the BEA:

\begin{quote}
165(3) Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.
\end{quote}

\textsuperscript{13} The majority judgment of Lamer C.J.C. and Iacobucci, L'Heureux-Dubé, Sopinka, Gonthier, Cory and Major JJ. was delivered by Iacobucci J. The dissenting judgment of La Forest and McLachlin JJ. was delivered by La Forest J.
\textsuperscript{14} Supra, footnote 1, para. 36.
\textsuperscript{16} Supra, footnote 1, para. 30.
\textsuperscript{17} Ibid., para. 37. For conversion in relation to cheques see in general paras. 30 to 41.
Although he acknowledged that on the facts of the case, the cheques were indeed “delivered to [the collecting] bank for deposit to the credit of a person”, so that “[a]t first blush” the collecting bank seems to be protected, Iacobucci J. nonetheless expressed his view that “the consequence of this approach would be far-reaching and overly broad”. He further took into account the purpose of the provision that was to protect the collecting bank either from the absence of an endorsement or from the existence of a restrictive endorsement of the depositor/customer. He accordingly concluded that “the ‘person’ in s. 165(3) must mean a person who is entitled to the cheque”, such as “the payee or the legitimate endorsee”, and not Alm. Hence, the provision did not shelter the collecting bank from the conversion action of the owner of the cheque.

In his dissent, La Forest J. did not deal with the conversion point, thereby implicitly embracing Iacobucci J.’s analysis. As for BEA s. 165(3), he pointed out that “the word ‘person’, is clearly capable of diverse meanings depending on the circumstances in which it is used” so that Iacobucci J.’s interpretation is not inevitable. Nonetheless, he acknowledged that that interpretation “is in keeping with the apparent intent of Parliament in introducing the section”. That intent was “the desire to protect banks in those situations where a cheque is restrictively endorsed or where the payee fails to endorse a cheque” delivered to a collecting bank for deposit. He therefore agreed that on the facts of the case BEA s. 165(3) provides no protection to the collecting bank.

However, as the holder of a cheque payable to bearer, who takes it in good faith and for value as well as in compliance with the other conditions specified in s. 55 of the Act, a collecting bank may become a holder in due course, thereby defeating all adverse

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18 Supra, footnote 1, paras. 74 and 76, and in general, paras. 69 to 85.
19 In fact, it appears that at the Supreme Court, the collecting bank itself conceded that “it is prima facie liable to the drawer for conversion”: supra, footnote 1, para. 39, judgment of Iacobucci J.
20 Supra, footnote 1, para. 109, and in general, paras. 107 to 109. This interpretation underlies also the reading of the good faith requirement into s. 165(3), as conceded, e.g., in Royal Bank of Canada v. Ryan (1993), 107 Nfld. & P.E.I.R. 1 (Nfld. S.C.) at p. 17. Conversely, the provision is explicit in modifying the “value” requirement, by being satisfied with a mere provisional credit to the account. The general holding in due course requirements are set out in s. 55 of the Act.
21 This cannot be the case for the bona fide possessor of a cheque payable to order, since without the endorsement of the payee or someone deriving title from the payee, no one can become a holder, and without a holder there can be no holder in due course. See the BEA ss. 1, 59, and 55.
claims creating defects of title under s. 73(b). Since all the cheques in *Boma* were made out to payees and not to bearer, this option, at first sight, did not seem to be available unless *BEA* s. 20(5) applied. This section provides that: “Where the payee is fictitious or non-existing, the [cheque] may be treated as payable to bearer.” The Supreme Court was divided on the interpretation of this critical provision.

Speaking for the majority, Iacobucci J. thought that s. 20(5) did not apply to any of the 155 cheques and he held for the companies. In the course of his judgment, he distinguished between cheques payable to existing employees and those payable to the imaginary person. He did not draw any distinction between cheques signed by Alm and those signed by the shareholder/officer. In his view, cheques payable to existing employees, no matter who signed them, were intended by the shareholder/officer, as the guiding mind of the companies and not as a mere signatory, to actually be paid to real people. Because “Alm was not the drawer, but was simply the signatory”, her intention was not determinative. As for the cheques payable to the imaginary person, Iacobucci J. appears first to concede that “such a person would be categorized as ‘non-existing’ and hence, fictitious”. Nevertheless, he continued, the shareholder/officer, effectively acting as the guiding mind of the companies, “was reasonably mistaken in thinking that [the imaginary person] was an individual associated with [the] companies” and “honestly believed that the cheques were being made for an existing obligation to a real person known to the companies”. Accordingly, in his view, these cheques ought to be regarded as payable to a real person, intended by the shareholder/officer to receive payment, who is neither fictitious nor non-existing. This is so notwithstanding Alm’s fraud which falsely represented to the shareholder/officer the existence of that person as well as that there was money owed by the companies to him.

In his dissent, La Forest J. did not share this interpretation of *BEA* s. 20(5). In his view, all 114 cheques payable to the imaginary person, whether the 108 signed by Alm or the 6 signed by the shareholder/officer, were payable to a non-existing person, and thus would fall into the ambit of *BEA* s. 20(5). As well, among the 41

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22 Supra, footnote 1, paras. 42 to 67.
23 Ibid., para. 55.
24 Ibid., para. 60.
25 See in general, Ibid., paras. 91 to 106.
cheques payable to existing employees, the 38 signed by Alm are payable to a fictitious payee, so as to be covered by that provision. Only the three cheques payable to existing employees and signed by the shareholder/officer were payable to real persons; being payable to neither non-existing nor fictitious persons, these cheques fell outside BEA s. 20(5). This means that 152 cheques may be treated as payable to bearer. With respect to these cheques, the loss is to be allocated to the companies. Conversely, loss is to be allocated to the collecting bank only with respect to the three cheques payable to existing employees and signed by the shareholder/officer. Such cheques, totalling $1,655.17, fall outside BEA s. 20(5) and, therefore, may not be treated as payable to bearer.

In the course of his judgment, La Forest J. specifically disagreed with Iacobucci J.'s conclusion that "Alm’s fraudulent intent as the signing officer cannot be equated to the intent of the drawer". He found this conclusion contrary to general "law of agency and of vicarious liability in tort", particularly as set out by Laskin C.J.C.'s statement of the position in Concrete Column Clamps. In attributing to the companies Alm’s intention for cheques signed by her he specifically noted that this position is quite consistent with that "implicit in the majority’s decision in Concrete Column. In that case, it was the intent of a signing officer that was held to be the intent of the . . . corporation/drawer, even though there was no indication that the signing officer in that case was a guiding mind of the corporation".

Expressing his view that “the requirement of an endorsement on the cheque will more often than not be ineffective in protecting against fraud”, La Forest J. thought that as between the employer/drawer and the collecting bank the former is “in the best position to minimize [the] risk”. He further pointed out that “courts in both England and Canada have traditionally been unwilling to find that a duty of care exists between the rightful owner of a cheque and [a collecting] bank”. He thus observed that in allocating the major part of the loss to the employer/drawer, his interpretation of BEA

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26 Ibid., footnote 1, para. 100.
28 Supra, footnote 1, para. 102.
29 Ibid., para. 95.
30 Ibid., para. 103.
V. DISCUSSION

Hopefully, in *Boma*, the Supreme Court settled, once and for all, that *BEA* s. 165(3) does not dispense with the lawful title requirement. Stated otherwise, notwithstanding the breadth of its language, the provision ought not to be read as conferring a holder in due course status to a collecting bank that derives its title to the cheque through a forged endorsement. At the same time, the disposition of the conversion issue by the court, as well as the treatment of the fictitious or non-existing payee issue by the majority, are troublesome.

1. The Conversion Issue

In allowing the drawer of an unissued cheque to sue the collecting bank in conversion, Iacobucci J. followed the conventional wisdom. The leading authority in Canada is *Jervis B. Webb Co. v. Bank of Nova Scotia*, which followed a line of English authorities. Nevertheless, under such circumstances, the remedy is contrary to principle. Conversion is an action for damages for the misappropriation of property by the person entitled to possession of the property.

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31 For an earlier authority in the same direction (cited with approval in *Boma* by Southin J.A. at the Court of Appeal, *supra*, footnote 8 at p. 453) see *Morguard Trust Co. v. Bank of Nova Scotia* (1982), 40 O.R. (2d) 211 (H.C.J.), affirmed 44 O.R. (2d) 384 (C.A.), where Maloney J. rationalized this rule (at p. 217), stating that “[*s]ection 165(3) refers to the ‘delivery’ of a cheque. Section [39] of the Act states that delivery ‘in order to be effectual must be made either by or under the authority of the party drawing, accepting or endorsing . . .’ . In this case there was no delivery within the meaning of this section and therefore there was no delivery of the cheque within the meaning of s. 165(3)”. A proponent of the contrary view on the effect of s. 165(3) is I. Baxter, “A Non-Negotiable Crossing” (1982-83), 7 C.B.L.J. 141.

32 See N. Rafferty, “Forged Cheques: A Consideration of the Rights and Obligations of Banks and Their Customers” (1979-80), 4 C.B.L.J. 208, pp. 228-29. Rafferty correctly points out (at p. 228), and Iacobucci J. agreed (*supra*, footnote 1, para. 37), that upon the issue of the cheque, namely, its delivery to the first holder, the right to sue in conversion is conferred on the first holder, so that from that point, all agree that no conversion remedy is available to the drawer.


34 Ibid., pp. 699-702. These authorities are discussed below in the text accompanying footnotes 48 to 61. I overstated the case in saying in “Reflections”, *supra*, footnote 4 at p. 330, that “[n]one of the authorities . . . compelled the result”. I should have said that none of the authorities is convincing, as further discussed below.

35 “For conversion there must be some conduct, however innocent in its intent, which amounted in effect to a denial of the plaintiff’s rights in the goods . . . [T]he claim [is] for damages only.” See C.H.S. Fifoot, *History and Sources of the Common Law Tort and
In the case of conversion of a cheque the remedy is available to the one entitled to the paper and thus to the debt or claim embodied in it. Since a forged endorsement does not pass title to the cheque, its "true owner", such as the dispossessed holder whose endorsement signature has been forged, may sue in conversion, or for money had and received, any person through whose hands the cheque passed subsequent to the forgery. It is the claim to the cheque, as a valuable chattel representing a monetary debt or claim, which provides the basis for the action for the conversion of the cheque.

On the other hand, the drawer of an unissued cheque does not own a claim on the instrument. In his hands, the cheque represents neither a claim against, nor a debt owed by, the bank or, for that matter, anyone else. In the drawer's hands, the unissued cheque is a mere piece of paper, whose destruction, loss or misappropriation will not deprive him of any valuable asset. There is no basis therefore for an action in conversion.

36 See BEA s. 48(1), under which "where a signature on a bill is forged ... the 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 ... ". A cheque is a species of bill. See BEA, s. 165(1).

37 In connection with the theft of a chattel and the conversion of its proceeds to the defendant's use, and as an alternative to conversion (or more precisely, its predecessor, trover), the action for money had and received was introduced in the late 17th and early 18th century. This is a species of indebitatus assumpsit action that can be brought instead of conversion on the basis of the "waiver of tort"; "the plaintiff may dispense with the wrong, and suppose [the disposition of the valuable chattel by the defendant] made by his consent, and bring an action for ... money received to his use" (as if the defendant has acted on the plaintiff's behalf in the disposition of the chattel). See Lamine v. Dorrell (1705), 2 Ld. Raym. 1215, 92 E.R. 303. Historically, compared to trover, "[t]he advantages of the new [money had and received] remedy were considerable; the pleadings were simpler, the action was not extinguished by death, and the plaintiff need not ... declare and prove the precise value of the goods which the defendant had converted to his use": Fifoot, supra, footnote 35, at p. 365. In the context of the present discussion, the two actions (of conversion and money had and received) are indistinguishable.

38 Unlike the position at common law (see Crawford, supra, footnote 15 at pp. 1702-1703), under BEA, ss. 156-57, dealing with the action on a lost instrument, the claim on the instrument is not forfeited with the loss of the physical possession of the paper. However, an action on a lost instrument may be costly and cumbersome, and in any event loss of tangibility leads to the impairment of the marketability of the claim embodied in the (now out of possession) paper. In fact, loss of possession may lead to the loss of the total value of an instrument payable to bearer (which may ultimately reach the hands of a holder in due course), but this is generally not true where the cheque is payable to order. Nevertheless, the law has overlooked this distinction and allows recovery of damages to the extent of the full value of a converted instrument, even where it is payable to order, as if the loss of possession is tantamount to the loss of the entire claim embodied in it.
Indeed, to avoid double liability, a party who has discharged his obligation on an instrument is entitled to its surrender. Nonetheless, upon refusal, he is not entitled to damages for the misappropriation of his property; rather, the cancellation or destruction of the instrument is a complete defence to the discharged party's action.\textsuperscript{39} Obviously, the wilful destruction of a chattel is not a good defence to a conversion action. This demonstrates that the discharged party's action to the surrender of the instrument is not in conversion.\textsuperscript{40} Rather, it is on the discharge agreement. Similarly, a drawer who has defences to his liability, such as the absence of issue of the instrument,\textsuperscript{41} is thereby discharged and is entitled to the surrender (or destruction) of the instrument, as a piece of paper, on the basis of the discharge, and not because of its value as property incorporating a debt.

Stated otherwise, conversion is available to an adverse claimant asserting an equity of ownership or claim to the instrument. It is not available to one pleading an equity of liability or defence to an action on the instrument.\textsuperscript{42} The adverse claimant must own the claim on the instrument through the claim to the instrument. Typically, he is a dispossessed holder.\textsuperscript{43} On his part, the drawer may not recover on the instrument;\textsuperscript{44} rather, he is a party liable on it, who may

\textsuperscript{39} In the early common law, it was the cancellation or destruction of a sealed document, rather than its surrender, which secured the paying party's discharge. See, \textit{e.g.} F. Pollock, \textit{Principles of Contract at Law and in Equity}, 3rd American ed. from 7th English ed. by G.I. Wald and S. Williston (Littleton, Colorado, Fred B. Rothman & Co., 1983), p. 843.

\textsuperscript{40} Indeed, not every claim to the surrender of the instrument is tantamount to a claim of ownership or right to possession, so as to give rise to an action in conversion. Suppose A drew on B a bill payable to C. B's acceptance was procured by A's fraud. C negotiated the bill to D who took it with knowledge of the fraud so that D cannot be a holder in due course. Under such circumstances, B has an equity of liability or defence, but is not an adverse claimant to the instrument. At most, B is entitled to receive the instrument temporarily in order to cancel his signature. See A. Barak, \textit{The Nature of the Negotiable Instrument}, pp. 67-68 (Jerusalem, Academic Press, 1972) [in Hebrew].

\textsuperscript{41} "Issue" is defined in \textit{BEA} s. 2 as "the first delivery of a bill or note, complete in form, to a person who takes it as holder". Under ss. 38 to 40 of the Act, except as against a holder in due course, the absence of delivery is a defence to liability on an instrument. Holding in due course status cannot be acquired through a forged endorsement.

\textsuperscript{42} For the fundamental distinction between these two types of equities affecting an instrument, see Z. Chafee, "Rights in Overdue Paper" (1917-18), 31 Harv. L. Rev. 1104, at p. 1109.

\textsuperscript{43} He could however be a dispossessed non-holder owner, as for example, the transferee of an unendorsed bill under \textit{BEA} s. 60(1).

\textsuperscript{44} The drawer may not recover on the instrument except for in unusual circumstances, such as under \textit{BEA} s. 139(a), providing that "where a bill payable to \ldots a third party is paid by the drawer, the drawer may enforce payment thereof against the acceptor". Barak, \textit{supra}, footnote 40 at pp. 93-95 explains this result on the basis of the property acquired by the
nevertheless have a defence to his liability. This does not provide standing to sue in conversion.

The point is well stated by an Official Comment to Article 3 of the Uniform Commercial Code:45

There is no reason why a drawer should have an action in conversion. The [cheque] represents an obligation of the drawer rather than a property of the drawer. The drawer has an adequate remedy against the [drawee] bank for recredit of the drawer's account for unauthorized payment of the [cheque].

The drawer of an unissued (or issued) cheque which was paid by the drawee bank over a forged endorsement may sue that bank for breach of contract for paying the cheque contrary to the drawer's instructions. The drawer's instruction was to pay the payee or someone deriving title from the payee. In turn, the drawee bank may pass on the loss to the collecting bank on the basis of s. 49(1) of the Act.46 No direct remedy is, however, available to the drawer against the collecting bank. Circuity of action is thus not avoided, but for a good reason: the drawee bank, with whom the drawer has an ongoing relationship, may be in a better position than the collecting bank to raise defences to the drawer's action, such as estoppel or the applicability of BEA s. 20(5), dealing with the fictitious or non-existing payee.47

Precedents upholding the conversion action of a drawer of an unissued cheque are unconvincing. Jervis B. Webb Co.,48 followed by Iacobucci J. in Boma, does not contain an analysis of its own but is based on several English authorities, which will now be considered.

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45 Official Comment I to ucc §3-420, as revised in 1990.
46 Section 49(1) provides that "[w]here a bill bearing a forged ... endorsement is paid in good faith and in the ordinary course of business by or on behalf of the drawee or acceptor, the person by whom ... payment is made has the right to recover the amount paid from the person to whom it was paid . . . ."
47 The point is well presented, from an American perspective, in J.J. White and R.S. Summers, Uniform Commercial Code, 3rd ed. (St. Paul Minn., West, 1988), §15-5. Under the ucc, where a duty of care is owed by the customer to his bank (see ucc §§ 3-406 and 4-406, as revised in 1990), the range of defences available to the drawee bank against its customer is likely to be broader than in Canada. Nevertheless, the policy argument is valid under Anglo-Canadian law as well.
48 Supra, footnote 33.
The first case is *Ogden v. Benas*.

This however was "an action upon *concessit solvere* in the Lord Mayor's Court, London". Such an action was described as "a form of action of debt on simple contract which lay by custom . . . [and] is said to have had the advantage of being more comprehensive count than almost any other". This seems to be a poor authority for the availability of the common law conversion action. Moreover, in the course of his judgment, Keating J. spoke of "the drawer's right to get back his money from one who has obtained it by means of the forged indorsement". He further spoke of the wrongful payment by the drawee "of the money of the [drawer]". This language strongly suggests a cause of action for the misappropriation or conversion of funds, a cause of action which is unknown to the common law and which is quite distinguishable from the conversion of the cheque itself.

*Arnold v. Cheque Bank* was an action by the purchaser and not the drawer of a bank draft payable to the purchaser's creditor. As such it is completely distinguishable. The next two English cases are *Vinden v. Hughes* and *Macbeth v. North and South Wales Bank*. The first did not discuss any theory underlying the drawer's action. In the second case, Bray J. thought that both *Ogden v. Benas* and *Arnold v. Cheque Bank* provided a basis for conversion as well as for money had and received. Both *Vinden* and *Macbeth* are thus poor authority for establishing the drawer's conversion action.
The last case relied upon in Jervis B. Webb is Morison v. London County and Westminster Bank Ltd. It is true that in the course of his judgment, Lord Reading C.J. stated that the drawer of an unissued cheque “is entitled, prima facie, to recover ... either ... damages for conversion or [in] money had and received”. This statement however was not supported by any rigorous analysis; and the Lord Chief Justice only cited cases dealing with a holder’s conversion action — clearly a very different situation.

In my opinion, therefore, the issue of the drawer’s conversion action should have been reopened in Boma. For reasons explained above, the better view is the one expressed in the United States, in Stone & Webster Corp. v. First National Bank & Trust Co., under which neither doctrine nor policy justify the drawer’s conversion action.

A step in the right direction was already taken in Canada in Arrow Transfer Co. v. Royal Bank of Canada. There, the British Columbia Court of Appeal first dismissed a conversion action against a collecting bank by a plaintiff whose signature was forged on a blank cheque stolen from the plaintiff. In the course of his judgment, Robertson J.A. stated that in order to succeed in conversion for the value represented by a bill of exchange, “the plaintiff must be the true owner of the piece of paper qua cheque and not simply the owner of the piece of paper qua piece of paper”. In the Supreme Court, both Martland and Laskin JJ. approved of this statement. In Boma, the trial judge purported to distinguish the cases on the basis that both Alm and the shareholder/officer were authorized signing officers so that the signed cheques “were not ‘worthless paper’”. Nevertheless, he overlooked the fact that in

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59 [1914] 3 K.B. 356.  
60 Ibid., at p. 364.  
61 Ibid. These cases were Gordon v. London City and Midland Bank, [1902] 1 K.B. 242 (C.A.) at p. 246, and Fine Art Society Ltd. v. Union Bank of London, Ltd. (1886-87), 17 Q.B.D. 705 (C.A.).  
62 184 NE 2d 358 (Mass., 1962), decided under the pre-1990 UCC Article 3, which did not specifically exclude the drawer’s conversion action. In explaining the present statutory preclusion of the drawer’s action, Official Comment I to current UCC § 3-420 specifically approves of this judgment.  
65 Supra, footnote 63 at pp. 87-88.  
66 Ibid., at pp. 103-105.  
67 Supra, footnote 7, at p. 377.
Arrow Transfer, the plaintiff was held to be estopped from asserting the forgery of his signature, so as ultimately to be liable for the amount of the cheques. Hence, the cases are not really distinguishable.

2. Fictitious or Non-Existing Payee Issue

On the conversion issue, the Supreme Court discussion was disappointing. The court chose to follow the existing jurisprudence uncritically and missed an opportunity to reconsider basic principles and to break new grounds. At the same time, in dealing with the fictitious or non-existing payee under BEA s. 20(5), the majority misapplied existing jurisprudence and overlooked pertinent policies.

According to a classic statement in Falconbridge, adopted by Iacobucci J. in his judgment,

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.

It is respectfully submitted that in applying this summary to the facts of the case, Iacobucci J. seems to have overlooked two principles. First, in dealing with the cheques payable to the imaginary person, he did not recognize the basic distinction between a “fictitious” and a “non-existing” payee. While “fictitiousness” is a subjective matter, determined from the point of view of “the creator of the instrument”, “non-existence” is an objective fact, “not depending on anyone’s intention”. Hence, the intent of neither Aim nor the shareholder/officer should have counted in dealing with cheques payable to the imaginary person. A payee who is either a dead person or a creature of the imagination is, by definition, “non-existing”, so as to fall within the ambit of BEA s. 20(5). Consequently, all 114 cheques payable to the imaginary person, whether signed by

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69 Supra, footnote 1, at para. 46.
70 For the objective nature of “non-existence”, the leading authority is Clutton v. Attenborough & Son, [1897] A.C. 90 (H.L.). As noted by Falconbridge, supra, footnote 15, at p. 1259 (in the paragraph reproduced by Iacobucci J. in Boma, supra, footnote 1 at para. 46), an imaginary name inserted by the drawer “is non-existing and is probably also fictitious”. For each of these reasons, standing alone, and not because of any identification between “fictitious” and “non-existing”, an instrument payable to such a person will fall under BEA s. 20(5).
Conversion of Unissued Cheques

Aim or by the shareholder/officer, were payable to a “non-existing” person, so that the loss with respect to them should have been allocated to the companies.

“Fictitiousness”, and therefore “the intention of the creator of the instrument”, matter only with respect to cheques payable to existing persons, or given the facts of Boma, with respect to cheques payable to existing employees. In identifying “the creator of the instrument”, the drawer of the cheques, Iacobucci J. departed from current authority, thereby overlooking a second principle.

Indeed, Iacobucci J. was correct in observing that in Fok Cheong Shing Investments Ltd. v. Bank of Nova Scotia, the signing officer, whose intention was held to determine the fictitiousness of the payee, was the president of the drawer company, namely, its guiding mind. It is equally correct that Royal Bank of Canada v. Concrete Column Clamps did not purport to determine whether the signing officer actually was “the creator of the instrument”; rather, it held that the person who supplied a signing officer with the name of a payee with the intention of subsequently misappropriating the cheque was not the creator of the instrument. Nevertheless, it was never held that the creator of the instrument was anyone other than the actual signer. The distinction proposed by Iacobucci J. “between the signatory and the drawer” of the instrument, the latter being the companies acting through their guiding mind rather than a mere authorized signatory, is unsupported in case law. In fact, in the leading case of Bank of England v. Vagliano, “the creator of the instrument”, whose intention determined the fictitiousness of the payee, was neither a guiding mind nor even an authorized signatory of the drawer; rather, it was a fraudulent employee of the acceptor, with respect to whose drawer’s signature the acceptor was estopped from pleading forgery against its banker.

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72 Supra, footnote 1, paras. 50 and 56.
73 Supra, footnote 27.
74 Supra, footnote 1, para. 55.
76 The case involved bills of exchange payable at a bank out of the acceptor’s account. The fraudulent employee of the acceptor, purporting to act as a creditor of his employer, forged bills drawn on the employer payable to an existing firm, intending to forge the firm’s endorsement and discount the bills. Unaware of the scheme, the employer accepted the bills, believing they represented genuine debts owed by it to the firm. The bills were subsequently presented for payment at the bank over the endorsements forged by the fraudulent employee. The acceptor was precluded from asserting the forged drawing and
In the light of these considerations, the 38 cheques payable to existing employees and signed by Aim were payable to fictitious persons and the loss with respect to them should have fallen on the companies. Only the three cheques payable to existing employees and signed by the shareholder/officer were not payable to fictitious persons and fell outside the scope of BEA s. 20(5). Loss with respect to them was correctly shifted away from the companies.

So far as the interpretation of BEA s. 20(5) is concerned, La Forest J., in his dissent, correctly applied the existing jurisprudence. Undoubtedly, he appreciated that the case presented a straightforward application of the previously cited summary by Falconbridge as followed by subsequent jurisprudence.

Obviously, the Supreme Court is not mechanically bound by existing jurisprudence. Its mandate ought to include improvements in the law, and in the course of carrying this mandate, the court ought to be free to depart from obsolete precedents.77 Unfortunately, Iacobucci J.'s novel interpretation of BEA s. 20(5) cannot be justified along these lines. Rather, it undermines the policies underlying the provision.

The pre-Act rationale of the fictitious payee rule, as stated in the case law, was estoppel against a party with knowledge of the fraud.78 That is, a drawer or acceptor who knew that the bill did not reflect a real transaction was estopped, usually as against a discounting bank, from raising a defence based on the forged endorsement of the payee whose name was inserted by the creator of the instrument by way of pretense only in order to create a misleading appearance of real transactions between the drawer and acceptor, as well as between the drawer and the payee.79 In Vagliano,80 the House of Lords interpreted the statutory provision corresponding to BEA s. 20(5) as rejecting this rationale.81 Lord Herschell

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77 In effect, this is what I have argued above in Part V(1) in connection with the conversion of the unissued cheque.
79 For an excellent account, not limited to doctrinal aspects, explaining the historic and socio-economic background of the fictitious payee, see J.S. Rogers, The Early History of the Law of Bills and Notes (Cambridge, University Press, 1995), pp. 223-49.
80 Supra, footnote 75.
81 In the words of Lord Herschell, "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": supra, footnote 75, at p. 144.
Conversion of Unissued Cheques

195

held that "[w]henever the name inserted as that of the payee is inserted by way of pretense 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". 82

The objective of the provision has thus become the protection of banks from fraud on the drawer committed by a third party, particularly internal fraud within the drawer organization. 83 Due to the operation of BEA s. 48(1), providing that a forged signature is not operative, the drawer does not usually bear the risk incurred by a forged endorsement. Conversely, where BEA s. 20(5) applies, namely where a third person, including an insider in the drawer organization, defrauds the drawer by generating instruments intended to be misappropriated, loss falls on the drawer, who is in a better position to minimize losses and to insure. It is with the view of implementing this rationale that s. 20(5) ought to be construed.

It is true that the technical rules generated in the course of the judicial interpretation of BEA s. 20(5) do not always meet this challenge successfully. For example, in Concrete Column Clamps, 84 the majority of the Supreme Court held that where the fraudulent insider was not the signer, but rather the one who either supplied the payees' names to or prepared the cheques for signature by the authorized signing officer, the provision did not apply to cheques made out to past employees. The ensuing loss therefore did not fall on the drawer. Indeed, the fraudulent clerk was not "the creator of the instrument" within Falconbridge's summary. 85 Nevertheless, inasmuch as the fraud was internal to the drawer organization, this interpretation is a clear victory of form over substance; undoubtedly it fails to bring the interpretation of the provision in line with its rationale. This becomes particularly obvious in light of the fact that, in that case, cheques payable to "non-existing" persons, whose names were also supplied to the signer by the fraudulent clerk, were held to fall within the ambit of the provision, since "existence" is an objective fact, determined irrespective of anyone's intention. 86

82 Supra, footnote 75 at p. 153.
83 See in general, Geva, "Fictitious", supra, footnote 4.
84 Supra, footnote 27.
85 Supra, text following footnotes 68 and 69.
86 Ibid.
In *Fok Cheong Shing*, the fraud was committed by the president, an authorized signing officer of the drawer company, who made out a cheque payable to an existing person, intending to misappropriate it. *BEA* s. 20(5) was thus held to apply and the loss was correctly allocated to the drawer. However, had the president signed the cheque fully intending to make payment to the payee, but changed his mind subsequently deciding not to mail the cheque, but rather, to misappropriate it, the provision would not have been applied. What counts is the instrument creator’s intention at the time of the creation; a subsequent change of intention is irrelevant.

It is clear, then, that the current interpretation of *BEA* s. 20(5), as correctly reflected in Falconbridge’s summary, is that it is a less than perfect tool in allocating internal fraud losses to the drawer. Efforts ought to be made for judicial improvement of the current position, if not for a legislative amendment.

It is in this light that I argue that the majority’s judgment in *Boma* is a step in the wrong direction. In the context of a third-party fraud on a customer, where increased protection to banks is called for and against the background of an already over-restrictive interpretation of *BEA* s. 20(5), Iacobucci J. further reduced the scope of the provision, with neither valid doctrine nor policy grounds to justify his conclusion. In the final analysis, on the facts of *Boma*, there was no valid policy rationale justifying the companies’ insulation even with respect to the loss associated with the three cheques payable to existing employees and signed by the shareholder/officer. Nevertheless, I agree with La Forest J. that the current interpretation of s. 20(5) compels this result.

**VI. CONCLUSION**

In the final analysis, the companies had a cause of action against the drawee bank for debiting their accounts in the amount of

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87 *Supra*, footnote 71.
88 As discussed in Geva “Fictitious”, *supra*, footnote 4.
89 In this context, note Laskin C.J.C.’s dissent in *Concrete Column Clamps*, concluding that the named former employees were “fictitious”, since due to the purely mechanical role of the authorized signer, it is the dishonest clerk’s intention, and not that of the authorized signer, that should be attributed to the drawer company: *supra*, footnote 27 at pp. 38-43. Supporting the result, Spence J. added, in his dissent (at p. 46), that on the facts of the case the bank was not “guilty of any negligence whatsoever”, while for the drawer, “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”.
90 For example, in line with pre-1990 *ucc* § 3-405, set forth in Laskin C.J.C.’s judgment in *Concrete Column Clamps, ibid.* The current *ucc* provision is § 3-404.
Conversion of Unissued Cheques

Cheques paid over forged endorsements. This cause of action was for breach of contract. Having failed to defend such an action, the drawee bank could have had its recourse against the collecting bank under BEA s. 48(1). However, no direct recovery from the collecting bank should have been allowed to the companies.

In any event, on the facts of the case, the drawee bank should have been able to defend the companies’ action on the basis of BEA s. 20(5) in connection with all but the three cheques made out to existing employees and signed by the shareholder/officer. The loss attributed to the other 152 cheques ought to have been allocated to the companies.

The Supreme Court’s decision in Boma establishes a good precedent in relation to BEA s. 165(3). Unfortunately, the same cannot be said with respect to the two other major aspects of the decision, namely, the conversion of unissued cheques and the fictitious or non-existing payee. On both points, the discussion was comprehensive and thorough. Nonetheless, the final result was in my view mistaken.

Altogether, five judgments at three court levels were given in Boma. With respect to the conversion issue, no judge went beyond the face value of current jurisprudence. With regard to the fictitious or non-existing payee, only La Forest J., in the Supreme Court, correctly understood and applied existing case law.

Regrettably, the Supreme Court was mesmerized by an excessive accumulation of technical precedents and failed to see the forest for the trees.