ABSTRACT

Z. ALSULAIMI: Ph.D. Degree in Law 1990.

THE RISK OF THE FORGERY OF SIGNATURES AND THE PROBLEM OF CONFLICTING ENTITLEMENTS IN THE LAW OF NEGOTIABLE INSTRUMENTS - A COMPARATIVE STUDY.

The concern of this thesis is to examine the risk of forgery of signatures in the context of negotiable instruments. The allocation of the said risk is submitted to represent one of the most controversial matters among the existing legal systems. It is believed that the issue under consideration has represented a major obstacle to the adoption of an acceptable unification of the law of negotiable instruments.

The main task of this thesis is to propose an efficient allocation of the risk of the forgery of signatures. The scope of this enquiry is confined to the forgery of two forms of signatures, namely, that of the proprietor of a blank document and that of the payee or indorsee of a negotiable instrument. The forgery of such signatures is submitted to represent the major incident of the problem of risk allocation in the context of negotiable instruments. Its involvement affects the currency of such documents and ultimately, it affects the determination of the property right of negotiable instruments, as well as the enforcement of the incorporated contractual promises and undertakings.

In formulating the proposed allocation of the risk of the forgery of signatures, this thesis takes into account economic considerations, as well as the considerations relevant to the institution of negotiable instruments. The theory underlying such an attitude is firstly, to reconcile with recent developments in the law, secondly to accommodate the needs of modern society and thirdly, to promote the efficiency of a significant finance instrument. The promotion of the efficiency of negotiable instruments would necessarily promote the efficiency of the market.

Finally, this thesis examines the attitude of the major existing legal systems in allocating the forgery of signatures in the context of negotiable instruments. In particular, it examines the attitude of the Anglo-American and the Continental Geneva legal systems. It examines the theories underlying such an attitude. It examines the validity of the advanced theories. It examines the compatibility of the attitude of the said legal systems with the considerations underlying the institution of negotiable instruments as well as those underlying economic reality. Ultimately, this thesis determines the most compatible legal system with the proposed risk allocation rule.

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DECLARATION.

The work described in this thesis was carried out in the Department of Law at the University of Durham between April 1986 and October 1990. All the work is my own unless stated to the contrary and it has not been submitted previously for a degree at this or any other University.

Zaki Alsulaimi.

STATEMENT OF COPYRIGHT.

ACKNOWLEDGEMENTS

Due to the complexity of the subject matter under investigation and the involvement of a number of diverse legal systems, my task was considerably onerous. The continuous revision of the law in question and the scarcity of materials relating to the foreign legal systems contributed to the lengthy time taken in presenting this thesis in its final shape. The carrying out of this research could not have been managed but for a number of factors. By far the most significant factor was the tutorship and supervision of my supervisor Mr. Thomas Anthony Downs. His sincerity and constant revision enlightened me to the modern conception and the recent developments in the law. The encouragement of my parents and the devotion of my wife were also major contributory factors in carrying out this research. They gave me the energy and the determination needed throughout the five years of my work. I make no secret of the fact that the exchange of views with my fellow course members and friends assisted me in developing some arguments which could be raised in connection with the subject matter of this work. Finally, my readers and typist were of great assistance. Their involvement resolved many of the language problems. To all of those people I express my deepest thanks and appreciation for their advice, encouragement and assistance.

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CHAPTER ONE

INTRODUCTION

I. Negotiable instruments are of ancient practice. Their usage goes as far back as the Babylonian civilisation.[1] Nevertheless, their form and essential characteristics witnessed a chain of evolutions, in a manner consistent with the necessities of trade until the 12th to 13th centuries. Italy, in that period, was considered to be the centre of trade in Europe. The merchants throughout Europe came in contact with the Italian Lombards, through whom negotiable instrument bills of exchange in their present form were introduced to Europe. The implications of negotiable instruments remained relatively constant throughout Europe, until the end of the 17th - the beginning of the 18th - centuries. Thus far, the practice relating to negotiable instruments on both sides of the Channel was, due to the common origin from which negotiable instruments evolved, as well as the trade exchange, substantially similar.[2] Since the 17th and 18th centuries, the essential characteristics of negotiable instruments have witnessed variant treatment. These differences became more apparent at the beginning of the 19th century when, incidentally, the practice of negotiable instruments was incorporated in special codifications.[4]

II. At present, the major codifications of the law of negotiable instruments could be divided into two groups. namely, the Anglo-American and the Continental Geneva legal groups. The main codification of the latter group is the Geneva Conventions of 1930 and 1931. These conventions were the fruit of a number of international endeavours to unify the laws relating to negotiable instruments, the most significant of which was The Hague regulations of 1910-1912.[5] The Hague regulations, however, did not experience success for two reasons, namely the large number of reservations which made the purpose of unification of limited value, and the outbreak of the First World War.[6]

After the First World War, new hopes were raised, calling for the unification of the laws relating to negotiable instruments. Under the auspices of the economic committee of the League of Nations, a group of experts were assigned the duty to report on the possibility of codifying a uniform law on bills of exchange, promissory notes and cheques.[7] The outcome of the experts' reports was in favour of unification.[8] However, Sir McKenzie Chalmers, the British member of the experts team. expressed the view that it was not feasible for Great Britain to join the unification process.[9] A similar remark was made by the representative of the United States of America in the 1910-1912 Hague conferences.[10]

In the light of the experts' reports, the economic committee was determined to pursue the unification process, the effect of which was not to apply to the Anglo-American group. The committee then assigned the duty to draw up a draft convention on the uniform laws on bills of exchange, promissory notes and cheques, to another team of experts.[11] This draft convention was intended to be the basis for subsequent deliberations.

In 1930, the committee convened a conference to discuss the experts' draft convention. However, it was decided that the conference should discuss the unification of the laws relation to bills, notes and cheques in two separate sessions. The 1930 session was concerned with bills of exchange and promissory notes. The 1931 session was, by comparison, concerned with cheques. Both sessions were held in Geneva. Each session came with three conventions. The conventions of the first session were the Conventions on the Uniform Laws Relating to Bills of Exchange and Promissory Notes (G.U.L. Bills),[12] the Convention on the Settlement of Some Problems of the Conflict of Laws Relating to Bills of Exchange and Promissory Notes[13] and the Convention on Stamp Charges.[14] The conventions of the 1931 session were, the Convention on the Uniform Law on Cheques (G.U.L. Cheques),[15] the Convention on the Settlement of Some Problems of the Conflict of Laws Relating to Cheques[16] and the Convention on Stamp Charges.[17] The six above-mentioned conventions, in particular those relating to the Uniform Law and those relating to the Conflict of Laws were ratified by the majority of the European legal systems and became a part of their respective national laws.[18]

The major codification in the Anglo-American group is the English Bills of Exchange Act (1882) B.E.A.[19] The draftsman of this Act, Sir McKenzie Chalmers' main task was to codify the English Common Law as it then stood,[20] in order to secure the approval of Parliament. However, the B.E.A. was not the first codification of law relating to negotiable instruments, nor did it repeal all previous codifications in this field. In particular, Section 19 of the 1853 Stamp Act[21] remains operative. The B.E.A. remains, in its major part, the law applicable to negotiable instruments, as far as the English municipal law is concerned.

In 1957, in the light of the Mocatta committee's report, an act relating to cheques and other analogous instruments was passed. It is purported to be a supplement to the B.E.A, apart from Section 4 which repeals Section 82 B.E.A.[22] The purpose of the 1957 Cheques Act was to afford the banking industry more protection. Collecting bankers were to benefit most from such protection.[23]

The influence of the B.E.A. was not confined to the English legal system. Rather, it travelled across the Atlantic and beyond the Continent. Canada and the Commonwealth countries adopted the B.E.A. wholly or partly. In the United States, the B.E.A. has also been consulted. The draftsmen of the 1896 Uniform Negotiable Instruments Law (N.I.L.), the first United States negotiable instruments codification, borrowed a great deal from the B.E.A. At the close of the first half and the beginning of the second half of the 20th century, it was felt that the N.I.L. necessitated review. The New York Commission on Uniform Laws included in the Uniform Commercial Code, two articles relating to negotiable instruments. One article was concerned with regulating the rules relating to commercial paper (Article 3) and the other was concerned with bank collection (Article 4). Both Articles, in their current version, were approved in 1962.[24] They constitute the municipal law of all states of the United States apart from Louisiana which still retains the N.I.L.

The draftsmen of Article 3 U.C.C. did not, however, intend to change the major portion of the N.I.L. provisions. Their intention was to recodify the provisions of the N.I.L. in order to clarify the uncertainties created by the latter, keep the standard of codification in line with modern standards and regulate new matters not covered by the N.I.L.[25] In summary, the rules of Article 3 in their major part were but old wine in a new bottle.

III. The issue of unifying the rules regulating negotiable instruments was also raised in the United Nations. In 1969, the United Nations Commission on International Trade Laws (UNCITRAL) expressed its desire to consolidate the rules regulating negotiable instruments in a uniform law. However, it was recommended that the scope of the intended uniform law should be confined to international negotiable instruments and it should be of optional application.[26]

That is to say that in instances where the parties to a negotiable instrument intend to subject their document to the rules of the uniform law, they would have to manifest their intention in express terms.

In carrying out the above-mentioned desire, UNCITRAL circulated a questionnaire among banks, the trade institutes and other interested organisations. Later, it asked the Secretary General, in the light of the deposited replies and with the assistance of its study group, to prepare a draft uniform law on international bills of exchange, together with a commentary.[27] In 1972 UNCITRAL formed a special working group and assigned to it the duty to:

(1) revise the draft uniform law,

(2) modify and extend the scope of the said uniform law to international promissory notes, and

(3) consider the possibility of drafting a parallel uniform law applicable to international cheques.[28]

In 1977, the scope of the draft uniform law on international bills of exchange was modified so as to apply to international promissory notes.[29] Later, UNCITRAL decided to incorporate the rules regulating international negotiable instruments in a convention rather than a uniform law. It also decided that, due to the differences in the function of the various forms of negotiable instruments, the rules formulating the document in question, should be regulated in two separate conventions. One convention should be concerned with regulating the rules relating to international bills of exchange and international promissory notes, whilst the other convention should be concerned with regulating the rules relating to international cheques.[30] It was emphasized again that the application of the said convention should be optional. In 1982 the Secretary General, with the assistance of the study group of UNCITRAL produced two draft conventions on international bills of exchange, international promissory notes and international cheques respectively, together with commentaries.[31] UNCITRAL circulated the two draft conventions with their commentaries among the member states for comment. In light of the deposited replies, the commission decided to confine its efforts momentarily to the task of unifying the rules relating to international bills of exchange and international promissory notes.[32] From 1984 until 1987, the working group on international negotiable instruments engaged in revising the draft convention on International Bills of Exchange and International Promissory Notes.[33] In 1987 UNCITRAL submitted the final version of the draft Convention to the General Assembly for approval. In 1988, the General Assembly approved the draft Convention. Accordingly, it invited all member states to ratify, accede, accept or approve, the Convention on International Bills of Exchange and International Promissory Notes.[34] It set 30th June 1990 as the last date for depositing documents of ratification, accession, acceptance or approval. By virtue of Article 86 of the Convention, for the Convention to come into force, twelve ratifications, accessions, acceptances or approvals would have to be deposited within the time mentioned above.

Apparently, the Convention on International Bills of Exchange and International Promissory Notes, has failed to obtain the necessary ratifications, accessions, acceptances or approvals. Until the 9th May 1990, only one country had deposited its document of ratification to the Secretariat of the United Nations.[35]

IV. A major obstacle which restrained the Anglo-American legal systems from joining the Geneva Conventions and which restrained the member states of the United Nations from joining the Convention on International Bills of Exchange and International Promissory Notes, is submitted to be the manner in which the said conventions allocate the risk of the forgery of signatures. This is due to the fact that the risk in question involves a large number of competing interests. Its determination affects the relationship of the competing parties, the rights and liabilities arising from the negotiable transaction as well as the function of negotiable instruments.[36] The erosion of the controversy surrounding the allocating of the risk of the forgery of signatures is relatively old. Its evolution[37] could be traced back as far as the 17th, 18th and 19th centuries.

Where's the evidence for this?

V. The issue of allocating the risk of the forgery of signatures still occupies the law in the various legal systems. In the United States, since the promulgation of the Uniform Commercial Code (U.C.C.), several legislative enactments and proposals were intended to address this very issue. Examples of these enactments and proposals are the Federal Regulation J,[38] the Uniform Consumer Credit Code (UCCC),[39] and the Uniform New Payment Code (UNPC).[40] Currently the American Law Institute (A.L.I.) and the United States National Conference of Commissioners on Uniform State Laws (NCCUSL) are engaging in reviewing the present version of Articles 3 and 4 U.C.C. The new Articles 3 and 4 are expected to be approved in the second half of 1990. The aim of reviewing the said articles is related to the manner of allocating the risk of the forgery of signatures.[41]

In the United Kingdom, urgent calls have been raised to review the manner in which the English legal system treats the problem of the forgery of signatures. It is thought that the said treatment is incompatible with modern reality. The Consumer Credit Act (CCA) is not considered to have a great impact on the English legal system, especially in the manner in which risk allocation has been treated.[42] Therefore, the new calls urge that dealing in negotiable instruments should be reviewed to follow the new changes.[43]

The subject of risk allocation in general has also been the concern of legal literature. Since the 1950's, a growing tendency has been witnessed, the aim of which is to examine the problem of risk allocation with reference to market needs.[44] More specifically, the tendency has been to allocate risk in a manner compatible with economic efficiency. This tendency was initiated in the United

States and, in recent years, it has been imported to the U.K. The significance of economic analysis considerations in allocating risk have been influencing the problem of risk allocation in the context of negotiable instruments. Federal Regulation J, the UCCC, the UNPC, the new Articles 3 and 4, as well as the urgent calls for renewal in the U.K.[45], are all directed to apply economic analysis considerations in formulating their respective risk allocation rule.

VI. Due to the growing tendency on the legislative as well as the legal literature scale to determine the issue of risk allocation on the basis of economic analysis, this thesis intends to examine the problem of the risk of the forgery of signatures in the context of negotiable instruments. It intends to determine the efficient manner in allocating the risk under consideration. It intends to examine the attitude of the Anglo-American and the Continental Geneva legal systems in allocating the said risk. Ultimately, it intends to determine the compatibility of the attitude of the legal systems under consideration with the proposed risk allocation rule.

The value of this work is of relevance in the context of the European Economic Community (E.E.C.). It supplements the harmonisation process in the said community. The objective of harmonising the rules of law is significant in the commercial context. It reduces the element of uncertainty among the members of the commercial community. Accordingly, the objective of harmonising the rules of law in the commercial context facilitates the engagement in commercial transactions. Such an objective is essential for the introduction and promotion of a single European market. It enhances the efficiency of such an institution.

A significant ingredient in shaping an efficient market is the introduction of an efficient finance instrument. This is because the finance instrument is the means through which the monetary obligations arising from the engagement in the market are settled. Since negotiable instruments are a significant finance instrument, the rules regulating their dealings must be efficient. They should be designed toenable such documents to fulfil their intended function. It is submitted that the reules relating to the allocation of the risk of the forgery of signatures play an important role in determining the nature of negotiable instruments. Ultimately, the rules under consideration are relevant in determining the efficiency of such documents. There, in order to prescribe an efficient negotiable instrument, the rules regulating the allocation of the risk of the forgery of signatures should be efficient. They should be designed to promote the economic function of negotiable instruments.

From the foregoing, it could be concluded that the formation of an efficient rule in allocating the risk of the forgery of signatures enhances the efficiency of the market. Thus, it is hoped that this enquiry would be taken into consideration at the European Economic

Community level. Such an attitude would go along with the intention to introduce a single European market as well as the desire to introduce a single European currency.

CHAPTER ONE

BACK NOTES - (1.-45.)

1. See for example Rifaat Abadiri Alawraq Altijaria Fil Alqanun Alkuwaiti, (1981), p.6, Kuwait University Press.

2. See for example Holdsworth, History of English Law, Holden, The History of Negotiable Instruments in Early English Law. (1955).
Beutel, F.K., The Development of Negotiable Instruments in Early English Law, (1937-38), 51 Harv. L. Rev., 813.

3. For the variant implications concerning negotiable instruments which occurred in the 17th-18th centuries, see pp. 223-231 infra.

4. The codifications relating to negotiable instruments which were promulgated in the 19th century were the French Code de Commerce 1807
the Allgemeine Wechselorelnung 1869 applying to the North American Confederation, 1869 Bundesgesetyblatt 379 and applying to the German Reich 1871, Bundesgesetyblatt 63, the English Bills of Exchange Act 1882, 45 & 46 Vict. and United States Uniform Negotiable Instruments Law 1896.

5. For a general background concerning the international endeavours to unify the laws relating to negotiable instruments see Hudson & Feller, The International Unification of Laws Concerning Bills of Exchange, (1931), 44 Harv. L. Rev. 333.

6. For the failure of the Hague regulations to be approved as a uniform law see Report of Jitta, submitted to Economic Committee, League of Nations, L.N. Doc. No. C, 487, M203 1923 II, pp.20-31.

7. L.N. Document No. C 487, M203 1923 II. Members of the experts team were Sir McKenzie Chalmers (Great Britain), Prof. J. Jitta (Netherlands), Prof. Fray Klein (Austria) and Prof. Ch Lyon Caen (France).

8. Ibid.

9. See - Report of Sir McKenzie Chalmers submitted to Economic Committee of League of Nations, L.N. Document No. C 487 M203 1923 II, p.97 et seq.

10. Ibid. p.100 et seq. The representative of the U.S.A. to the Hague Conference 1910-12 was F. Huth Jackson.

11. The members of the experts team were,
Percerou (France), Flotow (Germany),
Hermann - Otavsky (Czechoslovakia), Janne (Belgium),
Sulkowski (Poland), Vischer (Switzerland),
Vivot (Argentina), Weiller (Italy).
L.N. Document No. C 234 M83 (1929) II.

12. Geneva Convention No. 3313.

13. Geneva Convention No. 3314.

14. Geneva Convention No. 3315.

15. Geneva Convention No. 3316.

16. Geneva Convention No. 3317.

17. Geneva Convention No. 3318.

18. France ratified the said conventions by the legislative decree of 1935.
Germany ratified the conventions by the law of 1933.

19. 45 and 46 Vict.

20. Sir McKenzie Chalmers, Digest to Bills of Exchange, 3rd Edit. Introduction.

21. Section 19 of the 1853 Stamp Act reads,
"Provided always that any draft or order upon a banker for a sum of money payable to order on demand which shall when presented for payment purport to be indorsed by the person to whom the same shall be drawn payable, shall be a sufficient authority to such banker to pay the amount of such draft or order to the bearer thereof: and it shall not be incumbent on such banker to prove that such indorsement or any subsequent indorsement was made by or under the direction of or authority of the person to whom the said draft or order was or is made payable either by the drawer or any indorser thereof."

22. Section 82 B.E.A. reads,
"Where a collecting banker in good faith and without negligence receives payment for a customer of a cheque crossed generally or especially to himself and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment."

Section 4 of 1957 Cheques Act reads in part,

"4(1) Where a banker in good faith and without negligence
(a) receives payment for a customer of an instrument to which this section applies or
(b) having credited a customer's account with the amount of such an instrument, receives payment thereof for himself

and the customer has no title or a defective title to the instrument, the banker does not incur any liability to the true owner of the instrument by reason only of having received payment thereof ...".

23. For example see Byles, Bills of Exchange (1985) 25th Edit. p.292.

24. The draftsmen of Article 3 U.C.C. were J. Prosser, President and Fairfax Leary, Assistant.

25. See Fairfax Leary, Commercial Paper. Uniform Commercial Code Handbook (1964), p.87.

26. cf. General Assembly Official Records Supplement 18, (1969) pp.19-27.

27. For a brief account of the legislative history of the Unification of the laws relating to Bills of Exchange, Promissory Notes and Cheques,
cf. Vis, Unification of the Law of Negotiable Instruments - The Legislative Process, (1979), Am. J. Compl. L., 507.
Blomquist, The Proposed Uniform Law on International Bills of Exchange and Promissory Notes, A Discussion of Some Special and General Problems Reflected in the Form and Content, Choice of Law and Judicial Interpretation, Articles (1979) Cal. W. Int. L.J. 30.
Dohm, Draft Uniform Law on International Bills of Exchange and International Promissory Notes (1973) Am. J. Comp. L., 474.

28. cf. General Assembly official records Supplement 17, (1972) pp.30-33.

29. See U.N. Doc A/CN.9/W.G.IV/WP2(1972)
U.N. Doc A/CN.9/W.G.IV/WP6(1977)
U.N. Doc A/CN.9/W.G.IV/CRP11(1977)/

30. cf. General Assembly Official Records Supplement 17, (1980) pp.8 & 9,.

31. cf. U.N. Doc A/CN.9/211, A/CN.9/212, A/CN.9/213, A/CN.9/214.

32. cf. General Assembly Official Records Supplement 17, (1984).

33. cf. U.N. Doc A/CN.9/273, A/CN.9/274, A/CN.9/288.

34. The resolution by virtue of which the United Nations General Assembly approved the Draft Convention on International Bills of Exchange and International Promissory Notes is resolution no.43/165 9th December 1988.

35. The only country which ratified the Convention on International Bills of Exchange and International Promissory Notes is Canada. It deposited its document of ratification on 7 December 1989.

36. For a detailed consideration of the impact of forged signatures on the function of negotiable instruments and the rights and liabilities arising from such documents see pp.205-223 infra.

37. For a detailed account of the historical evolution of the manner of allocating the risk of the forgery of signatures see pp.223-231 infra.

38. The representatives of the Federal Trade Commissioners proposed three rules in respect of negotiable instrument transactions - these were as follows,

36 Fed. Reg. 1211 (1971)
38 Fed. Reg. 892 (1973)
40 Fed. Reg. 53,506 (1975).

The purpose of these rules was to afford the consumer who issues negotiable instruments, adequate protection against the seller's default in performing his obligations. The protection is illustrated in denying the related or referred financier, the holder in due course status. Thus, any risk arising from the seller's default will be allocated to the financier.

39. Almost every state in the U.S.A. has a consumer credit protection code. For example Iowa Code 537,3307 (Supp. 1978-79). Similar to the individual state codes is the Uniform Consumer Protection Ac 15 USC 1601-1693 (1982). Like the Federal Regulation J. the UCCC is of a limited application. It applies when the financier who purports to claim the holder-in-due-course status is related to his assignor i.e. transferor, or he is engaged with the latter in a deferral plan.

40. The National Conference of Commissioners on Uniform State Law assigned the duty to draft a new payment code, aimed at protecting consumers engaged in the making of negotiable instruments to an independent committee. The said U.N.P.C. failed to obtain support in its final versions.

For a general outline of the U.N.P.C. see -

Ellis, The Uniform New Payments Code, (1986), 23 Am. Bus. L.J., 617.

Benfield, The New Payments Code and the Abolition of the Holder in Due Course Status, (1983), 40 Washington and Lee L. Rev.

41. A final text of the New Articles 3 and 4 U.C.C. is not available. A first hand draft of the said articles could, however, be obtained from the American Law Institute (A.L.I.).

42. Section 123 of the Consumer Credit Act (1974) restricts the negotiation of cheques or the issuance of other forms of negotiable instrument as between the consumer, issuer and the supplier, payee. By virtue of Section 126, if the supplier violates the agreement between himself and the consumer, by negotiating the cheque or instrument in question, as the case may be, to a bona fide third party other than a bank, the latter may obtain the holder in due course status. Accordingly, he may enforce the instrument against the consumer, notwithstanding that the consumer may possess defences against the third party's transferor i.e. the supplier.

43. cf. The report of the Review Committee on Banking Services (1989) Cm 622 Ch.6.

44. See, in general
J.P. Brown, Toward an Economic Theory of Liability (1973) J. Leg. Studs., 323.
R.A. Posner, A Theory of Negligence, (1977), J. Leg. Studs., p.29 et seq.
R.A. Posner, Economic Analysis of the Law, (1972), 2nd Edit.
As far as specific topics which have been subjected to economic argument as a justification for the problem of risk allocation see, in particular,
G. Calabresi, The Cost of Accidents (1970).
D.S. Kitchens, The FTC's Holder-in-due-Course Rule, An Ineffective means of Achieving Optimality in the Consumer Credit Marker (1978), UCLA L. Rev., p.821 et seq.
Implied Consumer Remedy under the FTC Trade Reg. Rule, (1977), U.P.A. L. Rev., p.876 et seq.
D. L. Goldstein, The Buyer Secured Party Conflict and Sec. 9-307 1) U.C.C., (1982), Fordham L. Rev., p.657 et seq.

45. See n.38-42 above.

CHAPTER TWO

THE LIABILITY ON NEGOTIABLE INSTRUMENTS.

INTRODUCTION

(i) The concept of negotiable instruments is of a wide application. It involves every document that features three distinctive and inter-related attributes. Firstly, the holder of the document in question possesses an enforceable right in his own name. Secondly, the prima facie regularity of the document relieves the holder of the burden of establishing his claim, and finally, the holder of the document possesses a perfect and unimpeachable title.[1] The latter attribute is the most significant attribute of all. Its application distinguishes negotiable instruments from other forms of chose in action.

Two types of documents could, in the light of the foregoing application, qualify as negotiable instruments, viz. **"documents of title"** and **"money documents"**. Examples of the former are the bill of lading and warehouse receipts. Examples of the money document are bills of exchange, share certificates and treasury bills.

The main distinction between the above two mentioned types of documents lies in the right incorporated in the document in question. The document of title e.g. bill of lading, incorporates an obligation to deliver tangible property to a third party i.e. the consignee. The possession of the document in question conclusively presumes in favour of its lawful possessor, his entitlement to the said property. Thus the lawful possessor, i.e. holder of the bill of lading, may force the carrier, i.e. the issuer of the bill, to deliver to him the specified property.[2]

The money document, by comparison, incorporates a monetary obligation. The issuer of the document promises to pay to a third party a specified sum of money or arranges with another that payment of a specified sum of money shall be made in favour of a third party.[3] The possession of the money document conclusively presumes in favour of its lawful possessor, i.e. holder, a property right to the document. Accordingly the lawful possessor may force the issuer, or any other person to whom the payment order is directed, to make payment to him. The possessor, i.e. holder of the document, establishes a property right to the monetary claim incorporated in the document in question.

Notwithstanding the above distinction, the two types of document are deemed to qualify as negotiable instruments, in the sense mentioned above.[4] The holder of the document, be it a money document or a document of title, possesses an interest enforceable in his own name, a prima facie presumption of regularity and an unimpeachable title to the document in question.

(ii) By comparison with the wide application of the concept of negotiable instruments, the term under consideration, in this thesis, involves a narrower application. The concept of negotiable instrument, in its strict sense, is used to connote what the modern literature terms "commercial paper".[5] Generally speaking, a commercial paper could be defined as an unconditional promise or order in writing, to pay a third party a specified sum of money, on demand or at a future time.

The narrow application of the concept of negotiable instruments necessarily excludes documents of title. The obligation incorporated in documents of title is not monetary in nature. The issuer of the document in question undertakes to deliver the shipped property to the named consignee, or to any person to whose favour the delivery order is directed, i.e. the holder of the document.

Furthermore, for a document to qualify as a commercial paper, i.e. a negotiable instrument in the strict sense, the general mercantile custom of the land must accept the document in question as a commercial paper. The mercantile custom is deemed to be the determinative factor as to the admissibility of the various forms of commercial paper; it is submitted to be the creative source of such documents. Although share certificates, treasury bills and other securities might satisfy the general definition of negotiable instruments in the strict sense, they might not, in the eyes of mercantile custom, qualify as commercial paper.[6] Thus the main characteristic of negotiable instruments i.e. the fact that the holder of the instrument obtains an unimpeachable title (so termed the negotiability characteristic), may be subject to limitations which may not be applicable had the instrument in question been interpreted as commercial paper.[7]

(iii) Some doubts have been cast upon personal cheques, bills of exchange and promissory notes as proper negotiable instruments in the strict sense of the term.[8] The essence of these doubts is based upon comparing negotiable instruments with real money. Negotiable instruments in this sense are confined to those documents the purchasing power of which is definite. That is to say that for a document to satisfy the true definition of negotiable instrument the enforcement of the monetary claim incorporated in it must be certain and absolute.[9] Personal cheques, bills of exchange and promissory notes are not negotiable instruments in this sense. Their enforcement could be disturbed by the occurrence of various events, e.g. the issuance of cheques etc. against insufficient or non-existing funds, and the issuance of stop payment orders. Negotiable instruments, in the suggested sense of the term, as could be noted from the foregoing, would be confined to bank notes, cashiers cheques and other analogous instruments.[10]

To approach a proper conception of the term negotiable instruments, reference to this effect should be made to the creative source of such documents i.e. the general mercantile custom. It is by no means evident that merchants, through the practice of whom the mercantile custom was established, have intended that the concept of negotiable instruments shall denote real money. Had the merchants designed such intention, the purpose of facilitating the transmission of money would fail. The instances in which money would be easily transferable would have been severely limited, especially in the period when the business of banking had not taken its proper shape.[11]

In conclusion the term negotiable instrument, as used in this thesis, and upon which the essence of this thesis is based, will be construed in its proper restricted application i.e. to denote commercial paper.

The Creation of Negotiable Instruments

The creation of negotiable instruments in the proper strict sense presupposes the existence of one or more independent transactions. The number of the presupposed transactions varies according to the form of the instrument involved. If the instrument in question was a simple two party document, such as an ordinary promissory note, one independent transaction underlies the creation of the instrument. If, however, the instrument involved was a three party document such as a cheque, bill of exchange or a domiciled promissory note,[12] two independent transactions would underlie the creation of the instrument in question.

In both instances, the presupposed transaction or transactions, such as a contract of sale, give rise to a debtor/creditor relationship, the primary obligation of which is to pay a fixed sum of money. By way of discharging the underlying monetary obligation, the debtor in the independent transaction issues, accepts or indorses a negotiable instrument. By engaging on the instrument, the debtor **"promises"** to pay or **"undertakes"** the payment of the instrument, the face value of which is equal to the original debt arising from the underlying independent transaction e.g. the contract of sale. The said undertaking, in order to discharge the underlying obligation, runs in favour of the creditor.

In the two party form of instrument, where a single independent transaction underlies the creation of the instrument, the debtor in the independent transaction, by way of discharging his underlying obligation, issues the two party instrument, e.g. promissory note in favour of his creditor. The debtor's engagement on the instrument takes the form of **"making"**.[13] His signature operates in two capacities, namely, issuance and acceptance. By virtue of the latter, the obligor undertakes to pay the instrument on its day of maturity.

In the three party form of instrument, by comparison, where two independent transactions underlie the creation of the instrument, the creator, i.e. issuer of the instrument, acts in a double capacity if the two independent transactions are taken together. He, in one of them acts as a creditor, whilst he acts as a debtor in the other. In his capacity as a creditor, the issuer draws a bill of exchange or cheque on his debtor, e.g. a bank. In his capacity as a debtor, he negotiates the bill or cheque, as the case may be, to his creditor, whereby the latter becomes the beneficiary, i.e. "**payee**". Thus, in the three party instrument, the issuer must always be in credit. He must put the person upon whom he intends to draw the instrument in funds. However, by issuing the instrument in question the issuer or drawer engages to secure the payment of the instrument to the payee i.e. beneficiary. That is to say that the issuer/drawer guarantees that the "**drawee**" shall honour the instrument. Should the latter fail, the issuer undertakes to pay the payee the face value of the instrument, plus any incurrable expenses.[14]

The Relationships arising out of the Creation of Negotiable Instruments

The relationships arising out of the creation of negotiable instruments are closely connected with those arising out of the independent transactions underlying the creation of such documents. Thus, in instances of the two party instrument, the relevant relationship is that between the maker of the instrument and its payee. Since the making of the instrument necessarily incorporates its acceptance, due to the double capacity of the issuer as a maker and acceptor,[15] a direct relationship is created between the maker and the payee. It is analogous, but supplementary to that established in the independent underlying transaction. That is to say, that a debtor/creditor relationship is created by virtue of the making. The maker accepts to pay the payee a fixed sum of money on the day of maturity.

As to the three party instrument, a distinction must be made between **"immediate"** and **"remote"** parties. The determinative factor in this connection is, again, the independent transactions underlying the creation of the instrument in question. The parties are deemed to be immediate if there is a direct relationship connecting them. If, by comparison, no direct relationship exists, the parties in question are deemed to be remote. Since the two independent transactions underlying the creation of the three party instrument are independent, the direct relationship evolving from the issuing or drawing is confined to that between the drawer and drawee on the one hand and to that between the drawer and the payee on the other. Here too, the relationship in both instances is of a debtor/creditor nature. In the first, the drawer is the creditor whilst the drawee is the debtor. In the second, the drawer is the debtor whilst the payee is the creditor. Since, due to the independent nature of the underlying transaction, the drawee and payee are remote, no relationship could be established between them. The only remedy according to which the payee may force the drawee to make payment, is to base his cause of action on the negotiable instrument. This would not be established unless and until the drawee accepts the instrument.[16] The act of acceptance creates a direct relationship vis-à-vis the drawee and the payee, whereby the former undertakes to pay to the latter the instrument.[17] That is to say, by virtue of the acceptance, a debtor/creditor relationship between the drawee and the payee comes into existence.

The Liability on the Underlying Obligation

From the foregoing, it could be noted that negotiable instruments are means of securing payment. They operate as a means of discharging monetary obligations arising out of independent transactions. The debtor in a particular transaction transfers his monetary claim against his debtor in the said transaction to his creditor in another transaction. The monetary obligation on the instrument is a mere representation of the monetary obligation created by the independent transaction.

Since the creation of a negotiable instrument presupposes the existence of an independent transaction or transactions, it is essential to examine in particular the relationship between the obligations arising from the independent transaction or transactions, with that arising from the negotiable instrument transaction.

The Nature of Negotiable Instruments

The nature of negotiable instruments can be realised by making reference to their creative source, i.e. mercantile custom.[18] Merchants, through their practice, noted the risk of theft involved in the transmission of money. Their bilateral engagements, especially on the international sphere became, accordingly, vulnerable to the evolving risk. To promote international trade, it was felt that a substitute for money was essential. For the intended creation to fulfil its intended function, it had to possess some of the attributes of money. In particular, the intended creation had, firstly, to be freely transferable and, secondly, it had to operate as a means of discharging monetary obligations.

Bills of exchange were elected to serve the above mentioned function. The historical evolution of negotiable instruments clearly illustrates the bill of exchange's transformation of function in international trade. In the early stages, bills of exchange were used to facilitate foreign exchange transactions. A merchant who intended to do business in one locality arranged with a money exchanger in his locality to provide money in the currency of the former locality, to an amount equal to a specified sum of money. The exchanger, upon receipt of the money intended to be exchanged ordered, in writing, his agent based in the locality to which the merchant intended to travel, to make payment to the latter of a sum of money in the currency of that locality, equal to the sum of money deposited with him i.e. the exchanger.[19]

At present, bills of exchange are vested with the payment attribute. They are used to facilitate international sale contracts. The overseas seller, by way of securing the proceeds of the sale, i.e. the price of the sold goods, draws a bill of exchange payable to his order and presents it to the corresponding bank for payment, acceptance or guaranty. In instances where the bill was payable at a future date, the bank's acceptance served as a security to the seller. Thus, if he elects to cash the bill before its day of maturity, he may discount it with a third party, or he may use it as security in a back-to-back credit.

To state the obvious, the function of the bill of exchange in the early history and its function in the international sale contract are not synonymous, although they are both presumed to facilitate international trade. In the early part, the function of the bill of exchange was to exchange one specie of a particular genus for another specie of the same genus. That is to say that the bill of exchange operated to exchange money in one currency for money in another currency. In the international sale contract, the function of the bill of exchange is to secure payment of the price of the sold goods. The acceptance or guaranty of the corresponding bank enables the payee i.e. drawer/seller to transform the bill of exchange into money immediately, or use it as security, i.e. to attribute to it the characteristics of money.

A further illustration of the negotiable instrument's payment attribute is its capacity of being liquidated into money immediately. Cheques are the common types of such instruments. They are firstly drawn on a bank and secondly they are payable on demand. Cheques are submitted to be an offspring of bills of exchange, the first known form of negotiable instrument among merchants.[20] However, bills of exchange may also be liquidated into money immediately. Like cheques they may be drawn on a bank and payable on demand.[21] A common type of such an instrument is the domiciled bill.[22]

Although negotiable instruments are intended to substitute money, the resemblance between the two instruments is not absolute. There are two major distinctions between negotiable instruments and money.[23] In the first place, money possesses an absolute and certain purchasing power. The possessor may realise the credit incorporated in it exclusively to his favour. The holder of a negotiable instrument, by contrast, might not possess an identical right. His right of enforcement could be frustrated by the interposition of defences and claims or by the issuance of stop payment orders.[24]

In the second place, money affords in favour of its tenderer an absolute discharge. It is deemed to be the legal tender of the land. The acquirer of money forfeits his rights of recourse against the giver. By comparison, the tenderer of a negotiable instrument does not establish in his favour an absolute discharge. Negotiable instruments are not legal tender. Their acquisition suspends the operativeness of their discharge until their date of maturity. If the instrument was finally paid, the obligations incorporated in the instrument would be discharged. The effect of their discharge runs retroactively to the day of engagement. Since the obligations on the negotiable instruments are the creation of obligations incurred under an independent transaction, the discharge on the instrument would normally discharge the obligation incurred in the independent transaction.[25]

If, however, the instrument in question was dishonoured, the obligation incurred on it, as well as on the independent transaction, revives.[26] The holder then possesses two causes of action against his immediate transferor. The first is based on the negotiable instrument, whilst the second is based on the independent transaction.

The thesis underlying the creation of double cause of action in favour of the holder of a negotiable instrument is twofold:

1) to afford the creditor a second chance to protect his claim. For an example, if the time allowed for suing on the instrument was barred, the holder/creditor may be successful in resting his action on the original obligation, which time of prescription is normally longer,[27] and

2) to avoid the occurrence of unjustified enrichment.

Unjustified enrichment occurs if the party liable on the instrument was afforded an absolute discharge by reason that the holder fails to enforce his instrument within the time prescribed. The absolutely discharged party in this instance would then be allowed to receive value, i.e. consideration, without giving something in return. He would be allowed to keep the purchased value of the instrument upon which he engaged, as well as the monetary credit incorporated in it, against which the holder fails to satisfy his interest timely, where, by contrast, the defaulting holder would be deprived of the value which he offers as a consideration for the purchased instrument, as well as the monetary credit incorporated in it. The exchange of consideration is essential in bilateral contracts, such as negotiable instruments. The consideration of one party is presumed to be the inducement for the other party's promise to perform.[28]

Nevertheless, there are instances whereby the holder of the instrument would be deprived of the availability of double cause of action in the event of non-payment. The obligation incurred under the independent transaction could be impaired by virtue of the effect inflicted upon the obligation incurred on the negotiable instrument. The discharge of the latter may discharge the former. The focal issue of these instances is the injurious misbehaviour of the holder towards the party against whom the right of recovery is sought to be enforced.[29]

Since the obligation incurred under the independent transaction and the obligation incurred on the instrument are inter-related it would be in order to examine the liability established on negotiable instruments.

The Liability on Negotiable Instruments

The liability on negotiable instruments may be divided into **"primary"** and **"secondary"** liability.

Primary Liability

(i) The term primary liability has different connotations. It could mean that liability which is attached to the principal debtor in the transaction in question. In other words, the primarily liable person is the ultimate debtor who cannot recoup his losses from any other party in the transaction. For an example, the drawer of a negotiable instrument is primarily liable on it if he fails to make the fund from which the instrument is to be paid, available in the hands of the drawee.

The term primary liability could also mean that liability which is attached to the person from whom creditors seek their debts, without following procedural requirements for establishing their claims against the debtor. For an example, the acceptor and maker of a bill of exchange and promissory note respectively, are primarily liable on the bill or note. The payee/creditor or holder may proceed against the said acceptor or maker, notwithstanding the observance of the statutory duties of presentment, drawing up protest or giving notice of dishonour. Their liability crystallises on the day on which the instrument falls due.

(ii) The two senses of primary liability need not, however, be present in one person simultaneously. He could be primarily liable in the first sense, but not the second and vice versa. For an example, the drawer of a bill who fails to make funds available in the hands of the drawee is not primarily liable on the instrument, as far as the Geneva legal group is concerned. Article 53 of the G.U.L. (Bills) expressly dismisses the right of the negligent holder who fails to procure timely presentment, protest and notice of dishonour, of recourse against the drawer.[30]

This article reads in part ...

"After the expiration of the time limits fixed:
for the presentment of a bill of exchange drawn at sight or at a fixed period after sight,
for drawing up the protest for non-acceptance or non-payment,
for presentment for payment in the case of a stipulation 'retour sans frais'
the holder loses his rights of recourse against the indorsers, against the drawer and against other parties liable, with the exception of the acceptor ...."

By contrast, the accommodation party in the case of an accommodation instrument is primarily liable in the second sense, despite the fact that he is not the principal debtor, as between himself and the accommodated party. The accommodation acceptor is deemed to be primarily liable on the instrument as between himself and the holder of the instrument. The latter may proceed against the former, notwithstanding the observance of the statutory duties mentioned above.[31]

(iii) In the context of negotiable instruments, the concept of primary liability denotes the second sense of the term, i.e. to that attached to the party against whom the enforcement of the instrument is initially demanded. Such interpretation approaches a compatible and uniform application. On the one hand, there are instances, due to the special nature of the instrument involved or due to a special arrangement, whereby the principal debtors are deemed by law or by agreement to have intended themselves not to be bound primarily on the instrument, such as the drawer of a cheque and the drawer of an accommodation instrument.[32] Their engagement on the instrument, as drawers for example, manifests their intention, in the light of the special circumstances to provide a security in their favour and ultimately stand in a suretyship status.

On the other hand, the four corners of the instrument do not, it is submitted, name the principal debtor. Its appearance prima facie implies that the drawer is secondarily liable. For the holder to preserve his right of recourse against all signatories, he, in practice, proceeds initially against the drawer. When and only when the instrument is dishonoured, the true identity of the principal debtor may be revealed. Accordingly, the relationship between the holder of the instrument and the latter may be formulated

Secondary Liability

Secondary liability is the liability which is attached to parties who are liable when and only when the primarily liable party does not meet his obligation.

The liability of the drawer, generally speaking and the indorsors of a negotiable instrument is an illustration of secondary liability. It is not called into question unless and until the holder of the instrument first proceeds against the primarily liable party e.g. the drawee.[33] However, the initial recourse against the primarily liable party does not suggest that the holder must exhaust all available remedies against the primarily liable party, in order to exercise his right of recourse against the drawer and other indorsors, i.e. the secondarily liable parties. A demand of payment and subsequent refusal by the primarily liable party is sufficient to raise the liability of the drawer and indorsors.

Finally, in order to enforce the liability of the secondarily liable parties, the holder must show that the initial demand for payment from the party primarily liable has been met with refusal, and should communicate such refusal to the party whose liability is intended to be enforced. Thus, the legal systems under consideration impose upon the holder statutory duties to that effect. The holder must draw up a certificate of protest and/or give notice of non-payment. The failure to observe the said duties could cost the holder's forfeiture of his negotiable instrument remedy.[34]

Primary and Secondary Liability Distinguished

The difference between primary liability and secondary liability is that persons under the second form of liability stand as sureties. They are liable only when the primarily liable party fails to honour the instrument presented to him, and in the second place their liability is only called into question when the holder carries out his obligations i.e. presentment, protest and giving notice of dishonour. Whereas the primarily liable party is liable, notwithstanding the observance of the duties set out above.

The Status of the Parties to Negotiable Instruments

A person becomes a party to a negotiable instrument by expressing his engagement. The manner by which engagement on a negotiable instrument is expressed is the fixing of signature or other equivalent act.[35] Signatures appearing on negotiable instruments may take various forms. They may take the form of making, issuance, drawing, indorsement or even acceptance. Each of these signatures imposes upon the signatory in question certain liability. The type of the liability involved depends on the status of the signatory in question. As to the indorsors and acceptors, it is submitted that the former undertake secondary liability, whilst the latter undertake primary liability.[36] As a result, indorsors stand in a suretyship capacity. Their liability does not crystallise until the principal debtor refuses payment. Acceptors, by comparison stand as principal debtors. Their liability remains operative either to the holder or to the surety payor, until the former, i.e. the principal debtor, pays the instrument.

The status of the maker and issuer of negotiable instruments is not as obvious as the indorsor's or acceptor's. Their status varies according to the type of instrument involved. The maker and issuer of a negotiable instrument are collectively referred to in this chapter as the drawer.

The Status of the Drawer of a Promissory Note

The drawer of a promissory note is commonly known as the **"maker"**. A promissory note is defined as an unconditional promise in writing, undertaken by one person, to pay a certain sum of money on demand or at a determinable future time, to, or to the order of a specified person, or bearer.[37] It is notable from this definition that the promissory note involves two parties, namely the maker of the promise and the beneficiary, i.e. the payee. Unlike the bill of exchange and cheque, there is no third party on whom the note could be drawn. The maker issues the note and promises to honour it at its date of maturity. Thus the issuance and payment of a note is entertained by one person only viz. the maker. Thus it is submitted that the maker of the note assumes primary liability. In his capacity as the issuer and the acceptor, the maker firstly becomes the principal debtor on the note and secondly, the holder need not observe the statutory duty, in order to preserve his right of recourse against him. The liability of the maker is established on the day on which the note falls due.

Nevertheless, the maker of a note could assume secondary liability in one instance only. The maker of a note may stipulate that the note shall be paid at the locality of a third party. This is known as the **"domiciled note"** It is substantially similar to the domiciled bill mentioned above.[38] There, the liability of the acceptor is shifted from primary to secondary liability, whereas in the case of a domiciled note it is the liability of the maker which is shifted. In this instance, the maker acquires the advantages of parties secondarily liable.[39]

The Status of the Drawer of a Bill of Exchange

(i) A bill of exchange is defined as an unconditional order in writing, signed by the drawer addressed to another, directing him to pay to a third party a specified sum of money on demand or at a future time.[40]

For one person to draw a bill of exchange on another, he must be in credit as to the latter. The basis of the said credit could be **"causal"** or **"depository"**. Examples of the former are the contract of sale or loan, whereby the intended drawee becomes indebted to the supposed drawer for a sum of money equal to the face value of the bill intended to be issued. An example of the depository basis is the contract of deposit between a bank and its customer, whereby the latter puts the former in fund to an amount equal to the face value of the instrument intended to be drawn.

If there was no credit available in the hands of the intended drawee, there would be no basis, in the absence of a special arrangement, to expect that the intended drawee shall honour the supposed drawer's payment order. The supposed drawer, in this instance, occupies the status of the principal debtor. His engagement on the bill imposes upon him primary liability. Thus, the holder of the bill may exercise his right of recourse against the drawer, notwithstanding the compliance with the statutory duties of prompt presentment, drawing up protest and giving notice of dishonour.

The Anglo-American and the Continental Geneva legal systems are in agreement that the defaulting holder, in the instance under consideration, does not forfeit his right of recourse against the drawer. His right of recourse against the drawer is preserved either on the basis of the bill of exchange or on the basis of the general provisions of the law. Examples of the former are Section 46 B.E.A. and Article 170 of the French Code de Commerce. Section 46 reads in part:

> "....
> (2) Presentment for payment is dispensed with
> (c) As regards the drawer when the drawee or acceptor is not bound as between himself and the drawer, to accept or pay the bill and the drawer has no reason to believe that the bill would be paid if presented."

Article 170 reads:

> "La meme déchéance a lieu contre le porteur et les endosseurs à l'égard du tireur lui-même, si ce dernier justifie qu'il y avait provision a l'échéance de la lettre de change ...".

An example of the right to exercise the right of recourse based on the general provisions of the law is the German legal system. By virtue of Article 53 of the 1933 law the holder forfeits his right of recourse against the indorsors as well as the drawer, if he fails to comply with the duty of making timely presentment and drawing up protest.[41] Nevertheless, the holder may, on the basis of the concept of unjustified enrichment, have recourse against the drawer who does not make the fund from which the bill is to be paid, available in the hands of the drawee.[42]

(ii) The drawer's status shifts into a party secondarily liable if, by comparison:

1) the drawer makes the fund from which the bill is to be payable, available in the hands of the intended drawee, or

2) secures in a special arrangement the acceptance of the intended drawee.

Making funds available in the hands of the drawee signifies the existence of a credit in favour of the drawer. It illustrates the drawer's desire to discharge his monetary obligation by way of assigning his monetary right to his creditor against his debtor. If the holder were to ignore the drawer's instructions, the holder's conduct would, firstly, render the purpose of issuing negotiable instruments as a means of assigning debts, superfluous and secondly, it would create a situation of multiplicity of action.

Two actions would be needed to settle the monetary obligation incorporated in the instrument. The first is based on the holder's right of recourse against the drawer, whilst the second is based on the drawer's right of recourse against the principal debtor, i.e. the drawee.

If, by comparison, the holder was bound to proceed initially against the drawee, the actions involved in settling the monetary obligation could be condensed into one, namely, that based on the holder's right of recourse against the drawee immediately.

(iii) The acceptance based on a special arrangement is illustrated in the accommodation bill situation. This occurs when a person lends his name to another for the purpose of assisting the latter to raise money. The accommodated party draws a bill of exchange on the accommodation party, who fixes his acceptance in order to facilitate the negotiation of the bill and ultimately the raising of money.

To illustrate, assume that John Alex is the sole owner of a small brewery. John Alex intends to buy modern machinery to promote his business and compete in the market. Due to his financial instability, the bank refuses to lend him money. To secure the bank's loan, the applicant, John Alex must provide a security to the bank. The deposit of a simple bill of exchange would not satisfy the bank. Since the drawer is financially unreliable his engagement on the bill does not serve as a security. Thus, the drawer, John Alex may provide the necessary security by arranging with a reputable merchant to fix his acceptance on the bill. The bank may then accept to take the bill as a security for a loan. If the drawer does not pay the bill on the day of maturity, the bank may proceed against the reputable merchant/acceptor immediately. The latter's acceptance affords the bank, i.e. the holder, a primarily liable solvent party from whom it can satisfy its interest.

The reputable merchant in the above illustration is the accommodation party. The drawer, John Alex, is the accommodated party. Although the acceptor does not receive consideration from the drawer, his acceptance imposes upon him primary liability as between himself and the holder, who upon the former's acceptance, took the instrument. By comparison, although the drawer did not provide funds with the drawee, he possesses secondary liability as between himself and the holder. The latter, accordingly, may not proceed against the former unless and until he initially proceeds against the drawee/acceptor. In the event of non-payment, he must observe the statutory duties of drawing up protest and/or giving notice of dishonour.

The Status of the Drawer of a Cheque

A cheque is a bill of exchange payable on demand and drawn on a bank.[43] The deposit of money with a bank gives rise to a dual relationship as between the bank and its customer/depositor. In the first place, by crediting a sum of money with the bank, a creditor and debtor relationship is created. The bank is deemed to be the debtor, whilst the customer is deemed to be the creditor.[44] In the second place, by withdrawing the credited money by way of issuing a negotiable instrument, an agency relationship is created. The bank is deemed to be the agent, whilst the customer is deemed to be the principal.[45] By honouring the issued cheques, the drawee bank is presumed to appropriate so much money of the customer's credit equal to the face value of the instrument, to discharge the latter. In effect, the proceeds of the paid instrument are deemed to be the property of the customer.

Due to the special nature of the relationship vis-à-vis the bank and its customer, it is arguable that the drawer of a cheque possesses a primary liability. Since the funds against which he draws his cheques are deemed to be his, he is presumed to be the principal debtor in the negotiable instrument transaction.

To state the obvious, the concept of primary liability in the context of negotiable instruments in general, need not necessarily be acquainted with the principal obligor. There are instances in which principal debtors are released from the burden of primary liability. Their liability on the instrument does not crystallise on the day of maturity per se. The holder should observe the statutory duties of presentment, drawing up protest, and/or giving notice of dishonour.[46] On the contrary, primary liability could be attached to persons not intended to engage on the instrument in question. Primary liability, in the context of negotiable instruments, as has been indicated above,[47] is attached to a person whose liability is called into question per se on the day when the instrument falls due.

The primarily liable party thus is 1) the acceptor and 2) the drawer, who fails to provide funds with the drawee.

The drawer of a cheque is not primarily liable in this sense. His provision of funds with the bank affords him an immunity from the burdens of primary liability. The drawer of a cheque, like his counterpart in bill of exchange transactions, occupies a secondary liability. His liability does not crystallise unless and until the holder observes the statutory duties of prompt presentment, drawing up protest and/or giving notice of dishonour.

The Essence of Liability on Negotiable Instruments

Negotiable instruments are money documents. Their creation is a fulfilment of the desire to discharge monetary obligation arising out of the independent transaction. Like the independent transaction, the principal obligation incorporated in the negotiable instrument is the payment of a specified sum of money.

The essence of the said obligation is contractual. The party in question, by virtue of his making, issuance indorsement or acceptance, promises or undertakes to pay the specified sum of money. The legal basis of the said promise or undertaking is the affixing of the signature on the instrument. The act of signing prima facie presumes the signatory's willingness to engage on the instrument in question.

The engagement on the negotiable instrument takes the form of an undertaking, when its performance is primarily intended to be made by other than the signatory. This occurs when the order to pay the monetary obligation is addressed to a third party, i.e. the drawee. In this instance the signatory in question stands as a surety on the instrument. His liability crystallises when and only when the party to whom the payment order is addressed, i.e. the drawee, refuses to honour the mandate.[48] Examples of such signatories are the drawer and the indorsors.

The engagement takes the form of a promise if the incorporated monetary obligation was to be performed by the maker of the promise. By signing, the maker renders himself the principal obligor. His liability crystallises on the day on which the instrument falls due.

The promise or undertaking runs primarily in favour of the **"holder"**. The holder of the negotiable instrument is the party who establishes his possession to the instrument from or through regular or a prima facie regular chain of negotiations i.e. transfers. Thus the holder of a negotiable instrument is its payee, the subsequent possessor to whose order the instrument is indorsed, or the bearer.

The promise or undertaking might run to someone other than the above defined holder. It might run to any person who bona fide pays the holder of the instrument the monetary obligation incorporated in it. Thus, it could run in favour of the prior indorsor who, in the event of recourse against him, was compelled to make payment to the holder.[49] The indorser, by paying, stands in the shoes of the holder. He may recoup the face value of the instrument from the principal obligor or any sureties preceding the payor indorsor.

Finally, the monetary obligation, the performance of which discharges the promise or undertaking incorporated in the instrument is, in principle, the face value of the instrument, i.e. the amount for which the instrument is originally drawn. However, the enforceable monetary obligation could run higher than the face value of the instrument. The added value would normally be the result of the delay in the enforcement of the instrument. Examples of the added value are interest, in instances of delay, and the expenses of drawing up protest or giving notice in instances of non-payment.[50] The party who is entitled to the amount due would be the holder or the bona fide payor acting in a surety capacity.

Discharge of Liability

The liability on negotiable instruments is discharged by 1) making proper payment, or 2) causing financial injury to an innocent party against whom the enforcement of the instrument is sought to be directed.

The Injurious Behaviour of a Third Party

The behaviour injurious to parties liable on negotiable instruments could take various forms. It could take the form of depriving the party against whom the instrument is sought to be enforced of available securities; it could take the form of foregoing opportunities to prevent the occurrence of damage, or it could take the form of creating a situation of double liability.

(i) The first form of misbehaviour is illustrated in the holder's renunciation of the right of recourse against parties liable to the party against whom the holder intends to enforce the instrument. The act of renunciation is an arrangement between the renouncing and renounced party. The former chooses not to sue the latter, whereby the renounced party would be absolutely discharged on the negotiable instrument as well as the underlying obligation. The act of renunciation operates as a form of injurious misbehaviour because it could impair the rights of the party against whom the negotiable instrument is intended to be enforced. It could deprive the said party of recouping the enforced value from a valuable security.

To illustrate, suppose that a bill of exchange is drawn by John Alex on Jimmy Johnbow. The drawer, John Alex issues it to David Dove. Dove endorses the bill to Willy Williams. Williams finally endorses the bill to Billy Barnes. Suppose, moreover, that Barnes, the holder, presents the bill to Jimmy Johnbow for payment. The drawee disputes his indebtedness to John Alex and, accordingly, refuses payment. Billy Barnes then arranges with the notary public to draw up a certificate of protest and communicates it to the chain of indorsors and drawer.

The renunciation is presumed to be injurious if the holder Billy Barnes renounces the right of recourse against David Dove, the first indorsor, where by comparison he intends to enforce the bill against the second indorsor, namely Willy Williams.

In the context of negotiable instruments, the order in which parties secondarily liable appear, on the instrument, is immaterial. They are jointly and severally liable. The holder may enforce the full face value of the instrument against any party regardless of the order of his liability.[51]

David Dove, in the example under consideration, precedes Willy Williams in the chain of indorsements. The liability created by his indorsement runs in favour of each subsequent party. If the holder was allowed to renounce Dove's liability, Williams would lose a valuable security. He would be deprived of exercising his right of recourse against Dove. Thus, in order to prevent the occurrence of such injurious behaviour, it is submitted that the act of renunciation should be given a limited application. Its effect should not run beyond the renouncing party. That is to say, that if the holder elects to renounce the liability of a named party, it should be interpreted as a special arrangement between the renouncing party i.e. the holder and the renounced party. Other parties who might be injured by such renunciation should not be affected, otherwise they would be discharged as well.[52]

Is this uncited? Check

Finally, should the renunciation be given a wider application, the discharge from liability does not run in favour of all parties. Its effect is confined to those who might be injured by the renunciation. Thus, the drawer John Alex would not be discharged if Billy Barnes renounces the liability of David Dove. Dove is not liable to Alex on the instrument, thus his discharge would not injure Alex, the drawer.

The discharge resulting from the renunciation could have an overall impact if it was intended to be established in favour of the principal debtor such as the the drawee Jimmy Johnbow in the above example. The renunciation of his liability would damage the indorsors as well as the drawer. They stand as sureties. The liability of the principal debtor operates as a security in their favour. Renunciation of that liability deprives the sureties of their security. Thus, they would be discharged to that effect.

(ii) The **"foregoing opportunity"** form of misbehaviour is illustrated in the holder's laches. The holder of a negotiable instrument, who intends to enforce his instrument against parties secondarily liable, in particular the drawer, must observe the statutory duties of securing timely presentment, drawing up protest and/or giving notice of dishonour. If the principal obligor e.g. the drawee acceptor fails in the interval, the holder's right of recourse against the secondarily liable parties could damage the party against whom the instrument is sought to be enforced. The resulting damage is illustrated in causing the party in question to forego the opportunity to recoup the face value of the dishonoured instrument from the principal debtor during his solvency, which he would have been able to do had the holder observed the above mentioned statutory duties.

To illustrate, assume that John Alex draws a bill of exchange on Jimmy Johnbow, payable on 31st May 1989. He issues the bill to David Dove whereby the latter indorses to Billy Barnes. On the 3rd June 1989 the court declares the drawee Jimmy Johnbow bankrupt. On the 6th June Billy Barnes learns of the bankruptcy and presents the bill for payment. Due to the drawee's insolvency, the appointed receiver refuses payment. On the following day, the holder draws up a certificate of protest followed by a notice of dishonour, and communicates the two documents to the indorsor David Dove and the drawer John Alex.

Is it uncertain? Check

It is submitted that presenting the bill for payment six days after its day of maturity is too late. The drawing up of protest and giving a notice of dishonour is likewise deemed to be too late.[53] On the other hand, the failure of the principal debtor Jimmy Johnbow, i.e. the drawee, would necessarily entail the composition of his debts. The drawee's creditors will then get a portion of their credits. If the holder, Billy Barnes, was allowed to exercise his right of recourse against the indorsor and the drawer, he, due to his negligence, would, in light of the insolvency proceedings instigated against the insolvent drawee, involve the said parties in the composition arrangement. Accordingly, they would not be able to recoup the full face value of the bill from the bankrupt drawee. Had the holder secured timely presentment and so forth, the drawer against whom he would have exercised his right of recourse would be successful to recoup the full face value of the bill from the drawee, before the latter would be declared bankrupt.

However, the party secondarily liable is not, by reason of the holder's negligence discharged from his liability on the negotiable instrument absolutely. He is discharged to the extent of the damage. Thus, it is submitted that the holder is subrogated to the insolvent drawee. He participates with the other creditors in the composition arrangement. The portion with which he comes out from the composition is deemed to signify the face value of the instrument.[54]

(iii) The creation of a double liability situation as a form of misbehaviour, is illustrated in the holder's negligence in the custody of the instrument. Negotiable instruments are a form of chose in action. They possess some of the attributes of chattels. Their possession establishes in favour of the bona fide acquirer a prima facie good title. Their possession presumes ownership in favour of the possessor. Thus, the holder of a negotiable instrument must take adequate care in respect of the custody of his instrument. He must ensure that the instrument shall not come into the possession of a third party who could qualify as the protected holder, i.e. to whose favour a prima facie ownership of the instrument could be established. The failure to provide such care could result in subjecting the principal debtor or his sureties to double liability. The first is based on the underlying obligation in favour of the true owner from whose custody the instrument escapes and the second is based on the negotiable instrument in favour of the third party into whose possession the instrument comes.

To illustrate the instance in which the negligence of the holder of a negotiable instrument in the safe custody of his document, could result in an injury to an innocent party, assume that John Alex issues a cheque payable to bearer. By way of discharging his indebtedness to David Dove, he delivers the cheque to the latter. David Dove receives the cheque shortly before the company's board meeting. Dove places the cheque on his desk and leaves the office to attend the meeting. The cleaner, Willy Williams, enters the office to do the routine cleaning. In the course of his job, Willy Williams notices the cheque lying on the desk. Due to his financial difficulties, he decides to misappropriate the cheque. To conceal his dishonesty, he negotiates the cheque for value with Billy Barnes, a bona fide third party.

Examples too elaborated

The bearer form of negotiable instruments is an example of those documents the possession of which could create a good title in favour of the bona fide acquirer. Bearer instruments such as the cheque in the above example, are equivalent to money as far as their free transferability is concerned. They do not specify a particular person to whose order the monetary claim incorporated in them shall be payable. They indicate that they are payable to bearer. The status of bearer may be satisfied by mere possession of the instrument. In the light of the special nature of bearer instruments as chattels, on the one hand, and as money on the other, the bona fide acquirer of such instruments, Billy Barnes, for an example, could qualify as their lawful holder. He, accordingly, may enforce the instrument in his own name and he may, moreover, transfer good title to bona fide third parties.

In the Anglo-American, as well as the Continental Geneva legal systems,[55] the finder or thief of a bearer instrument, such as the cheque in the above example, may pass good title in favour of bona fide third parties. Since Billy Barnes derives his title to the cheque from a person possessing a prima facie good title, he may qualify as the lawful holder of the cheque. He, firstly, establishes a good title to the cheque and secondly, he may enforce the monetary claim incorporated in it, against the obligors e.g. John Alex, the drawer.

The instance which led the instrument to come into the possession of a third party capable of satisfying the lawful holder status is the original true owner's, i.e. David Dove's negligence, in the custody of his instrument. Had he taken the necessary precautions, he would have prevented its escape from his possession in the first place. Thus, it is submitted, that the negligent true owner of the instrument may not exercise his right of

...ld have been [illegible] to [illegible] [illegible].

recourse against his immediate or remote obligor e.g. John Alex, either on the instrument or the underlying obligation.[56] By securing the delivery of the bearer instrument in favour of the former party, the prior obligor is presumed to have foregone the opportunity to exercise an effective control on it and ultimately he is presumed to have foregone the opportunity to provide against its misuse. If the original true owner in such an instance was entitled to exercise a right of recourse against the prior obligor, the risk arising from the fraudulent misuse of the instrument in question would be allocated to an entirely innocent party, whilst the relatively negligent party i.e. the original true owner would escape liability. In order to avoid approaching such an inefficient and unjust rule the original true owner in the instance under consideration should be disentitled from exercising a right of recourse against the prior obligor whilst the latter party should be afforded a valid discharge of his obligation by mere delivery of the instrument to his creditor.

Proper Payment

A negotiable instrument is deemed to be discharged if properly paid. Proper payment occurs if the payor complies strictly with the mandate of his creditor, i.e the instrument. Thus, for a payment to qualify as proper it must be made:

1) to the holder of the instrument, and

2) on or after the day of maturity.[57]

The non-compliance with the mandate could damage its maker i.e. drawer or issuer of the instrument.

Payment to other than the holder, damages the maker of the mandate, in the sense that it does not discharge him as between himself and the lawful holder. The maker remains liable, either on the instrument or on the underlying obligation to his creditor i.e. the lawful holder. The damage resulting from the payment before the day of maturity is illustrated in charging to the maker, undue obligation. The maker of the mandate against whom the payment is charged would either forfeit the advantage of available credit or the advantage of available security.

To illustrate, assume that John Alex purchases an advertised secondhand car from David Dove. By way of guaranteeing that the purchased secondhand car is reasonably reliable, John Alex arranges with Dove to pay him a post dated cheque. If the drawee bank was allowed to pay Dove the cheque on the day of presentment, he would be discharging John Alex's security. Should the secondhand car prove to be faulty before the post dated day, the issuer, John Alex, would forfeit the advantage of countermanding payment.

The Holder's Conundrum

It has been alluded to above[58] that the essence of the promise or undertaking incorporated in negotiable instruments is to pay the "**holder**" of the instrument its face value. Payment to the holder discharges the parties to the instrument absolutely. They are discharged as to their negotiable instrument transaction, as well as their underlying obligations arising out of the independent transaction to which they were parties.

The term holder, applies to any person to whose favour the property of the instrument is established. It is equivalent to the concept of owner in the law of property. The party to whose favour the property of the instrument is established, is the party to whose favour the negotiability characteristics of negotiable instruments run. He, firstly, possesses an enforceable right in his own interest. Secondly, he enjoys the advantages of a prima facie regularity. Finally, and more significantly, he obtains a good title to the instrument or to the paid proceeds. He may enforce the instrument against all signatories. He may retain the proceeds of payment and he may negotiate his instrument with third parties.

The status of the holder in the area of negotiable instruments, like the law of property, could be the subject of conflicting claims. Two parties may each claim to satisfy the holder status. An example of such instance is the theft of bearer instruments. The party from whom the instrument was stolen and the party into whose hands the instrument comes, claim to satisfy the holder status. The purpose of such claim is to assert the exclusive right to the instrument and to the rights evolving from it.

The determination of the holder status necessarily involves the allocation of risk. The rule proposed, in determining the holder, would necessarily deny the holder status to one of the competing parties, whilst it establishes it in favour of the other. The party against whom the rule operates would be left to suffer the resulting loss. He either would be denied the right to enforce the monetary obligation incorporated in the instrument, or the right to retain its proceeds.

The determination of the party to whose interest the holder status should be established and ultimately the party to whom the evolving risk should be allocated, must be founded on rational bases. The relevant interests should be taken into account in formulating the rule. The interests relevant to formulating the risk allocation rule are those compatible with policy considerations of a rational legal system. The relevant interest, as well as the rational policy considerations are discussed more fully in the following chapter.

CHAPTER TWO

BACK NOTES - (1.-58.)

1. For the wide application of the concept of negotiable instruments in general see Byles on Bills of Exchange (1983) 25th Edtn., p.3 .
See also McLoughlin, Introduction to Negotiable Instruments, (1975), p.24.

2. For the negotiability attribute of negotiable instruments and its main characteristics see Schmitthoff's EXPORT TRADE, (1986), 8th Edtn., pp.481-482.

3. For the general definition of money document and its various forms see pp.37-40 infra.

4. See p.36 supra.

5. For example, the draftsmen of the United States Uniform Commercial Code (U.C.C.) depart from the formal Negotiable Instruments Laws method of regulating the rules relating to negotiable instruments. They separate between the various forms of such instruments. In Article 3, they regulate the rules relating to Bills of Exchange (drafts) Cheques, Promissory Notes and Bankers Deposit Receipts. Article 7 regulates the rules relating to Documents of Title. Article 8, by comparison, regulates the rules relating to Investment Securities. In distinguishing the type of instrument regulated under Article 3 from the various forms of negotiable instruments, the draftsmen of the U.C.C. collectively refer to the said instruments as Commercial Paper.

6. The U.C.C. illustrates the restricted application of the concept of commercial paper. Article 3 regulates four types of commercial paper. See Note 5. It excludes share certificates, treasury bills and other forms of investment securities from its application. They are regulated under a separate article i.e. Article 8. Similar to the U.C.C. are the Continental Legal systems where share certificates and other analogous investment securities are not deemed to form a type of commercial paper.

7. For the liberal interpretation of the negotiability characteristic, see part II of this thesis.

8. J.S. Rogers. The Irrelevance of Negotiable Instruments Concepts in the Law of the Check-Based Payment System, (1987), 65 Texas L. Rev. 929.

9. Ibid.

10. Examples of negotiable instruments analogous to cheques are certified cheques. They are similar to cashiers' cheques in the sense that they incorporate the drawee's acceptance. Accordingly, the drawee acceptor engages primarily to pay the holder of the instrument its face value. He may not, on the one hand, raise against the holder, personal defences which the acceptor possesses against his immediate creditor, nor may the acceptor issue a stop order to prevent the cashing of the instrument. The holder acquires, against the acceptor, a certain and absolute right of enforcement.

11. The involvement of a bank on a negotiable instrument is essential to clothe the instrument in question with the attributes of real money. The liability of a bank in favour of the holder directly, provides to the latter a certain and absolute security. The bank's direct engagement with the holder estops the former from challenging the validity of its liability. Accordingly, the payment of the instrument is almost always certain.

12. The main distinction between a domiciled promissory note and an ordinary promissory note is that the latter is a two party instrument. The maker of the note promises that on the day of maturity, he shall pay the holder of the note its face value. The domiciled note, by comparison, is a three party instrument. The maker of the note specifies a third party to whom the note shall be presented and from whom payment shall initially be demanded. For a definition of the domiciled promissory note, and the status of the parties arising out of it, see pp.55-56 infra.

13. See p.55 infra.

14. cf. Section 57 B.E.A. Article 48 G.U.L.(Bills).

15. See p.55 infra.

16. In the French legal system, however, the drawee may be liable to the holder on the instrument, even in the absence of the former's acceptance. His liability is based on the application of **"la provision"** doctrine. By providing funds with the drawee, the drawer transfers to the holder of the instrument a property right to the cover. In the event of the drawer's failure the holder may proceed exclusively against the drawee to satisfy his right to the instrument, from the credit available with the drawee. In the event of the drawee's failure i.e. insolvency, the holder may proceed against the former. He acquires a priority right to the credit in the hands of the drawee. The drawee's creditors may not compete with the holder for the credit arising out of the cover which the drawer made available with the drawee.

This right of action is not recognised in either the Geneva or the Anglo-American legal systems. In the first i.e. the Geneva legal systems, the issue of provision has been excluded from the Conventions because it has been established that (1) such subject is not susceptible to unification and (2) it is not a matter closely related to the law of negotiable instruments. By comparison, it is related to the law of bankruptcy. Therefore it was submitted that the right of a holder to the provision and matters relating to the availability of it, shall be the concern of the national laws of the individual countries, rather than the Conventions.

See Hudson and Feller, The International Unification of Laws Concerning Bills of Exchange, (1931), 44 Harv. L.Rev.

For an overview of **"la provision"** doctrine see -

Amos & Walton, Introduction to French Law, (1966), 3rd Ed., p.366.

Léonie M. Mitchell, The British Conception of Negotiable Instruments v. the French, (1928), 10 J.Comp Legal & Int'l Law (3rd Ser) p.242.

Newman, Law of Negotiable Instruments in France, Unity of Law, (1978), p.110.

In the Anglo-American legal systems, both the B.E.A. and the U.C.C. expressly provide that the negotiable instrument shall not operate as an assignment of funds in the hands of the drawee.

See Section 53 B.E.A. and corresponding Article U.C.C..

17. cf. section 54 B.E.A. and Article 28 G.U.L.(Bills).

18. See p.39 supra.

19. For a fuller account of the historical evolution of bills of exchange, the ancient form of negotiable instruments see pp.223-231 infra.

20. For the nature of cheques and their evolution from bills of exchange see Holden, History of Negotiable Instruments in Early English Law p.220.

21. cf. Section 10 B.E.A. and Articles 2 and 33 G.U.L.(Bills).

22. Domiciled bills are defined as those documents in which their drawer or drawee stipulates that they shall be payable at the locality of a third person. The drawer or drawee of such documents normally indicates a banker as the third person in whose locality the domiciled bill should be payable cf. Section 19 B.E.A. and Article 4 G.U.L.(Bills).

23. There are other distinctions between money and negotiable instruments. For example, the former is a bearer instrument, it passes from hand to hand by mere delivery, whereas negotiable instruments could be issued to bearer or to order. In the latter situation, the instrument passes from hand to hand by signature and delivery. In the second place, money is not subject to time prescription.

24. See p.39 supra.

25. cf. Article 3-802 U.C.C. and
Allen v Royal Bank of Canada (1926) 134 L.T.
Kearslake v Morgan (1794) 5 T.R.
Stedman v Gooch (1793) 1 Esp.

26. Ibid.

27. For an example, in the Continental Geneva legal systems and by virtue of Article 70 G.U.L.(Bills) the holder forfeits his right of action on the bill of exchange against his immediate indorser, if he fails to proceed against the latter within one year following the day of protest. By comparison, if the holder of the instrument proceeds against his immediate indorser on the basis of the underlying obligation in question, the time allowed within which the holder may bring his action could run up to fifteen years.

28. cf. G.L. Kock, Negotiable Instruments and the Doctrine of Consideration, (1961-62), 36 Tulane L. Rev., p.271.

29. See pp.64-72 infra.

30. In the Anglo-American, as well as some of the Continental Geneva legal systems, the drawer who fails to provide funds with the drawee, remains primarily liable on the instrument in favour of the holder. Thus the holder may exercise his right of recourse against the drawer, notwithstanding observance of the statutory duties of timely presentment, protest and notice of dishonour. cf. Section 46 B.E.A. and Article 170 French Code de Commerce cited infra p.57.

As far as the Continental Geneva legal systems adopting Article 53 G.U.L.(Bills), although they discharge the drawer who fails to provide funds with the drawee, from liability on the instrument, they, with reference to the application of the general principles of the law, hold him liable on independent bases. For an example, the German legal system holds the defaulting drawer liable to the negligent holder on the basis of unjustified enrichment, ibid.

31. For more detail concerning the accommodation bill see pp.59-60 infra.

32. See pp.59-60 and 61-62.

33. By analogy, the liability of general partners in a partnership does not crystallise unless the creditor of the partnership first proceeds against the said partnership, and only in the event that the partnership fails to pay its debt, may the creditor proceed against the general partners. It is submitted that their liability is of a secondary nature.

34. cf. Section 48 B.E.A. and Article 53 G.U.L.(Bills).

35. Examples of acts equivalent to signatures are fingerprints stamps and corporate seals.

36. The acceptor, however, may in instances of qualified acceptance, shift his liability into secondary liability. If the acceptor stipulates on the instrument that the instrument shall be presented and paid at a particular locality only, "**a bank normally**" the holder must observe prompt presentment and notice of dishonour to preserve his right of recourse against the acceptor. The status of the acceptor would be likened, as far as the necessity to observe the statutory duties of presentment, notice of dishonour and/or protest is concerned, with the status of a drawer of a bill of exchange. cf. N.39 and authorities cited there.

37. cf. Section 83 B.E.A.

38. cf. pp.46-47 supra.

39. By virtue of Section 89 B.E.A., Part II of the Act, i.e. that concerned with bills of exchange, shall be applicable to promissory notes. By virtue of sub-section 4, the maker of a note is treated as the acceptor of a bill. Since by Sect.19 B.E.A. the acceptor may qualify his acceptance as to the place of presentment and payment and by virtue of Sect.52 in instances of qualified acceptance, the holder in order to preserve his right of recourse against the acceptor, must observe the duty of procuring prompt presentment and giving notice of dishonour, the maker of a promissory note is entitled to qualify his making as to the place of presentment and payment as well as the right to require the compliance with the statutory duties of presentment and giving notice of dishonour.
See Halstead v Skelton 1843 5 QB 86
Chalmers - Bills of Exchange 13 Edtn. p.175-176, 1964.
cf. Art.3-121 U.C.C. and
Stone, U.C.C. in a Nutshell, (1975), p.219.

As to the German legal group, by virtue of Article 78 G.U.L.(Bills), the status of a maker is presumed to be tantamount to that of the acceptor. Since, by virtue of Article 27, the acceptor may stipulate a different locality than that of his where presentment for payment should be procured; there is no sound argument to prevent the maker from stipulating the same.

40. cf. Section 3 B.E.A.

41. Article 53, 1933 German law is identically worded to Art.53 G.U.L.(Bills). For the provision of Article 53 G.U.L. see p.51 supra.

42. See reply of German delegation to Questionnaire circulated at the Geneva Conference on the Unification of Laws relating to Bills of Exchange, Promissory Notes and Cheques, First Session 1930, p.27.

43. cf. 73 B.E.A.

44. Foley v Hill 1848 2 HL Cas 28 [1843-60] All E.R. Rep 16.

45. Westminster Bank v Hilton (1927) 136LT 43 T.L.R.

46. By comparison, the liability of the party primarily liable crystallises on the day of maturity. The holder need not observe the duty of procuring timely presentment, drawing up protest or giving notice of dishonour to preserve his right of recourse against the former.
cf. p.50 supra.

47. Ibid.

48. For an example, if John Alex issues a cheque for the amount of £750 to David Dove in consideration for a secondhand car purchased from the latter and Dove indorses the cheque to Billy Barnes in discharge of a pre-existing debt. Barnes may not enforce the cheque against Dove or Alex unless he presents the cheque to the drawee bank for payment and the latter fails to honour it on its day of maturity. By virtue of the order incorporated in the cheque, the drawer, e.g. John Alex and the subsequent signatories e.g. David Dove, stipulate that the monetary obligation incorporated in the cheque i.e. the £750, shall be paid by the drawee. By way of such stipulation they are deemed to guarantee the payment of the cheque by the latter. In their capacity as guarantors i.e. sureties, their liability on the instrument e.g. cheque, would not crystallise unless the prima facie principal debtor, i.e. the party to whom the payment order is addressed fails to behave in a manner consistent with it.
See Article 3 413 (2) and 3 414 U.C.C.
and Articles 9 and 15 G.U.L.(Bills).
cf. Section 55 B.E.A..

49. cf. Section 55 B.E.A. and Article 47 G.U.L.(Bills).

50. cf. Section 57 B.E.A. and Article 48 G.U.L.(Bills).

51. cf. Article 47 G.U.L.(Bills).

52. cf. Section 62(1) B.E.A. which reads in part ...
"When the holder of a bill at or after its maturity absolutely and unconditionally renounces his rights against the acceptor, the bill is discharged ...."
See also Article 3 - 606 (1) U.C.C.

53. In the English legal system presentment for payment would be too late if it was made after the day on which the instrument falls due, cf. Section 46 B.E.A., and the giving of notice of dishonour is deemed to be too late if it is made on the day following the day after dishonour cf. Section 49 (12) B.E.A.

As far as the above illustration is concerned, the presentment of the bill of exchange is deemed to be late in the English Legal system if it is made after 31st May 1989 whilst the giving of notice of dishonour is deemed to be late if it was made after 1st June 1989.

As far as the Continental Geneva legal systems are concerned, the presentment for payment is deemed to be late if it was made after the elapse of two days following the day on which the instrument falls due, cf. Article 38 G.U.L.(Bills), and the drawing up of protest is deemed to be late if it was made beyond the said date.
cf. Article 44 G.U.L.(Bills).

As far as the above illustration is concerned, the presentment for payment and the drawing up of protest would be late in the Geneva legal systems if they were made after 2nd June 1989.

54. For the Anglo-American legal systems -
cf. Article 3-502 1(1b) U.C.C. and
Grist v Osgood 90 Nev 165 521 p.2d 368 14 (1974) U.C.C. 100.

Some of the Continental Geneva legal systems approach the subrogation rule outlined in the text above by applying **"la provision"** doctrine. **"La provision"** as mentioned in n.16 above affords the holder of the instrument a property right to the funds in the hands of the drawee. The drawer, by drawing the instrument to the payee or holder assigns to the latter the said right. The holder may then satisfy his claim on the instrument from the drawee directly. The significance of **"la provision"** doctrine materialises in instances where the drawer is discharged on the instrument as to its holder. In such an instance the holder's only remedy to recover the face value of the instrument would be to base his cause of action against the drawee on the fund which the drawer made available with the latter.

In other Continental Geneva legal systems, which do not adopt **"la provision"** doctrine, the subrogation rule is approached by applying the general principles of the law such as unjustified enrichment. An example of such legal system is the law of Germany, see authorities cited in n.30 above.

55. For the Anglo-American authorities cf. Articles 1, 201-219 and 3, 306 U.C.C.
See also Charles v Blackwell 2 CPD 151 (1877)
Peacock v Rhodes (1781) 2 Doug 633
Miller v Race (1758) 1 Burr 452.

As for the Continental Geneva legal systems' authorities cf. Articles 20 and 21 G.U.L.(Cheques).

56. Charles v Blackwell ibid.

57. cf. Sections 59 and 60 B.E.A.

58. cf. pp.62-64 supra.

CHAPTER THREE

COMPETING INTERESTS

INTRODUCTION

The problem of competing interests, generally speaking arises in instances of disturbances of the performance of contracts. Contract disturbance negatively affects the reasonable expectation of parties. It alters the circumstances in reliance on which the parties in question consented to be bound. Such alteration in the basic circumstances may affect the original undertaking of the parties. Accordingly, the reasonable expectations of the parties involved in the original undertaking might not be reconciled. The role of the law in this instance is to determine the party whose interest would be favoured. In determining the favourable interest the law should take account of certain material considerations, the application of which would approach a rational rule.

For an example assume that Dove and Co. is a mail order business. It markets its merchandise by way of doorstep delivery of its catalogues. The company encloses with the catalogue an offer slip. The customer indicates in the slip the particulars pertaining to the required merchandise. The customer then posts his offer to the company in its provided envelope. The company packs the requested merchandise and arranges for the doorstep delivery to its customer. The customer may then try the delivered merchandise. In the event of satisfaction, the customer should arrange for payment.

Assume further that John Alex, a customer of Dove and Co., is satisfied with the delivered merchandise. By way of payment, John Alex posts a cheque equal to the face value of the merchandise to Dove and Co. as payee. Due to postal mis-delivery, the cheque is delivered to another Dove and Co., a small grocery shop carrying out business in the same locality as that of Dove and Co., the mail order business. Assume, finally, that the former, Dove and Co. misappropriates the cheque. Willy Williams, the sole manager of the grocery shop indorses the cheque in the business's name and deposits it in the firm's account for collection. The collecting bank presents the cheque to the drawee bank for payment. The latter, accordingly honours the cheque and pays its proceeds to the collecting bank.

The enforcement of the negotiable instrument i.e. cheque is disturbed in two respects. Firstly, the payment instrument is delivered to someone other than the intended holder. The cheque is delivered to Dove and Co., the grocery shop instead of Dove and Co. the mail order business. Secondly, payment is made in favour of someone other than the intended payee. The drawee bank paid the proceeds of the cheque to the agent of Dove and Co. the grocery shop, whilst the maker of the mandate intended payment to be made in favour of Dove and Co., the mail order business.

The delivery of the cheque to the grocery shop and the subsequent payment to its favour are inconsistent with the reasonable expectation of the drawer of the cheque i.e. John Alex. He neither intended to deliver the cheque to the grocery shop, nor did he intend that the latter should possess an interest in the instrument. Thus, if the payment to Dove and Co., the grocery shop, was upheld, and ultimately John Alex was denied the right of recovery, the latter would, in effect, be bound by a contract to which he did not assent. Since, on the other hand the instrument, cheque, did not reach the intended payee i.e. Dove and Co., the mail order business, the purchaser drawer i.e. John Alex would remain liable on the independent transaction which gave rise to the issuance of the cheque in favour of the intended payee. If the drawer John Alex was denied the right of recovery against Dove and Co. the grocery shop, he would be liable for double payment, viz. that arising from the instrument in favour of the grocery shop, and that arising from the independent transaction in favour of the mail order business. As far as the first payment is concerned, it is submitted that upholding the entitlement of the grocery shop to the erroneously paid proceeds is incompatible with the application of the general principles of the law. The intention of the parties should be taken into consideration, so far as it is not inconsistent with the application of other material principles.

The Causes of Contract Disturbance

(i) The enforcement of contracts is disturbed by either the mistake,[1] or the misconduct of the parties to the transaction in question, or by the intervention of an extraneous element. An example of the parties' misconduct as a cause of contract disturbance is the employer's negligence in the policing of his business. The lack of policing is illustrated by the employer's failure to provide:

1) Effective selection test of employees.
2) Effective supervision, and
3) Periodic examination of statements, invoices and accounts prepared by employees.

To illustrate the instance in which the employer's lack of policing could cause a situation of contract disturbance assume that John Alex is the sole proprietor of a construction firm operating under the name of Alex Euro-Construction. The firm engages with Jessor Ltd., whereby the latter provides to Alex Euro-Construction machinery and construction equipment, as well as maintenance for its supplies. Alex recruits David Dove, a young inexperienced and recently hired employee, in the post of financial secretary. As financial secretary Dove settles the firm's accounts. In his capacity as such he is empowered to issue cheques in the firm's name, in the light of the invoices prepared and filed by Willy Williams, the firm's accountant.

Willy Williams, aware of Dove's inexperience, decides to misappropriate the firm's funds to settle his gambling debts. He fraudulently prepares invoices in favour of Jessor Ltd. He then files the said invoices for David Dove to arrange for payment to be made in favour of Jessor Ltd., equal to the face value of the forged invoices. Dove, in ignorance of the true facts, issues cheques to the supposed creditor and hands them to Williams for delivery. As Willy Williams does not intend that Jessor Ltd. shall have an interest in the issued cheques, he forges the payee's indorsement and makes the cheques payable to his order, whereby he may cash the cheques and misappropriate their proceeds to his personal interest.

The disturbance evolving from the fraudulent practice of Willy Williams is twofold. In the first place, the firm, through its financial secretary, was fraudulently induced to issue cheques in favour of a party not entitled to the proceeds. In the second, the proceeds of the cheques were diverted from their normal currency. They were paid to a party not intended prima facie to possess an interest.

Although the disturbance was the direct cause of fraud practised by an independent party, namely Willy Williams, in the above example, the proprietor's negligence in not providing an effective selection test and supervision, as well as not arranging for a periodic examination of invoices etc., is presumed to have facilitated the occurrence of fraud. Due to the recruitment of inexperienced and unreliable senior employees, as well as the failure to review statements,

Justify

invoices and accounts prepared by them, the perpetration of fraud is made more likely.

(ii) The extraneous element, the intervention of which causes contract disturbance, is illustrated in the involvement of an independent party. His involvement disturbs the enforcement of the contract in question in the sense that his intervention affects the normal currency of the contract. His involvement may render the enforcement of the original terms of the contract more onerous to the parties in question. Or it may render the enforcement of the contract inconsistent with the intention of the parties.

In the context of negotiable instruments, the independent party, the intervention of whom disturbs the negotiable instrument transaction, is usually a fraudulent person. He could be a stranger, in the full sense, to the negotiable instrument transaction, or he could be a party not intended to possess an enforceable interest, such as a trustee.[2] In both instances, the disturbance of the normal currency of the instrument takes the form of unauthorised disposal. The unauthorised disposal of the instrument or its proceeds is perpetrated by intercepting the instrument or by the commission of a fraudulent practice. The intervention of the stranger illustrates the interception of the instrument, whilst the intervention of the trustee illustrates the commission of the fraudulent practice.

The fraudulent person, be he a stranger or a trustee, disturbs the normal currency of the instrument in question by transferring it to a bona fide third party, whereby he diverts the property of the instrument, as well as its proceeds. The property would be diverted by transferring it to a bona fide third party whose involvement was not intended in the first place. By transferring the instrument to the bona fide third party, the fraudulent person is deemed to have divested the property of the instrument from its original true owner e.g. the principal, and vested it in favour of the transferee, i.e. the bona fide third party. The proceeds of the instrument would be diverted by cashing the instrument with the bona fide third party. The fraudulent person, by cashing it, pockets the proceeds of the instrument. His unauthorised fraudulent cashing either leaves the bona fide third party with a worthless piece of paper, or he impairs the right of the original true owner of recouping the proceeds of his instrument.

To illustrate, assume that David Dove runs a take-away restaurant. The number of staff in his employ are three, two cooks and a cashier, Willy Williams. The latter during the twenty years of service demonstrated devotion and honesty. Every three years, Dove leaves with his family for a two weeks short holiday. Whilst he is away, Dove entrusts Williams with the job of managing the financial affairs of the restaurant. He deposits the business's cheques and settles its obligations. As a trustee, Willy Williams does not possess an enforceable interest in cheques issued in favour of the restaurant.

His authority is confined to depositing the cheques in the business's account and when appropriate, discharging its obligation by way of cheques or otherwise.

Thus, if Willy Williams misappropriates his principal's cheques, by re-indorsing them in the restaurant's name in favour of his accomplice, for the purpose of facilitating the cashing of the cheques, he is deemed to have disturbed the normal currency of the cheques. He, firstly, diverts the property of the cheques from his principal to a third party, namely, his accomplice. Secondly, he diverts the proceeds of the deposited cheques to his favour through his accomplice. His unauthorised transfer of the cheques is a form of intervention. Since the said intervention lacked authority, it is deemed to be made fraudulently.[3] It is submitted that the perpetration of fraud is solely attributable to the trustee. No negligence as such could be attributed to the principal.[4]

What's the authority for these contentions?

The Scope of Contract Disturbance

(i) The disturbance of contracts does not only affect the relationship of immediate parties; its effect runs to other parties whose involvement is foreseeable. An example of such contracts is negotiable instruments. The fraud perpetrated by an independent party does not disturb the relationship between the maker/drawer of the instrument and its immediate payee, or between the indorsor and the immediate indorsee, rather the fraud disturbs the relationship between the drawer and drawee, the drawer and the remote indorsee/holder as well as that between the drawee and the holder to whom the proceeds of the instrument were paid.

The involvement of a multitude of parties is due to the special nature of negotiable instruments. On the one hand, they are mainly three party instruments. Their creation presupposes the existence of two independent transactions. The drawer of the instrument functions in a double capacity. As a creditor, he issues the instrument in question on his debtor in the first transaction. As a debtor, he issues the instrument to his creditor in the second transaction, whereby the latter becomes the payee.[5] On the other hand, negotiable instruments are freely transferable, they pass from hand to hand by indorsement and/or delivery. They could be transferred more than one time, so far as it occurs within the maturity of the instrument. Thus, remote third parties may qualify as the lawful holder of the instrument.

(ii) Since negotiable instruments are multi-party documents, each involved party possesses a valid interest. Briefly speaking, the interest of the drawer of a negotiable instrument is to be accountable for a single payment. The interest of the original true owner is to have the property of the stolen instrument restored to him. The interest of the subsequent bona fide acquirer is to have the property of the instrument established in his favour. The interest of the drawee is to have himself either discharged from his obligation or afforded the right to recover the erroneously paid proceeds from the recipient.[6]

The said interests, however, arise from the reasonable expectation of the parties in question. The interest of the drawer to be accountable for a single payment arises from his reasonable expectation that payment shall be made to the proper holder, namely the specified payee or someone to whose order the instrument is properly indorsed. The original true owner's interest to have his property restored to him arises from the reasonable expectation that his property shall be protected. The bona fide acquirer's interest to have the property right to the instrument established in his favour arises from his reasonable expectation that his bona fide engagement with prima facie, bona fide parties and in a prima facie regular transaction shall be secured. Finally, the drawee's interest of having himself either discharged or having conferred upon him the right to recover erroneous payments arises from his reasonable expectation that payment is made in favour of the proper holder or that the proceeds of the improper payment shall revert to him.

Too long affecting repetitions

(iii) In instances of disturbance, the satisfaction of the above mentioned interests may not be reconcilable. Where a negotiable instrument, due to the mistake or misconduct of the parties in question, or due to the intervention of the fraudulent party, is diverted from its normal currency and comes into the hands of someone other than the intended holder, the interest of the original true owner i.e. the party from whose possession the instrument escapes, and the interest of the bona fide acquirer i.e. the third party into whose possession the instrument comes, in particular would compete. Each of the parties is interested to have the property right to the instrument in question, conferred exclusively upon him.

The interest of the remaining parties e.g. the drawer and drawee, is closely associated with determining the party to whose favour the property right to the instrument is established. If the property right to the instrument is established in favour of the original true owner and accordingly, he is declared to be the holder, the rights arising from the negotiable instrument transaction will run in his favour. The bona fide acquirer would be left with a worthless piece of paper. He neither possesses an enforceable right on the instrument nor does he possess a right to the proceeds of the instrument. Thus, the bona fide acquirer may not exercise a right of recourse against the drawer, nor may he demand payment from the drawee. The denial of the right of recourse to the bona fide acquirer satisfies the drawer's interest of being accountable for a single payment only, i.e. that established in favour of the original true owner. The denial of the right to demand payment, on the other hand, satisfies the drawee's interest. His liability to make payment would run in favour of the original true owner only. If payment is erroneously made to the bona fide acquirer, the drawee payor would be entitled to demand the recovery of the improperly paid proceeds from the recipient, acquirer.

By comparison, if the property right of the negotiable instrument is established in favour of the bona fide acquirer whereby he is declared to be the holder, the rights arising from the negotiable instrument transaction will run exclusively in his favour. The original true owner would be divested of the holder status. He would forfeit his enforceable rights on the instrument as well as on the independent transaction. Because the original true owner forfeits the holder status, he may not exercise his right of recourse against the drawer, nor may he demand payment per se[7] from the drawee. The denial of the right of recourse satisfied the drawer's interest. He would be accountable for a single payment, namely, that established in favour of the bona fide acquirer. The denial of the right to demand payment satisfies, on the other hand, the drawee's interest. His liability to make payment is established in favour of the bona fide acquirer only. Should the said payment be made, the drawee is deemed to have been discharged on the instrument.

too long. ...ole section cld have been halved.

(iv) Interests may also compete in instances where the property right of the negotiable instrument is not the concern of conflicting claims. An example of such instances is the fraudulent making of negotiable instruments, whereby the drawee pays the fraudulently made instrument to its bona fide acquirer and charges the purported maker's account with the face value of the instrument. For instance, the theft of a cheque from the cheque book of another, the forging of the latter's signature as issuer, the issuing of the cheque in favour of the thief/forger and finally, the cashing of the cheque with a bona fide third party, gives rise to a problem of competing interests.

To illustrate such an instance, assume that Willy Williams breaks into John Alex's office, forces the locked drawer open and steals a cheque from Alex's cheque book. Williams, next fills in the stolen cheque, makes it payable to his order and forges the signature of John Alex. By the said fraudulent practice, Williams makes the cheque read as if it was originally issued in his favour. As payee, Willy Williams then indorses the cheque for value to David Dove, the proprietor of a small grocery shop, in consideration for the purchased food. Dove then deposits the forged cheque with his bank for collection. The latter presents the cheque to the drawee for payment. Due to the clever execution of the forgery, the drawee fails to detect the fraud. Accordingly, the drawee settles the cheque and charges Alex's account with the face value of the cheque.

In this instance, there is no negotiable instrument in the strict sense. For an instrument to qualify as negotiable, it must be signed by its maker.[8] In the above example, the purported maker, John Alex, did not fix his signature. The signature appearing on the cheque is neither his, nor is it made with his authority. Since the fraudulently drawn instrument is not a cheque and, ultimately, is not a negotiable instrument, the purported maker, John Alex does not possess a property interest in it. As far as he is concerned, the fraudulently made instrument is a worthless piece of paper. It incorporates no rights in favour of third parties.

As to the bona fide acquirer, David Dove, the instrument purports to satisfy the negotiable instrument concept. It is presumed to be a valuable piece of paper. It purports to confer upon the proprietor, i.e. holder, enforceable rights. Accordingly, the bona fide acquirer is interested to establish a property right to the instrument. Since he is the only party whose interest runs to the property in the instrument, the problem of conflicting claims to property in the instrument would not emerge.

The interests competing in this instance are that of the drawee and that of the acquirer/recipient. The interest of the purported drawer is not related to the negotiable instrument transaction. As between himself and the drawee, the interest of the drawer is related to the contractual relationship vis-a-vis himself and the drawee, whereby the latter engages to discharge the former's obligation in a manner consistent with his mandates. In light of the said contractual relationship, the purported drawer, in the instance under examination, is interested not to have the instrument interpreted as a mandate authorising the drawee to charge the face value of the instrument to the drawer. The charge back made in reliance on the fraudulently issued instrument would then be interpreted as inconsistent with the underlying contract.

The interest, as between the drawer and the holder, is likewise of a contractual nature. The drawer is interested to deprive the instrument of its value. Accordingly, he is interested to have himself unaccountable for the promise or undertaking purported to be incorporated in the instrument. The holder would then forfeit an enforceable right of recourse against the drawer.

As far as the interests of the drawee and the bona fide acquirer/recipient are concerned, they are, by comparison, related to the negotiable instrument transaction. The drawee is interested to have the holder status denied to the bona fide acquirer/recipient, whereby he would have the right of recovering the proceeds of the improper payment, conferred upon him. The bona fide acquirer/recipient is interested to have the holder status conferred upon him, whereby he would have the right to retain the proceeds established in his favour. The property right to the instrument in question is, likewise, the determinative factor in reliance on which the various interests arising from the negotiable instrument transaction may compete.

The denial of the property right to the acquirer recipient raises the interest of the drawee, whilst the establishment of such right to the acquirer/recipient raises the interest of the latter.

The Allocation of Risk Arising from Contract Disturbance

The disturbance of the performance of contracts normally involves risk. The risk is illustrated by the probability that the reasonable expectation of the parties in question will not be satisfied. Since reasonable expectations signify interests, in instances of contract disturbance, the satisfaction of the relevant interests might not be reconcilable. The law, in like instances, should intervene to allocate the risk in question.[9] To this end, the law making body should determine the interest, the protection of which is paramount.[10] Accordingly, the proposed risk allocation rule should run in favour of the interest intended to be protected. The determination of the paramount interest should be made with regard to a number of important considerations.

In the context of negotiable instruments, risk would arise when the normal currency of the instrument in question is disturbed, either due to the mistake or misconduct of the parties involved, or due to the intervention of an independent party. The reasonable expectation of the parties would be likewise disturbed because the entitlement to the claim incorporated in the instrument, or to the retention of the proceeds, would be in dispute. Accordingly, the interests arising from the reasonable expectation of the parties might not be reconcilable.

Since the interests, the conflict of which is under consideration, are intertwined with the property right to the instrument, the risk allocation rule should run in favour of the person to whom the property right to the instrument is established. Nevertheless, in identifying the person in whose favour the property right to the instrument is established, the law should take into account considerations compatible with the promotion of the institution of negotiable instruments, the interests of the community involved, the interest of the public at large, the allocation of risk in an economically efficient manner and the notions of fairness and equity. The holder status of negotiable instruments should be defined in the light of those considerations. Ultimately the risk allocation rule should be formulated in a manner compatible with those considerations.

Some of the info needed below in [illegible].

The Significance of the Proposed Considerations in Determining Risk Allocation in the Context of Negotiable Instruments.

I. The Interest of the Institution of Negotiable Instruments

The necessity to promote the institution of negotiable instruments arises from the need to finance transactions other than by money.[11] It is submitted that the institution of negotiable instruments is a convenient device for the provision of finance. The mercantile custom recognised the convenience of negotiable instruments as a finance institution. It devised the "negotiability" rule to promote the finance by negotiable instruments. It conferred upon the bona fide acquirer/holder a perfect title, independent from the title of prior transferors. It afforded him the advantages of the free of equity doctrine. The title of a bona fide acquirer/holder could not be impeached by personal defences and claims between two prior parties where he had no knowledge of their significance.

The major legal systems recognised the necessity of promoting the institution of negotiable instruments. They incorporated in their laws the negotiability rule as devised by the mercantile custom. The bona fide acquirer/holder is afforded an unimpeachable title as against prior parties.[12] The application of the negotiability rule, accordingly, became the main characteristic which distinguished negotiable instruments from other choses in action. However, the convenience of negotiable instruments outweighs that of its main rival, the "institution of credit cards". In light of the millions of payment transactions concluded every day by way of issuing, negotiating, accepting and honouring negotiable instruments, the institution of negotiable instruments is submitted to function as the real currency of the realm.

The convenience of negotiable instruments is three fold. On the one hand, their utility could be enjoyed by every person. Negotiable instruments, in particular cheques, may be purchased on the market for the purpose of financing a single transaction. Thus, the poor consumer may enjoy the utility of negotiable instruments by purchasing them from a bank. On the other hand negotiable instruments could be involved in every transaction for the purpose of facilitating finance. They could be involved in face to face transactions or in transactions concluded by mail. They could be involved in transactions concluded by two individuals, as well as in transactions the parties to which are small and large businesses, or a combination of individuals and businesses. They could be involved in arranged transactions and transactions the finance of which is intended to be made on the spot. The involvement of negotiable instruments does not require other than the consent of the parties in question to accept the instrument as a means of discharging payment.

Finally, the application of negotiable instruments safeguards the interest of the parties involved in the negotiable instrument transaction. In the first place, the theft of a blank instrument would not prejudice its original proprietor. If the stolen instrument bore the proprietor's forged signature, he would not be liable for the promise fraudulently attributed to him. The drawee would not be able to debit the proprietor's account with the face value of the instrument, should it be erroneously paid.[13] The proprietor may compel the drawee/payor to restore his account as if payment had not occurred.

In the second place, the proprietor of a negotiable instrument is afforded measures sufficient to protect himself against instances in which third parties might claim an advantage detrimental to his interest. The proprietor, by way of "**restricting**" or "**negating**" the negotiability attribute of the instrument in question, subjects the third party acquirer/payor to defences and claims, the application of which could deny them the protection they would have obtained had the negotiability attribute been fully applied in their favour.[14] The proprietor would then be able to challenge the entitlement of the acquirer/recipient to receive or retain the proceeds of the instrument and he would be able to challenge the validity of the drawee's act of payment.

In the third place, the bona fide third party to whom the instrument comes in its full negotiability characteristic, may be availed an enforceable right. His acquisition or payment in reliance on its apparent regularity may afford him a good title or a valid discharge.[15] His reasonable expectation would, accordingly be satisfied.

Lastly, the application of negotiable instruments protects the economic interest of the ordinary consumer. The purchasing power of which the ordinary consumer could avail himself, by way of issuing negotiable instruments, is valued by reference to the actual credit available in his account. His capacity to issue negotiable instruments would be restricted to the extent of the existing credit. Thus, the ordinary consumer would utilise the available credit to satisfy his most urgent needs. The credit would be utilised to finance whatever the ordinary consumer most values.

The Institution of Credit Cards

Credit cards, by comparison, are incapable of substituting money and ultimately they are inconvenient for functioning as a finance instrument in the full sense; on the one hand they are not, literally speaking, available to every person. The poor consumer might not be offered a credit card. His inability to repay the credit would discourage the card issuer from offering him a credit facility. On the other hand, credit cards are not involved in financing every transaction. Their chief involvement is in the face-to-face transaction and transactions conducted through the telephone. They are not normally involved in transactions concluded by mail. The insertion of the credit card number in a letter could involve the risk of fraudulent misuse of the authorisation provided by the card holder in favour of the merchant. The credit card number may be used to debit in excess of the authorised amount, or it could be used by other than the intended merchant.

A further illustration of the credit card's restricted utility as a means of finance is that credit cards are not involved in transactions, the parties to which are individuals. For a credit card to function as a finance device, the party to whom it is offered as such must be a merchant authorised by the card issuer to accept the credit card in question. Merchants would be authorised to accept a given credit card if they subscribe to the credit card scheme in question. To this end, the credit card issuer charges the merchant certain fees. Small businesses, because of the chargeable fees, do not wish to become parties to the credit card scheme. Others are in favour of introducing their own credit cards. Due to the above restrictions, the utility of credit cards in general would be limited to financing transactions, one of the parties of which is a merchant authorised to accept the offered credit card.

Finally, the application of credit cards could create inconvenience to their proprietors i.e. holders. The holder of the credit card would, in instances of theft, bear part of the risk evolving from the unauthorised use of his card, even if no blame could be attributed to him in not safeguarding his card. The card issuer, as the current legislation and banking practice stands, may charge to the holder a portion of the unauthorised use of the card.

In the second place, due to the special nature of credit cards, the card holder does not enjoy absolute control of his card. Once the card is acquired, the holder cannot effectively alter the general characteristics of the card. He can not at all times prevent the card from being misused by an unauthorised person. He cannot prevent the card from being used to induce the bona fide merchant to accept it. He has no means of alerting the merchant to the fact that the user of the card is an unauthorised fraudulent person. Accordingly, he cannot challenge the merchant's entitlement to retain the proceeds of the sale, or his entitlement to receive the same or to challenge the validity of the card issuer's act of payment in favour of the merchant.

Lastly, credit cards may create economic inconvenience to the ordinary consumer, card holder. Because of the credit available to the holder, the ordinary consumer might be led to engage in transactions in excess of his actual purchasing power. Ultimately, he might be led to engage in transactions, the utility of which are less valuable to the card holder.

The Institution of Electronic Fund Transfer

The regulation of the rules of electronic fund transfers has not taken its final shape.[16] There are difficulties relating to legal questions which have yet to be resolved, in particular, that relating to the manner of allocating risk in instances where the transfer of funds occurs in excess of, or in breach of the mandate.[17] Electronic fund transfers, on the other hand, are chiefly involved in financing arranged transactions. They are not by comparison, involved in transactions the finance of which is intended to be made on the spot. The purchaser, i.e. the party who intends to finance the ad hoc transaction by way of an electronic fund transfer device, would not be able to vest his finance with confidentiality. The code number which he has to quote for the purpose of facilitating the electronic fund transfer might be intercepted by a stranger.

Finally, for electronic fund transfers to operate efficiently as a finance device would require the existence of advanced technology. At present, the said technology might not be available for every jurisdiction. Ultimately, electronic fund transfers would not be available to every person and to finance every transaction in every jurisdiction.

II. The Interest of the Commercial Community

The necessity of protecting the interest of the commercial community involved in the negotiable instrument transaction arises from the need to promote the institution of negotiable instruments. Once the interest of the proprietors, acquirers and payors of negotiable instruments were protected, negotiable instruments would be freely marketable.

It has been argued that since negotiable instruments are not often transferable more than once, the interest of remote third party acquirers would not arise.[18] Should it however occur, no great reliance would exist between the acquirer and the remote transferor or purported transferor. The third party in his acquisition relies on his immediate transferor, the party with whom he engages in an independent transaction.[19]

In reply, it could be stated that the mere fact that negotiable instruments are not often negotiated to remote third parties does not render the acquisition of a negotiable instrument by a remote third party, unforeseeable. Because of the special nature of negotiable instruments, they are freely transferable unless their transferability is negated or restricted. Thus any member of the public may, in the particular time, acquire from the market a negotiable instrument in circulation.

As to the second argument, it is submitted that negotiable instruments as chattels transfer with them the incorporated promise or promises, undertaking or undertakings. The liability arising from the promise or undertaking runs in favour of the acquirer/holder.[20] Each promise or undertaking serves as a security in favour of the acquirer. The signatory in question promises or undertakes to pay the acquirer/holder the face value of the instrument. The more promises and undertakings are incorporated in the instrument, the more security would be provided and ultimately, the more marketable the instrument becomes.

The party who acquires the instrument does not, for the purpose of enforcing the face value of the instrument, rely on the promise or undertaking incurred by the immediate transferor only. He places an equal reliance on the other promises or undertakings, especially that negotiable instruments in general do not confer upon the acquirer an absolute and certain credit. The drawee might, for one reason or another dishonour the presented instrument. For the purpose of enforcing the face value of the instrument, the acquirer would need to exercise his right of recourse against the signatories in question. The significance of the promises or undertakings of remote signatories arises when the immediate transferor at the relevant time would not financially be able to satisfy the interest of the acquirer/holder. The acquirer/holder considers the said promises or undertakings as securities, the purpose of which is to satisfy his interest in full.

III. The Interest of the Public and the Notion of Fairness and Justice

(i) The necessity of protecting the interest of the public at large and to allocate risk in an equitable and just manner arises from social needs. The community at large is interested to avoid accident occurrence. Accident involves cost assumption. Cost, in instances of avoidable accidents, is deemed to be a form of wealth misallocation. Wealth is deemed, in the eyes of the community, to fulfil an economic function. It is intended to satisfy the community needs. The incurring of cost in avoidable accidents is inconsistent with community needs.

The need to avoid accident occurrence becomes more apparent in instances where accidents are facilitated by the perpetration of a crime. An example of such an instance is the diversion of the normal currency of negotiable instruments. Its occurrence is normally perpetrated by the criminal behaviour of an independent party. The latter diverts the negotiable instrument from its normal course by, firstly, divesting its property from its original true owner and secondly, by forging the latter's signature.

Crime is submitted to be an evil. The society may accordingly impose upon itself a moral duty to punish or deter the wrong-doer.[21] More important is the prevention of the crime. Every member of the society should take adequate precautions to avoid the perpetration of crime. Once crime was made impossible or more onerous, accident occurrence would be minimised and ultimately social needs would be satisfied.

(ii) The doctrine of fairness and justice is an ancient principle. Its source is submitted to be the application of the general principles of nature. Its validity remained sacred throughout the ages. Almost every civilised legal system engrafted in its laws the policy to approach an equitable and just rule.[22] However the doctrine of fairness and justice might prove to be vague. In order to remove such vagueness the application of the said doctrine might need to be associated with more concrete doctrines.

The necessity to devise an equitable and just rule in the general sense may prove to be unavailing, in instances where the manner of allocating risk arises from situations where the involved competing parties are innocent. Justice would be undone by allocating the evolving risk to either party. An example of such an instance, as far as the risk of negotiable instrument fraud is concerned, is the postal mis-delivery of a negotiable instrument in a properly addressed registered mail to a person bearing a name identical to that of the intended payee, and the fraudulent negotiation of the said instrument to a bona fide third party, neither the sender i.e. original true owner, nor the bona fide third party acquirer could be blamed for the fraudulent negotiation of the mis-delivered instrument. The former is deemed to have observed reasonable care, once he properly addresses the letter and secures a reliable means of delivery. The third party acquirer is deemed to have observed reasonable care once he accepts a negotiable instrument, the form of which does not raise the least suspicion as to its regularity or genuineness. Injustices would be done if the risk of fraud was allocated to either party.

However, in this and like instances, the risk allocation rule could be brought very close to an equitable and just application. This could be approached by comparing the gravity of the hardship of the risk allocation rule to the competing party in question.[23] The risk allocation rule would be closest to the principle of fairness and justice if it was allocated to the party who would suffer the least hardship.[24]

IV. Economic Efficiency as a Mechanism for Risk Allocation

(i) The necessity of forming a risk allocation rule in a manner compatible with economic efficiency arises from the needs of the market. 'The market' is the institution through which a significant portion of commercial engagements are conducted and it is the institution through which the relationship of the commercial community is finally settled. Thus it is essential for the rules of the market to be admissible as finalising the relationship of the involved parties that they should satisfy the interest of the commercial community. It is submitted that one of the main objectives of the commercial community is value maximisation.

The doctrine of value maximisation promotes the utility of the particular entitlement. It empowers the commercial community to derive the maximum utility from the said entitlements. Ultimately it enables the community in question to invest the derivable utility to satisfy its most urgent needs. The value of a particular entitlement would be maximised if it is allocated in its proper channels. Value will be allocated in its proper channels when its allocation generates the optimal utility.

Rational persons, through their behaviour engage to maximise value. They incur expenses when and only when the item or service which they intend to purchase generates to them a utility at least equal to its face value. Rational persons in their purchases endeavour to incur the least expense on an item of a given utility.[25]

The doctrine of value maximisation also finds support in the various rational legal systems. They endeavour to protect persons unable to allocate value in its proper channels. The mentally incapacitated and the inexperienced are protected against economic exploitation. The transactions in which they engage are rendered void or voidable in a manner compatible with their interests.[26]

(ii) The significance of economic efficiency became more apparent in the second half of this century.[27] Several attempts were made to justify legal principles and rules on economic bases.[28] In particular, the concept of negligence,[29] the rules relating to it, as well as the rules relating to automobile accidents,[30] product liabilility,[31] respondeat superior[32] and consumer credit[33] were based on economic arguments. The problem of determining the manner of risk allocation was the centre point of the above studies.[34]

Theories in Value Maximisation

Since the essence of the economic efficiency approach as could be noted from the foregoing is to maximise value, several theories have been advanced in determining the most efficient test for value maximisation. The advocates of the following theories utilised their selected value maximisation test in settling the problem of risk allocation in situations of competing entitlements. They allocated the entitlement, which is the subject matter of conflicting claims, in a manner which they believe would achieve most efficiently the objective of value maximisation. The theories in value maximisation are as follows.

<u>The Posnerian Theory</u>

(i) This theory derives its title from its author and prime advocate Professor Richard A. Posner.[35] It deems the party's willingness to pay more to acquire a particular entitlement the determinative test for maximising the value of the said entitlement. It is of the view that the value of a particular entitlement would be maximised when more value was allocated for its acquisition. In instances where the said entitlement was the subject of a conflicting claim, the Posnerian Theory allocates it to the party who values it most.[36] From the foregoing it could be inferred that the Posnerian Theory tends to allocate the property right to the entitlement, the subject matter of a conflicting claim, in instances where the needs of the said party are as significant as those of the other competing party, in favour of the wealthier party. Accordingly, it could result in allocating the risk arising from such a situation to the relatively poor party.

(ii) To illustrate the Posnerian concept of value maximisation and its application as a test for allocating entitlements, assume that John Alex and Billy Barnes are in dispute over a barrel of water in a desert. The theory of value maximisation initially allocates the right to the barrel of water to the party who is willing to pay more to obtain it. If John Alex was richer than Billy Barnes, he would be willing to pay more for the barrel of water. Thus, the right to the barrel of water would be initially allocated to John Alex.

The allocation of the right to an entitlement to the richer party would maximise the value of the said entitlement in the sense that, the subject matter of the entitlement would not be given away unless the party to whom it is initially allocated demands in return a value equal to that which he applies to it. Thus, if Billy Barnes intends to buy the barrel of water from John Alex i.e. the party to whom the right to the barrel of water is initially allocated, he would have to "bribe" the latter. The value of the bribery would be computed by reference to that which John Alex applies to the barrel of water.

By analogy, if the property right to a negotiable instrument was in conflict, the Posnerian Theory of value maximisation allocates the entitlement to the negotiable instrument in favour of the party who is willing to pay more for it. If the original true owner, the party from whom the instrument was stolen, was richer and he was willing to pay more than the bona fide acquirer, the entitlement to the instrument would be allocated to the former.

(iii) The main defects of the Posnerian Theory of value maximisation are twofold. Firstly, it allocates entitlements in a socially undesirable manner; it tends to prefer the rich over the poor, it allocates entitlements in favour of the former party.[37] Secondly, the said theory is economically incohesive. Its application allocates to the party against whom it operates i.e. the relatively poor party, the duty to incur cost. The said cost is illustrated in the bribery which the said party would have to invest to induce the richer party to give up the entitlement in conflict to him. In such an instance, the costs incurrable might not generate an enforceable value in favour of the relatively poor party. Accordingly, it would operate against him as a misallocation of wealth.[38]

The economic invalidity of the Posnerian Theory of value maximisation becomes more apparent in the context of negotiable instruments. The value of such documents is always fixed. It is determined by reference to the contractual promises and undertakings to pay a certain sum of money incorporated in them. The need for maximising the value of a negotiable instrument in instances where its entitlement becomes the subject matter of a conflicting claim would then be economically undesirable and even meaningless. The investment of an additional value to its face value in order to establish the party's entitlement to it might not generate value in favour of the said party. His investment of an additional value as such could result in a misallocation of wealth to him.

The Coase Theorem

(i) This theory derives its title from the name of its author, Professor Ronald Coase.[39] It deems the allocation of entitlements by way of private settlement as the efficient test of value maximisation. It is of the view that competing parties through negotiation are better able to determine the value of the entitlement in conflict. Thus, the theory under consideration does not consider the initial allocation of the entitlement in conflict to either of the competing parties of a particular significance.[40] In instances where the entitlement in conflict was allocated to either of the competing parties, the other competing party, through negotiation can purchase the said entitlement from his adversary and ultimately, through such behaviour, he can re-allocate the entitlement in question to his favour. The Coase theorem, however, bases its application on two general assumptions. Namely, that social wealth is distributed equitably among the members of the community in which the situation of conflicting entitlements arises and that the process of negotiation does not involve transaction costs.[41]

(ii) To illustrate the Coase theorem application as a test for value maximisation, assume that John Alex engages in manufacturing penicillin and other drugs. His factory is located on the River Y, in which it dumps its waste. Assume further that a residential estate is located on the other side of the River Y. The tenants of that estate take their water from the river. Assume finally that the current of the River Y runs in the direction of the residential estate. It takes with it the contaminated chemical materials. Ultimately, it pollutes the water consumed by the tenants of the residential estate.

It could be noted that the foregoing illustration represents a situation of conflicting entitlements. This is demonstrated in the tenants of the residential estate and John Alex's entitlement to a quiet enjoyment of the River Y. The former are interested to have their only source of water uncontaminated. John Alex, by comparison, is interested to have the right of dumping the waste in the river maintained and ultimately, he is interested to resume conducting his business, in the same manner as before, at no additional expense.

The Coase theorem resolves the above mentioned conflict by allocating the function of establishing the entitlement in question to the competing parties themselves. It is of the view that the competing parties, such as the tenants of the residential estate and John Alex, are better situated to determine the value of the free access to the River Y. In such an instance, and by reference to the allotted value, the entitlement in question could finally be allocated. The party who values the free access to the River Y most, by increasing his asking price for giving up the said entitlement or by offering a large bribe for its acquisition, may establish the entitlement to a quiet enjoyment of the River Y in his favour.

(iii) The main defects of the Coase theorem are threefold. In the first place, its application is based on the assumption that social wealth is distributed equitably among the members of the community in which the situation of conflicting entitlements arises and that the process of negotiation does not involve transaction cost. It is submitted that the foregoing assumptions are hypothetical. In reality and practice, the process of negotiation does not always resolve the conflict between the competing parties. In many instances, the negotiation process comes to a halt. Ultimately, the competing parties would have to settle their dispute in court. Court settlement, as could be noted, involves transaction cost. Such cost constitutes added expenses. Its assumption might not generate an enforceable value in favour of the party to whom it is allocated. Transaction cost, as could be concluded, results in a misallocation of wealth. Its involvement accordingly would be economically undesirable.

As to the second assumption, namely that related to the equitable distribution of social wealth, it is submitted here also that social wealth is not always distributed equitably. In such an instance the competing parties would not be similarly situated. The wealthier party is presumed to be better situated to establish the entitlement in conflict to his favour. This he can maintain by increasing his asking price for giving up the entitlement in question to his adversary in instances where the said entitlement was allocated initially to him and by offering an affordable offering price so as to induce his adversary i.e. the party to whom the entitlement in conflict was initially allocated, to give it up to him. From the foregoing, it could be concluded that the Coase theorem, in instances where social wealth was not distributed equitably is socially unjust. It favours the rich over the poor.[42]

In the second place, by throwing the burden of allocating entitlements on the involved parties, the Coase Theorem encounters two difficulties as to its theoretical application. On the one hand, it does not determine with predictability the party to whose favour the entitlement in conflict should be allocated. It determines such a question by reference to the outcome of negotiation. The process of negotiation, as could be noted, involves time. It is submitted that the involvement of time is undesirable in commerce. It compels the parties involved in the process of negotiation to disturb their commercial engagements, the performance of which is dependent on the outcome of their private negotiation. Accordingly, it prevents the said parties from satisfying their commercial interests in a timely and efficient manner.

From the foregoing, it could be concluded that the Coase Theorem is inconvenient as a risk allocation theory in instances where the situation of conflicting entitlements arises in commercial transactions, such as those underlying the issuance, indorsement and acceptance of negotiable instruments. Due to its reliance on the process of negotiation in determining the party to whose favour the entitlement in conflict should be allocated, its application prevents the parties from determining their entitlements in a predictable and speedy manner. Ultimately, it prevents the said parties from satisfying their commercial interests in an economically efficient manner.[43]

On the other hand, the application of the Coase Theorem as a test for allocating entitlements does not crystallise until the situation of conflicting entitlements arises. It does not attempt to provide against the occurrence of such a situation. Ultimately, its application could result in allocating the duty to incur costs for the purpose of purchasing the entitlement in conflict to the party who is in no position to derive an enforceable value from it, or absorb it. That is to say that the Coase Theorem could result in a misallocation of wealth.

An example of the instance where the Coase Theorem could result in a misallocation of wealth is that illustrated in the context of negotiable instruments. In instances where a stolen or lost negotiable instrument comes into the possession of a bona fide third party for value and the original true owner i.e. the party from whom the instrument in question was stolen or lost, blocks its payment by ordering the drawee, with the assistance of the initial maker, i.e. the former's customer to dishonour the said document, the bona fide third party acquirer would have to bribe the drawee's customer and ultimately, he would have to bribe the original true owner in order to establish in his favour the property right to the stolen or lost negotiable instrument and have its proceeds released in his favour.[44] The bribery which the bona fide third party acquirer would have to offer the original true owner in order to induce him to give up his property right to the stolen or lost negotiable instrument, represents a cost. The bona fide third party acquirer, due to his status as such is not, as will be shown below,[45] in the position to derive an enforceable value from it nor is he in the position to absorb it. Accordingly, the allocation to the bona fide third party acquirer of the duty to bribe the original true owner is economically invalid. Its application results in a misallocation of wealth to him.

In the third place, by stating that the initial allocation of the entitlement in conflict to either of the competing parties is insignificant, the Coase Theorem is submitted to be conceptually incorrect. The party to whom the entitlement in question is initially allocated would apply to it a higher value than that which he would apply had it been in the hands of another party. That is to say, that the asking price for giving up a particular entitlement does not necessarily correspond with its offering price. Accordingly, the party to whose favour the entitlement in conflict is initially allocated may, by increasing his asking price, prevent his adversary who may be a potential competing party, from reallocating the said entitlement in his favour.[46]

[illegible]

The Theory of Cost and Benefit Analysis

(i) The essence of this theory is to allocate entitlements in a manner which brings about social justice. It deems the allocation of entitlements in a manner which does not cause either of the competing parties to be worse off than that of their status ante, as the efficient way of approaching social justice in a situation of conflicting entitlements.[47]

For the purpose of determining the most efficient rule which is compatible with allocating entitlements without causing either of the competing parties to be worse off and ultimately, for the purpose of determining the rule which is capable of approaching the objective of social justice in an efficient manner, the theory of cost and benefit analysis has been the subject of variant applications. The most favoured version is that proposed by the theory's liberal advocates such as Ackerman,[48] Hirschoff,[49] Calabresi[50] and Michelman.[51] The cost and benefit analysis in its liberal version is of the view that the allocation of entitlements would not cause either of the competing parties to be worse off when -

1) the gains and losses resulting from allocating the entitlement in conflict in one way or another were examined,

2) the entitlement in question was allocated to the party,

the satisfaction of those interest would result in greater gains to the community in which the situation of conflicting entitlement arises, than the losses that would result from establishing liability for causing the said situation against the other competing party, and
3) the party to whose favour the entitlement in conflict is established was required to compensate the other competing party for the loss caused to him by such an application.[52]

The thesis underlying the establishment of liability against the other competing party is based on the issue of causation. The theory in its liberal version deems the physical involvement of the said party or his behavioural engagement as the cause of the conflicting entitlement situation. It deems the evolving situation as the external cost of the competing party's physical involvement or as the external cost of the said party's behavioural engagement. In the light of such an interpretation, the theory under consideration is of the view that the party against whom it operates must internalise the evolving cost and ultimately he ought to bear it.[53]

(ii) To illustrate the application of the theory of cost and benefit analysis in its liberal version as a test for allocating entitlements, recall the hypothetical on river pollution.[54] There, the factor which gave rise to a situation of conflicting entitlement was the dumping of chemical waste in the River Y. On the one hand, it raised

John Alex's entitlement to resume his business in the same manner as before at no additional cost. On the other hand, it raised the entitlement of the tenants of the residential estate to have their only source of water uncontaminated. The determination of whose entitlement should prevail, as far as this hypothetical is concerned, is closely related to determining to whose favour the right to a quiet enjoyment of the River Y should be allocated. The party to whose favour the free access to the River Y is allocated should, in the last analysis, have his respective entitlement preserved.

The theory of cost and benefit analysis in its liberal version resolves the above-mentioned conflict by examining the gains and losses evolving from allocating the right to a quiet enjoyment of the River Y to either John Alex or the tenants of the residential estate. If the gains evolving from allocating the said entitlement to the latter party were firstly, greater than the evolving losses and secondly, they were greater than those evolving from allocating it to John Alex, the theory under consideration would allocate the right to a quiet enjoyment of the River Y to the tenants of the residential estate. As far as the hypothetical under consideration is concerned, it would seem that the theory of cost and benefit analysis in its liberal version is more inclined to allocate the right to a quiet enjoyment of the River Y to the tenants of the residential estate. This is due to the fact that had the said entitlement been allocated to John Alex, the tenants of the residential estate would, due to water pollution, experience an increase in the rate of disease. If, however, they were required to install equipment, the purpose of which is to purify the river water, they would experience an increase in their expenses. The creation of a situation where either of the foregoing consequences would arise, could result in social unrest in the residential estate and ultimately it could result in public disorder. It is submitted that the losses from such an allocation are greater than those evolving had the right to a quiet enjoyment of the River Y been established in favour of the tenants of the residential estate. The losses that could result from such an allocation are illustrated in the investment of expenses for the purpose of preventing the pollution of the River Y.

By determining the party whose entitlement should prevail and ultimately by determining the party to whose favour the free access to the River Y should be allocated, as far as the hypothetical under consideration is concerned, the theory in its liberal version holds the party against whom it operates, such as John Alex, liable for the factor which gave rise to the situation of conflicting entitlements, namely, the dumping of the chemical waste. It deems the pollution of the River Y as the external cost of John Alex's own behaviour. Accordingly, it considers it proper for John Alex to internalise such cost and ultimately bear it.

Finally, the role of the theory of cost and benefit analysis in its liberal version in allocating entitlements, does not terminate by determining the party to whose favour the entitlement in conflict should be allocated. For the purpose of providing against instances whereby the other competing party would be placed in a situation worse than that of his status ante, the theory under consideration requires the gainers from its application, such as the tenants of the residential estate, to compensate the losers, such as John Alex.[55] By such a provision, the said theory purports to preserve social justice.

(iii) The main defects of the theory of cost and benefit analysis are three fold. In the first place, the gains and losses which the theory takes into account in allocating the entitlements are determined by reference to the impact of the allocation of entitlements rule on the competing activities. It allocates the entitlement in conflict so as to further the activity which the policy considerations of the jurisdiction in question intend to promote. An example of such an instance is that illustrated in the hypothetical relating to river pollution. It is submitted that the objective of achieving social stability is more significant than the objective of marketing a particular product. Since the allocation of the right to a quiet enjoyment of the River Y in favour of John Alex could result in social unrest, every rational legal system in which such a conflict may occur would not desire to approach such a rule. Rather it would be more inclined to allocate the entitlements in respect of the River Y in favour of the tenants of the residential estate.

To state the obvious, the theory of determining the relevant gains and losses which could shape the allocation of entitlements rule by reference to the impact of the rule in question on the competing activities, does not always operate as a test for allocating entitlements. There are instances in which the competing activities are of equal significance for the purpose of promoting a particular institution. The allocation of the entitlement in conflict in favour of the community engaged in a particular competing activity could deter the other community from engaging in the equally significant competing activity. Ultimately, the objective of promoting the institution in question would fail.

An example of the instance in which the competing activities are of equal significance for the purpose of promoting a common legal institution and where the restriction of either competing activity could prevent the promotion of such an institution is illustrated in that arising from negotiable instrument fraud. In instances where a negotiable instrument was stolen and its thief fraudulently negotiated it for value to a bona fide third party, the title to such a document would be the subject of conflicting entitlements. The original true owner i.e. the party from whom the negotiable instrument was stolen, is interested to have the title of the said document and its proceeds restored to him. The third party acquirer is interested, by comparison, to have the title to the negotiable instrument and its proceeds established in his favour.

As could be noted, the activities which give rise to the foregoing situation are the lawful negotiation of negotiable instruments and their acquisition. Had the document in question not been issued in the first place, its theft and fraudulent misuse would not have occurred. Had it not been acquired, by comparison, its thief would not have succeeded in misappropriating its proceeds and ultimately his fraudulent practice would not have resulted in a loss.

On the other hand, the act of negotiation, and the act of acquisition are of equal significance for the purpose of promoting the institution of negotiable instruments as a substitute for money and ultimately they are of equal significance for the purpose of promoting its function as a finance device.[56] Without the act of negotiation, negotiable instruments would not come into existence. Without the act of acquisition, such documents would not function as a substitute for money and ultimately they would not function as a finance device. The preference of either act would necessarily, in instances of conflicting entitlements, restrict the other competing act. If the act of negotiation was made paramount by restoring the title to the stolen negotiable instrument and its proceeds to the original true owner, the act of acquisition would be restricted. The members of the commercial community to whom a negotiable instrument is offered for a valuable exchange would be deterred from acquiring it. If, however, the act of acquisition was made paramount by establishing the title to a stolen negotiable instrument and its proceeds in favour of the bona fide third party acquirer, the act of negotiation would be restricted. The members of the commercial community to whom a negotiable instrument was offered as a discharge for the underlying obligation would be deterred from taking it up from its issuers. Ultimately, the act of negotiation such as issuance would be of no practical value.

In the second place, the theory under consideration does not provide a reasonable basis for establishing liability against the party to whom it intends to allocate the risk arising from the situation of conflicting entitlements. The determination that the said party's physical presence or his behavioural engagement is the cause of creating the situation of conflicting entitlements is not quite accurate. It is submitted that in situations of conflicting entitlements, the physical presence and the behavioural engagements of each of the involved competing parties is the cause of creating the said situation.[57] For an example, had the residential estate not been located on the other side of the River Y to the factory, as far as the hypothetical on river pollution is concerned,[58] the situation of conflicting entitlements to a quiet enjoyment of the River Y would not have arisen. By the same token, had the factory not been located on the River Y, the very same situation would not have arisen. In the light of the foregoing, it would be unreasonable in the absence of an existing rule of law to determine that a particular competing party, rather than the other competing party is liable for causing the situation of conflicting entitlements.

The unreasonable application of the theory of cost and benefit analysis becomes more apparent in instances where the behavioural engagements of the competing parties could, in the general sense, be interpreted as being the cause of creating the situation of conflicting entitlements. An example of such an instance is that arising from negotiable instrument fraud, such as that arising from the theft of a negotiable instrument, the forgery of its proprietor's indorsement and its fraudulent negotiation in favour of a bona fide third party. In such an instance, the act of the proprietor in not exercising due care in the safe custody and negotiation of his document, and the act of the bona fide third party in not exercising due care in shopping for information relating to the status of the offered instrument, the identity of its possessor and the validity of his title, are presumed to be the cause for giving rise to the risk of loss.[59] Had the said parties complied with the above-mentioned care, they would have prevented the fraudulent person i.e. the thief from misusing the negotiable instrument, or they would have prevented him from misappropriating its proceeds. In such an instance, the determination that one of the above-mentioned behaviours only is the operative cause of the resulting loss and ultimately, the determination that the party responsible for it should be held liable for the said loss does not seem, in the absence of an existing rule of law, to be reasonable. Its application could result in allocating the whole blame to one particular party, whilst it could result in releasing the equally or more guilty party from liability. In other words, the allocation of loss to one competing party, in instances where both competing parties are, in general, guilty of causing it, could encourage the equally or more guilty party in behaving carelessly. It could result in an increase in the rate of loss occurrence and ultimately, it could result in a misallocation of wealth.

In the third place, the theory of cost and benefit analysis does not foreclose the issue of allocating entitlements by establishing liability against one of the competing parties. It requires the other competing party i.e. the gainer from the rule of establishing liability against his adversary, to compensate the latter in order to prevent placing the said party in a situation worse than his status ante and in order to approach social justice.[60] The theory calculates the amount of the compensation that ought to be paid to the loser from the allocation of entitlements rule, such as John Alex as far as the hypothetical on river pollution is concerned, by making reference to the offering or asking price for acquiring or giving up a particular entitlement. It consults an independent party as to what price he would be asking to give up the entitlement in conflict or it consults him as to what price he would be offering to purchase the said entitlement. In the light of the offered answer, the theory under consideration determines the compensation which the gainers would have to pay the losers.[61]

To state the obvious, the allocation to the gainers of the duty to compensate the losers in in principle inconvenient to qualify the general allocation of entitlements rule. Its application could impair the rule resulting from the general allocation of entitlements. It could render the said rule of no practical value. This becomes more apparent in instances where the amount of the payable compensation, due to the rate of the offering or asking price, is higher than the gains derivable from the allocation of the entitlement in conflict in the first place to the gainers. In other words, the allocation of the duty to compensate the losers could alter the general allocation of entitlements rule. It could end up with allocating the entitlement in conflict in a manner favourable to the party against whom it establishes the liability for creating the situation of conflicting entitlements.

On the other hand, the allocation to the gainers of the duty to compensate the losers could result in a misallocation of wealth. This is due to the fact that the payable compensation represents a cost to the gainers. The incurrable cost, by comparison, might not be of an enforceable value in favour of such parties. It might not generate as benefit to them or it might not be absorbed by them. Accordingly, the gainers would have to assume cost without being in the position to derive an enforceable value from it or even be in the position to spread it among other parties.

An example of the instances in which the allocation to the gainers of the duty to compensate the losers could result in a misallocation of wealth is that arising from the allocation of the entitlement to the property right to a stolen negotiable instrument in favour of its bona fide third party axquirer.[62] The bona fide third party acquirer, as will be shown below[63] is not, due to his status as such, in the position to derive an enforceable value from the assumption of cost. Moreover, he is in no position to spread such cost among other parties and ultimately he is in no position to recover it, had it been allocated to him. Thus, the allocation to the bona fide third party of the duty to compensate the original true owner i.e. the party from whom the instrument in conflict was stolen, would result in a misallocation of wealth to him. It would compel him to incur cost despite his inability to derive an enforceable value from it or absorb it.

The Theory of Cost and Benefit Analysis Reconstructed

(i) The notion of social justice in the context of the allocation of entitlements is submitted to be valid. On the one hand, it incorporates the notion of fairness and equity. It takes into account the status of each party in relation to the entitlement in conflict. Unlike the other theories, it does not favour one competing party over another by reason of his wealth or productivity. On the other hand, by examining the status of the involved competing parties independent from extraneous elements, the notion of social justice promotes more efficiently the objective of value maximisation. It allocates entitlement to the party who is in the least position to purchase it had it been the subject matter of conflicting claims and who would suffer the most hardship had the duty to purchase it been allocated to him.

The notion of examining the gains and losses arising from the allocation of entitlements by comparison is presumed to be the efficient manner of bringing about social justice. It incorporates more effectively the theory of examining in abstract the status of the evolving competing parties. It determines the party who would suffer the most hardship from the allocation of the duty to purchase the entitlement in conflict. Ultimately, it determines the party to whose favour the entitlement in question should be allocated.

In order for the notion of examining gains and losses to operate as an efficient way of achieving social justice it should be considered by reference to the cost of abating the factor giving rise to the situation of conflicting entitlements. That is to say that the gains and losses which are to be taken into account in determining the allocation of entitlements rule should denote those arising from the assumption of the cost of abatement. The cost of abatement is presumed to result in a gain when its assumption generates an enforceable value in favour of the competing party to whom it is allocated. The said cost is presumed to result in a loss by comparison when its assumption does not generate an enforceable value in favour of the competing party to whom it is allocated or when it cannot be spread among other persons. From the foregoing, it could be concluded that the cost of abatement is presumed to result in a loss when it takes the form of a valueless obligation and an irreparable damage.

In the light of the above interpretation, the allocation of entitlements rule should be allocated in favour of the party who is -

1) in no position to derive an enforceable value from the assumption of the cost of abating the factor giving rise to the situation of conflicting entitlements, and

2) who is in no position to absorb such cost.

In such an instance, the entitlement in conflict should be established in favour of such a party. Ultimately, the liability giving rise to the situation of conflicting entitlements should be established against the party who is in the position to derive an enforceable value from the assumption of the cost of abatement or who is in the position to absorb it.

Such an application, as could be noted, is in line with the notion of social justice. It establishes the entitlement in conflict in favour of the party who is in no position to provide against the situation of conflicting entitlements and who would suffer the most hardship had the cost of abating it been allocated to him. By comparison, the above application enforces the allocation of entitlement rule against the party who is best situated to provide against the occurrence of the situation of conflicting entitlements. It allocates to him the duty to assume the cost of abating the factor giving rise to the said situation. Ultimately, in instances where the said party fails to comply with such a duty, it holds him liable for creating the situation in question.

Finally, by determining the gains and losses which underlie the allocation of entitlements rule by reference to the cost of abatement, the theory of cost and benefit analysis in the advocated sense is presumed to promote in an efficient manner the objective of value maximisation. This is achieved by restricting the duty to assume the cost of abatement i.e. a form of value, to the party who derives an enforceable utility from it or to the party who is in the position to absorb it. By comparison, it releases the party in question from the duty to incur cost in instances where he is in no position to derive an enforceable value from the assumption of such cost and who is in no position to absorb it. By such an application the theory under consideration provides against the misallocation of wealth. It only operates against the party who would suffer the least economic detriment from its application.

From the foregoing it could be concluded that the theory of the cost and benefit analysis with reference to the cost of abatement provides an efficient basis in the economic sense for allocating entitlements. Its application promotes, in an efficient manner, the objective of value maximisation. In the light of the foregoing, and unless a more efficient basis for allocating entitlements is forthcoming, the theory under consideration is presumed to provide the most efficient basis for allocating entitlements. Accordingly it will be advanced as the theory for determining the allocation of entitlements rule in the context of negotiable instrument fraud.

Note p 136.

Theories in Allocating Risk on the Basis of Liability

The problem of allocating entitlements and ultimately the problem of risk allocation is intertwined with the question of liability. This is due to the fact that the situation of conflicting entitlements evolves as a result of either or both of the competing parties' own conduct. Therefore, many theorists endeavoured to allocate entitlements on the basis of liability. They come to such an approach by examining the respective conduct of the involved competing parties. By determining the guilty party whose conduct gives rise to the situation of conflicting entitlement, they establish liability against him and ultimately they allocate the entitlement in conflict to the innocent competing party. The main theories advanced in this context are the negligence,[64] contributory negligence,[65] comparative negligence[66] and insurance[67] theories.

The Negligence Theory

(i) The application of the negligence theory allocates risk to the party at fault. The main advantage of the said theory is that it conforms with the notion of fairness and equity. Nevertheless, its application encounters several difficulties and inconveniences. In the first place, the negligence theory could be applied as a risk allocation mechanism in instances of fault only. Where, by comparison, no fault could be attributed to either competing parties, or where the involved competing parties are at fault, the theory, in its traditional version, allocates the risk arbitrarily to the plaintiff.[68] The terms plaintiff and defendant, in this context, denote the injured and the injurer. Thus, in instances of no fault and where the competing parties are at fault, the risk arising would be allocated to the injured party.

(ii) In the context of negotiable instruments, the terms plaintiff and defendant in the sense of injured and injurer have no definite application in instances of risk arising from fraud. The risk of creating a situation of conflicting entitlements is not the direct consequence of the parties' conduct. Rather, it is the perpetration of a fraudulent practice by an independent party i.e. the fraudulent person. The inapplicability of the term injurer to the instance under consideration, becomes more apparent where no fault could be attributed to the competing parties in question. An example of such a situation is the dispatch of a negotiable instrument by registered mail to a payee. Due to postal mis-delivery, the instrument comes into the hands of a third person bearing a name identical to that of the party to whom the instrument is intended to be delivered. The third party into whose hands the instrument erroneously comes, misappropriates its proceeds by negotiating it with a bona fide acquirer. In this example, no fault - in the strict sense - could be attributed to either the sender or the acquirer. The former is presumed to have acted reasonably once he properly addresses the instrument and secures a reasonable means of dispatch. The acquirer is presumed to have acted reasonably once he acquires an instrument, the face value of which does not arouse suspicion as to its genuineness. The fraudulent person in the above instances is always deemed to be the actual injurer. However, his involvement in the risk allocation scene does not normally arise either due to his disappearance or insolvency.

Since the fraudulent practice of the fraudulent person takes the form of diverting the normal currency of the negotiable instrument, the interest of the party from whom the instrument was stolen and whose signature was forged, as well as the party into whose hands the instrument may bona fide come, could be injured. The former's interest would be injured if he was dispossessed of the property right to the instrument or its proceeds.

The acquirer's interest would be injured if he was disentitled to retain the instrument or its proceeds. The determination of which of the above-mentioned competing interests is intended to be directed against by the fraudulent practice of the fraudulent person is submitted to be the role of the applicable law. It determines which of the competing parties is deemed to be the plaintiff in the action in question and ultimately it determines the party who should not be entitled to recover the loss resulting from negligence. From the foregoing, it could be concluded that the negligence theory allocates risk by reference to an applicable rule of law. It does not formulate the risk allocation rule in the context of negotiable instrument fraud. This is incompatible with the objective of this work. The objective of this work is to detemrine a risk allocation rule that could shape the rule of law.

(iii) In the second place, the concept of negligence which the theory under consideration employs as a test for risk allocation, creates inconvenience to commerce in general and in particular to international trade. On the one hand, the concept of negligence is not of a uniform application. The Anglo-American and the continental Civil legal systems are in disagreement as to the essential requirements of negligence. The former require that for a defendant to be held negligent, he must be in breach of a specific duty of care owed to the plaintiff.[69] The continental Civil legal systems do not require the existence of a specific duty of care. Every person owes to the public a general duty of care not to injure the latter.[70] Thus, if the cause upon which the liability for damage in an action involving two different legal systems is to be based, was negligence, the plaintiff may be frustrated as to his reasonable expectation. The proper law may prove to be that of a foreign legal system. It may require the establishment of the defendant's breach of a specific duty of care owed to the plaintiff.

To illustrate, assume that John Alex is the proprietor of a business engaged in supplying dairy products in the United Kingdom. He employs Willy Williams as the financial secretary of his business. In his capacity as such, Willy Williams is empowered to indorse and issue cheques in the business name. Willy Williams decides to misappropriate business funds to purchase a French Renault car. He fraudulently implies to his principal that the firm is indebted to a dairy farm a sum of money, purporting to be the purchase value of the dairy products. Willy Williams forges invoices to that effect and files them to his principal. John Alex signs a blank cheque and instructs Willy Williams to fill the spaces as appropriate. The latter fraudulently fills in the French dealer's name, the party from whom he intends to purchase the Renault, as payee, and fills in the value of the car as the sum of money for which the cheque is to be payable. Finally, Willy Williams misrepresents to the French dealer that the car in question is intended to be purchased for business use.

As consideration, he posts the fraudulently made cheque to the French dealer. The latter ships the car to Willy Williams who misappropriates it. Before the cashing of the cheque, John Alex learns of the forgery. He writes to the bank and instructs it to countermand the cheque.

Under the French law, John Alex is liable to the French dealer on the cheque. The doctrine of **"respondeat superior"** attributes to him a prima facie presumption of fault.[71] The liability evolving from the presumptive fault runs in favour of every party who might be injured by it. Under English law, by comparison, John Alex is not liable to the French dealer. The drawer of a negotiable instrument in general owes no specific duty of care to its holder.[72] Thus if the French dealer intends to enforce the cheque in an English court, he would be frustrated. Since the drawer's negligence is not actionable in England, the English court would not grant a liability rule in favour of the plaintiff, i.e. the French dealer.[73]

Connection

Because the cheque has a significant close-connectedness with the English law, the mere actionability of negligence in the lex loci delecti i.e. French law, would not suffice to establish the liability of the drawer John Alex.[74]

For the plaintiff to succeed in his action against the defendant, he may need to purchase information as to the rule of the applicable foreign law and he may need to establish under that law the existence of a specific duty of care owed to him. The imposition of the duty of enquiry and the imposition of the burden of proof on the bona fide acquirer of a negotiable instrument is incompatible with the promotion of the institution of negotiable instruments as well as the nature of the said institution.

The shopping for information concerning the rule of law in the applicable foreign law may involve cost. If the acquirer, the party upon whom the duty of enquiry is imposed, would not derive enforceable value from the incurring of cost, he would refrain from the acquisition of negotiable instruments. Accordingly, the free transferability of negotiable instruments would not be promoted.

The allocation of the burden of proof to the bona fide acquirer/holder is contrary to the application of the general characteristics of negotiable instruments. Negotiable instruments create, in favour of their acquirers, a prima facie presumption of regularity. The purpose of the said characteristic is to promote the free transferability of negotiable instruments. If the acquirer/plaintiff was under a duty to establish the negligence of the defendant and its actionability under the applicable foreign law, he would be divested of the advantage afforded to him by the prima facie presumption of regularity arising out of the special nature of negotiable instruments. Accordingly, the acquisition of negotiable instruments in general would be discouraged.

(iv) On the other hand, as a further illustration of the inconvenience of the concept of negligence to commerce, the standard of care which ought to be observed is not uniform, it does not vary as between the different legal systems only, rather its non-uniformity could be traced into the single legal system. For an example, the standard of the required care varies according to the size of business. Large businesses are under a duty of care to observe more stringent control than small businesses.[75] If loss occurs as a result of lack of supervision of employees, large businesses are more likely to be held liable than small businesses.

Here also, in light of the non-uniformity of the standard of care, the plaintiff may need to shop for information concerning the required standard of care and he may need to establish the defendant's failure to observe the said standard. The allocation of the said duties to the plaintiff/acquirer may be incompatible with the promotion of negotiable instruments. Their free transferability may, due to the above duties, be curtailed.

(v) Finally, the theory of negligence employs a factual test. Each case which raises the element of negligence should be determined on its particular facts. The need for court settlement will, accordingly, increase. The increase in court settlement will necessarily involve time consumption and transaction costs. Time is of the essence to the commercial community. Merchants utilise time to satisfy their commercial needs. If the said time was involved in litigation, merchants would forego the opportunity to satisfy their needs. Transaction costs, on the other hand are a form of wealth appropriation. If the need for litigation was avoidable, the incurring of cost in the course of court settlement would be deemed a form of misallocation of wealth. Lastly, the need for court settlement involves uncertainty as to the applicable risk allocation rule. Accordingly, merchants would either refrain from engaging in other transactions, the finance of which is dependent on the court's finding as to the transaction in question or they might need to disturb the performance of the dependent transaction. Ultimately the need for court settlement might damage their financial situation.[76]

The Contributory Negligence Theory

(i) The concept of negligence has undergone a refined definition. Learned Hand J. in **United States v Carroll Towing**[77] subjected the concept of negligence to economic analysis. The judge considered the standard of care of a **"rational man"** as the proper test for determining the liability of parties. The duty to exercise care, in the words of the judge, is the function of three variables, namely the cost of avoiding accident occurrence, the probability of accident occurrence and the gravity of the evolving damage.[78]

A rational party would be under a duty to avoid accident occurrence if the cost employed for the purpose of avoiding accident occurrence was less than the probability of accident occurrence and the gravity of damage should it occur. To express the above formula in an arithmetical equation, let C signify cost, P probability of accident occurrence and G gravity of damage. Learned Hand's formula will thus run: a party would be liable for accident occurrence if $C<PG$.[79]

To illustrate the application of the above mentioned liability rule, assume that John Alex, due to his car's brake failure, caused Billy Barnes to be injured in an accident, the gravity of the injury of which is measured at £500. Assume further that John Alex could have avoided the accident by remedying the said defect at a cost of £100. Because of the high probability that the brake failure would cause an accident and because the cost of avoiding the accident is less than the evolving injury, the contributory negligence theory holds John Alex liable for the injury caused to Billy Barnes.

(ii) Learned Hand's liability rule is further supplemented by comparing the cost incurrable by the defendant, i.e. injurer to avoid accident occurrence, with that incurrable by the plaintiff i.e. injured. The liability for the evolving damage is allocated to the party who could have avoided the occurrence of an accident at the lower or at no cost.[80] Thus, assume that two cars were involved in an accident. The total damage of the accident is measured at £1000. Assume further that the accident occurred due to defects in the defendant's as well as the plaintiff's car. Assume, finally, that either the defendant or the plaintiff could have avoided the accident by remedying the defects in question. The defendant's cost of avoidance is measured at £100, whilst the plaintiff's cost of avoidance is measured at £50. Since the cost of the plaintiff's avoidance is, firstly, less than that of the defendant's and, secondly, is less than the evolving damage i.e. £1000, the contributory negligence theory allocates the risk evolving from the accident to the plaintiff. It bars him absolutely from raising the liability of the defendant.

By way of analogy, in instances where the evolving damage of an accident was related to the property right of a negotiable instrument or its proceeds, the theory under consideration allocates the damage in its entirety to the party who could have avoided the occurrence of the fraudulent practice at the lower or at no cost. It would deny the said party any enforceable interest either to the instrument or its proceeds. It would bar him from the right of enforcing the instrument, the right of claiming a replacement, the right of retaining the instrument or the right of claiming and retaining its proceeds.

To illustrate, assume that John Alex, David Dove and Willy Williams are solicitors. They join in a partnership to run a firm of solicitors. As the normal business of solicitors requires, the firm opens with the Abbey National a trust account, for the purpose of managing their clients' account. In order to facilitate the transmission of proceeds in the trust account, every partner individually is empowered to issue cheques in the firm's name against the said account.

Assume further that Willy Williams is known to the other two partners for his gambling activity. On one occasion, and without the knowledge of the other partners, he used the firm's fund to finance his short holiday. Nevertheless, and subsequent to John Alex's and David Dove's knowledge of Willy Williams' dishonest appropriation of the firm's fund, they, for the purpose of maintaining the running of the business, do not restrict his authority to issue cheques in the firm's name.

Assume also that Willy Williams, due to his indebtedness to a gambling club, misappropriates the clients' funds. He issues a cheque in the firm's name against the trust fund, in favour of the gambling club. The club, however, takes the cheque in ignorance of the special nature of the account against which it is issued. The club finally presents the cheque for payment. The bank, unaware of the fraud, pays the cheque to the club and debits the trust account with the face value of the cheque.[81]

Although the issuance of the cheque in the firm's name by the authorised agent does not constitute forgery in the strict sense, the misappropriation of the clients' fund constitutes a breach of trust. The funds in the trust account, due to the fraudulent practice, is deemed to have been diverted in a manner inconsistent with its purpose. The debited fund is used to finance transactions not related to the clients' interest. The competing interests arising from this instance are related to the entitlement to the proceeds of the fraudulently made cheque. The firm of solicitors is interested to claim the surrender of the proceeds from the gambling club, on the grounds that the said proceeds are misappropriated from the trust account. The gambling club is interested to have itself entitled to retain the paid proceeds, on the grounds that it was acquired in reliance on a prima facie genuine instrument.

Assume, finally, that the gambling club and the firm of solicitors are in a position to detect the fraudulent practice perpetrated by Willy Williams. The gambling club could have avoided the fraud by enquiring with the firm of solicitors as to the genuineness of the cheque. The cost of the enquiry is estimated at £1, i.e. the charge of the telephone call. The firm of solicitors would have, by comparison, avoided the fraudulent practice by entrusting an independent party with the job of managing the financial estate of the business, and by providing collectively adequate supervision on his job. The cost of employing the said party, however, is estimated at £250 per week as wages payable to him.

Since the cost of avoiding the misappropriation is less costly to the gambling club, the contributory negligence theory allocates the risk in its entirety to the gambling club. It would deny the latter the right of retaining the proceeds of the misappropriated cheque. It would bar it from the right of claiming any enforceable interest against the firm of solicitors. The firm of solicitors, by comparison, would be entitled to recover the misappropriated proceeds. The theory would discharge the firm absolutely from liability.

(iii) The advantages of the contributory negligence theory are two in number. In the first place, it substitutes the "rational" man test for the "reasonable" man test. It avoids some of the difficulties concerning the application of the traditional negligence theory. The rational man test approaches a uniform application. The duty to exercise care and the standard of the required care would be interpreted in a substantially similar manner. The uncertainty evolving from the non uniform nature of the negligence concept would be minimised. The need for court settlement would likewise be minimised.

In the second place, the contributory negligence theory in the sense mentioned above, unlike the traditional negligence theory, allocates damage in a relatively rational manner. In instances where the competing parties are at fault, the theory under consideration allocates the evolving damage to the party who could have avoided the accident at the lower or at no cost. It does not allocate the damage arbitrarily to either party, e.g. the plaintiff.

(iv) The disadvantages of the contributory negligence theory are threefold. In the first place, it does not reduce the need for court settlement to a minimum. In instances of "evidentiary uncertainty", the need for court settlement remains indispensable. In a jurisdiction where information shopping is not available, the need for court settlement would be necessary to determine the party who could have avoided accident occurrence at the lower or no cost.

In the second place, the contributory negligence theory, in the sense under consideration, does not provide a rational risk allocation rule in every instance. Like its predecessor, it does not provide a rational risk allocation rule in instances of **"no"** or **"equal fault"**. In instances where neither the plaintiff nor the defendant could have avoided the occurrence of an accident at any cost, or where either party could have avoided it at the same cost, the theory allocates the risk arbitrarily to the plaintiff.[82]

In the third place, in instances where the cost of avoiding accident occurrence is comparable, the contributory negligence theory does not achieve a substantially rational rule. It, on the one hand, allocates the risk in its entirety to a party who could have avoided it at the **"lower"** or **"no cost"**. The other competing party is absolutely discharged from liability. Thus, in a jurisdiction where information could be gathered as to the cost of accident avoidance, the party for whom the cost of avoidance is higher, might refrain from the exercise of care to avoid accident occurrence. For an example, if the firm of solicitors in the hypothetical relating to the misappropriation of a trust account mentioned above,[83] was aware of the fact that the cost incurrable by third parties in the enquiry as to the genuineness of its instruments or the circumstances surrounding their issuance, is at any rate, less costly than the cost incurrable in the provision of adequate policing of its business, it would refrain from taking the necessary precautions to avoid accident occurrence. That is to say, as far as the above hypothetical is concerned, the firm of solicitors would refrain from employing an independent party for the job of managing the financial affairs of the business.

Although the contributory negligence theory purports to maximise value in the sense that it employs the minimum cost for the purpose of avoiding risk, its application could facilitate accident occurrence. It encourages the party, for whom the cost of avoidance is higher, to act carelessly. If the rate of accident occurrence was increased, the probability of damage would likewise increase. Damages involve cost assumption; once they are increased, the incurrable cost will likewise increase. Cost is a form of wealth appropriation. If its assumption was increased in instances of avoidable accidents, the appropriated wealth would be deemed to be misallocated.

On the other hand, the allocation of accident losses to the party who could have avoided it at the lower cost, might not be compatible with value maximisation. The cost incurrable by the party upon whom the duty to avoid risk is imposed might not generate an enforceable value in his favour, nor may the said party be in the position to absorb it. The incurrable cost would then take the form of misallocation of wealth. If, however, the duty to avoid accident occurrence was allocated to the other competing party, the latter would be in a better position to utilise or absorb the incurrable cost. For an example, if the gambling club was under a duty to shop for information concerning the genuineness of the cheque and the surrounding circumstances of its issuance, the cost incurrable for the said purpose would not generate enforceable value to the gambling club. The cost incurred in the course of information shopping would not be recovered. If the firm of solicitors was, by comparison, under a duty to provide adequate policing for its business, the incurring of cost in the employment of a qualified party for the purpose of managing the financial affairs of the business would increase the firm's reliability. Ultimately, the estate of the business would grow. The cost of employing the independent party would then be absorbed by distributing it among the firm's clients.

Finally, the allocation of accident losses to the party whose cost of avoidance is less, might overlap with other significant considerations, such as the interest of the legal institution in question and the interest of the particular community. If the gambling club was under a duty to shop for information concerning the genuineness of the cheque and the circumstances surrounding its issuance, the cheque would fail to perform its intended function. It would not be capable of being transmitted into money immediately. Ultimately it would not operate as a payment device. And since information shopping might involve cost assumption, the bona fide third party might, due to the failure to derive an enforceable utility or to absorb the incurrable cost, refrain from the acquisition of negotiable instruments. Accordingly, the free transferability of negotiable instruments would be severely curtailed.

The Comparative Negligence Theory

(i) The basis of the comparative negligence theory is to allocate loss resulting from a negligent act, to the negligent parties, in "**proportion**" to their fault. For an example, assume that John Alex drives his car in excess of the speed limit in a busy road, hits Billy Barnes, a pedestrian, who recklessly jumped out to cross the road. Assume further that Billy Barnes, as a result of the accident, lost one of his legs and, finally, that the bodily harm caused to him was estimated in monetary terms at £1000. The comparative negligence theory does not afford the injured Billy Barnes a full recovery of the £1000. The loss is apportioned upon the defendant/injurer and the plaintiff/victim, in accordance with the gravity of their respective fault. Thus, if John Alex was found to be 75% at fault and Billy Barnes 25% at fault, the latter is entitled to £750 only. If, however, neither the defendant nor the plaintiff were guilty of negligence, the theory allocates the loss resulting from the accident arbitrarily to the latter.

(ii) The advantages of the comparative negligence theory are three in number. In the first place, it achieves the main advantage of the traditional negligence theory, namely that it determines the risk allocation problem on an equitable basis. It allocates the loss evolving from an accident proportionately to the negligent parties. In the second place, the comparative negligence theory avoids some of the difficulties of the traditional negligence theory. It resolves the problem of multiple negligent parties by allocating the risk to the negligent parties in proportion to their gravity of fault. In the third place, more importantly, the theory under discussion provides incentives for accident loss avoidance. Each of the parties involved will take safety measures in order to avoid risks. This is approached by increasing their standard of care to the **"optimum level"**. In other words, and in terms of economic analysis, the apportionment of damages between negligent defendant and plaintiff, i.e. injurer and injured, achieves economic efficiency. The apportionment rule, on the one hand, allocates accident loss to the parties whose conduct contributes to the accident occurrence. The rule, on the other hand, motivates parties interested to avoid liability, to optimise their standard of care. The standard of care, in instances of evidentiary uncertainty, would exceed the legal standard, consequently accident occurrence will be minimised.

(iii) As far as the law of negotiable instruments is concerned, the application of the comparative negligence theory would suggest that the loss resulting from the acquisition of instruments vitiated by forged indorsements, would be apportioned between the acquirer, i.e. the taker from the forger and the true owner, e.g. the drawer, in instances where both parties are negligent. An illustration of the instance in which both true owner and acquirer are negligent, could be noted from the assumption where a company entrusts a dishonest employee, Willy Williams, with its seal and the remittance of company cheques to its bank account. The dishonest employee steals one of the company's cheques, indorses it in the company's name to his own order and reindorses it to a third person, e.g. Billy Barnes, who takes it up in good faith but without adequately identifying his transferor, i.e. the forger, Willy Williams. The negligence attributable to the company is illustrated in their employment of a dishonest person in a delicate office, namely that related to the safekeeping of the corporate seal and the payment of accounts. The negligence attributable to Billy Barnes, i.e. the bona fide third party acquirer, by comparison is illustrated in his failure to identify his prior transferor and investigate the validity of his title. The loss resulting from the acquisition of the stolen cheque would, under the comparative negligence theory be apportioned between the company and Billy Barnes according to the gravity of their negligence. Thus, if Billy Barnes was found to be 30% negligent, the theory under consideration would entitle him to enforce in his favour the face value of the acquired cheque less 30% i.e. the gravity of his negligence.

(iv) The main defects of the comparative negligence theory are threefold. In the first place, it fails to stipulate a rational rule for every risk instance. In instances where no fault could be attributed to either competing party, the comparative negligence theory allocates the evolving risk arbitrarily to the plaintiff.[84] In the second place, the theory under consideration does not minimise the need for court settlement. On the contrary, it renders court settlement indispensable, in almost every instance of comparative negligence. The need for court settlement would be essential for the purpose of measuring the gravity of the fault of the particular party and the manner of determining the apportionment of damage. Since the gravity of fault is factual, the manner of loss apportionment would be determined by a court finding only. Court settlement involves time consumption, transaction cost and increases uncertainty. As has been illustrated above,[85] they are hindrances to general commerce as well as the commercial community.

In the third place, the apportionment of losses between the competing parties is inconsistent with the special nature of negotiable instruments. Negotiable instruments are writings of dual nature. They, on the one hand, create rights and obligations. The maker of the negotiable instrument in question, or its indorser, promises or undertakes to pay the holder of the instrument its face value, provided that certain requirements are met.[86] These writings, on the other hand, possess the characteristic of chattels. Their property is freely transferable from one hand to another. The relationship between the contractual obligation incorporated in the writing in question, and the latter's transferability, is that the liability of the promisor is created in favour of whoever qualifies as the **"owner"** of the writing. Thus, the liability of a drawer of a cheque, for an example, is dependent on the fact whether the claimant of the cheque satisfies the true owner/holder's status. If this question is answered in the affirmative, the claimant will be entitled to the full face value of the instrument. If, by comparison, the above question is answered in the negative, the claimant will not be entitled to any payment.

The comparative negligence theory does not allocate entitlements to negotiable instruments in a manner consistent with the special nature of the said institution. It apportions the loss between the competing parties. The apportionment of the loss between the taker from the forger and the true owner, seems to suggest that the entitlement to the instrument in question is divided between the two parties. As far as the above illustration is concerned,[87] two thirds of the cheque would be owned by the company and the last third would be owned by Billy Barnes. This is unacceptable in the context of negotiable instruments. The taker from the forger cannot qualify as a holder of a part of the instrument in question, whilst he fails to qualify as such as far as the remaining part, in instances where the acquisition of the instrument occurred under a single set of facts.[88]

A further illustration of the inconsistency of the comparative negligence theory with allocation of risk in the context of negotiable instruments, is that it applies in settings inapplicable to the risk of negotiable instrument fraud. As has been shown above,[89] the damage evolving from the negotiable instrument fraud is not normally the direct cause of the conduct of either competing party. The terms defendant and plaintiff in the sense of injured and injurer have no defined counterparts in the context of negotiable instrument fraud.

The Insurance Theory

(i) The insurance theory allocates the evolving loss from an an accident to the party best able to provide for insurance. In determining the party best able to provide for insurance, the theory under consideration takes account of the party's appreciation of the gravity of the evolving risk in the particular activity, his capacity to provide against it, and his capability to absorb the cost incurrable in the course of providing against the said risk. The party's capability to provide against risk necessarily requires that the said party should be in a position to control the activity giving rise to the risk in question, or he should be in a position to control the party whose activity gives rise to the risk. By virtue of the available controlling power, the party in question would be able to provide against risk.

(ii) In the context of negotiable instruments, banks are presumed to be in the best position to provide against negotiable instrument fraud.[90] Due to the special nature of its business, the bank would be more able to determine, in light of the rate of fraud, the gravity of the risk. Due to its involvement in the collection and payment of negotiable instruments, the bank is presumed to have a controlling power over its depositor or customer. And, finally, due to its involvement in the banking business, the bank is presumed to be in the best position to absorb the cost incurrable in the course of provision against negotiable instrument fraud. The cost incurrable by way of insurance or by way of employing the available expertise and technology is, on the one hand essential for promoting the banking business and, on the other hand, is recoverable from the beneficiaries of the banking services. By way of periodic and service charges, the bank may distribute the incurrable cost among its depositors and customers.

(iii) The main advantage of the insurance theory is that its strict application stipulates a rational risk allocation rule in instances where no clear case of "**fault**" could be attributed to either competing party. It initially allocates the evolving risk to the party best able to provide against it. By way of distributing the incurrable cost, the insurance theory re-allocates the risk to almost every beneficiary of the activity which gives rise to the risk in question. In the context of negotiable instrument fraud, the theory re-allocates the risk of fraud to the drawers and holders of negotiable instruments. The insurance theory finally determines with certainty, as far as negotiable instruments are concerned, the party to whom risk is normally allocated i.e. the bank. Accordingly, the need for court settlement would be minimised, transaction costs would then be eliminated and time would be saved.

(iv) The main defects of the insurance theory are fourfold. In the first place, by allocating accident losses to the party best able to provide for insurance, other parties may be encouraged to behave carelessly.[91] The risk would then be initially allocated inefficiently. The negligent party might escape the loss caused by his careless behaviour, especially in instances where the loss is comparatively trivial and where the negligent party is not connected with the party against whom risk is normally allocated. The latter, accordingly, might not be able to charge to him the loss, or he might not, due to the trivial amount of the loss, desire to file a cause of action against the negligent party.

To illustrate, assume that John Alex purchases from a neighbouring food store two pints of milk, one pack of eggs, one loaf of bread and some fruit. In consideration, John Alex issues a cheque to David Dove, the proprietor of the store, for the amount of five pounds and seventy five pence, the face value of the purchased food. David Dove opens the till, puts in the cheque and leaves the till open to serve another customer. Willy Williams enters the shop, notices the cheque and steals it. Later David Dove realises the theft, he contacts Alex and advises him to stop the cheque. The latter stops the stolen cheque and issues a replacement to Dove. Willy Williams then forges Dove's signature and makes the cheque endorsable to his, i.e. Williams favour. Willy Williams then misrepresents to Billy Barnes that the cheque in his possession was taken in discharge of a debt owed to him. Accordingly, Barnes accepts to cash the cheque for Williams. The former deposits the cheque with his bank for collection. With reference to a special arrangement, Barnes draws the proceeds of the cheque before its clearance. By the time the collecting bank presents the cheque for payment, the drawee bank receives a stop payment order from its customer, John Alex. In compliance with the stop payment order, the drawee bank dishonours the cheque.

If the risk of forgery was to be allocated initially to the collecting bank, David Dove might escape the loss evolving from his negligent behaviour. Since Dove is not a customer of the collecting bank, the latter would not be able to charge to the former the face value of the cheque and since the amount of the cheque is trivial, the collecting bank might not desire to bring an action against the negligent party. The amount recoverable does not make it worth the cost incurrable in the law suit.

In the second place, as far as the risk of negotiable instrument fraud is concerned, the allocation of the risk to the bank does not cover every instance of negotiable instrument fraud. On the one hand, negotiable instruments might not pass in a chain of collection. The holder may present his instrument directly to the drawee bank for payment. An example of such instrument is the uncrossed cheque. The holder need not, in this instance, secure the payment of the cheque through a collecting bank. On the other hand, negotiable instruments might not be paid by the drawee bank. The latter, due to its receipt of a stop payment order, may dishonour the presented instrument.

In the instances where banks are not involved in the negotiable instrument risk of fraud, such as the case in the above instances, the insurance theory would have no application as a mechanism of risk allocation. Neither the drawer, nor the original true owner, nor the bona fide third party acquirer may be in the position to provide for insurance. The risk in this instance would then need to be allocated on a basis other than insurance.

In the third place, the allocation of risk to a bank might not approach an efficient risk allocation rule. The bank might not be in a position to control the activity of issuing or negotiating negotiable instruments, or it might not be in the position to control the party engaged in such activity. The bank does not, once it issues cheque books to its customers, control the activity of cheque issuance and negotiation. The cheque book becomes the property of the customer and issued cheques become the property of the intended payee or indorsee. The bank, prior to the issuance of cheque books to its customer, does not normally stipulate unilaterally in the blank cheque, terms, the effect of which could restrict the cheques utility. Each cheque is intended to incorporate contractual obligations. The unilaterally incorporated terms might affect the customer's or the subsequent indorsor's capacity to utilise the cheque in question in the desired manner. Third parties might not be willing to take the instrument, the utility of which is restricted. Accordingly, the cheque would fail to perform its intended function. It would not be freely transferable as a payment device.

The bank's incapacity in controlling the party who engages in the activity of issuing and negotiating negotiable instruments, is illustrated by the non-existence of an effective connection between the bank and the said party. The drawee bank does not normally establish a connection with the indorsor or presenter of a negotiable instrument. The drawee bank's only connection is with its customer, i.e. the issuer of a negotiable instrument. The collecting bank, by comparison, does not establish any connection with the issuer or the indorsor. Its connection with the presenter i.e. depositor could, however, be incidental. It could be based on a single transaction, whereby the collecting bank engages to collect a single deposit item. The relationship terminates as soon as the collection arrangement is completed.

If, however, the bank was required to accept negotiable instruments from parties with whom it establishes an effective connection only, such as that it establishes with its customer, in its strict sense, negotiable instruments would fail to fulfil their desired function. They would not be readily transferable into money immediately. Non-bank customers would not be able to cash their instruments. Ultimately, the objective of promoting the institution of negotiable instruments would not be fully achieved.

Finally, collecting and drawee banks are not necessarily the party best able to provide for insurance. Drawers and indorsors may be better able to provide for insurance. Large companies which have been in business for long periods may be in a better position to provide for insurance, either by purchasing private insurance or by forming with other businesses a portfolio insurance. The cost of insurance could however be absorbed by distributing it among their employees or customers.

The Theory of Value Maximisation with Reference to Cost and Benefit Analysis re-visited

The value maximisation theory in the advocated sense, on the one hand achieves the advantages of the above mentioned theories collectively and it, on the other hand, avoids the defects of the said theories. By associating the duty to provide against risk with the party's ability to utilise the cost involved in the provision against risk and his ability to absorb it, the theory firstly approaches a fair and equitable rule. It allocates the risk of accident occurrence in a manner compatible with the status of the competing parties. It operates in favour of the party who is neither in the position to derive an enforceable value from the cost incurrable in the course of the provision against risk, nor is he in the position to absorb it. It allocates the risk of accident occurrence to the party who suffers the least hardship from it.

Secondly, the theory under examination fixes the standard of the required care in a manner compatible with the competing parties' ability to provide against risk in the sense mentioned above. It distinguishes between the required standard of care of the party best able to provide against risk and that of the party least able to provide against it. It raises the standard of care of the former to that of the rational man, while it fixes the standard of care of the other competing party with that of the reasonable man, in the loose sense.

Thirdly, the theory, by allocating to each party the required standard of care, imposes a deterrent rule. It motivates each party to observe the fixed standard of care. Where the failure to exercise the fixed standard of care results in the occurrence of an accident, the theory would allocate the evolving loss entirely or proportionately to the negligent party.

Fourthly, by associating the duty to exercise care with the duty to provide against risk with reference to the cost and benefit analysis, the value maximisation theory could be employed to regulate almost every risk instance. As far as the risk of negotiable instrument fraud is concerned, the theory under consideration provides a risk allocation rule in instances of fault, no fault, payment, as well as non-payment instances. In instances of fault, the theory deems the party at fault as the party best able to provide against risk. It accordingly allocates the risk entirely to him. If, however, each of the competing parties was at fault, that is to say that each of the competing parties breached the fixed standard of care, the theory deems each party as the best party to provide against risk. It, accordingly, apportions the evolving damage according to the gravity of the fault of each party. Where no fault is involved in instances of payment or non-payment, the theory defines the party best able to provide against risk so as to denote the party who is in the best position to utilise and absorb the cost, the assumption of which is necessary to avoid the occurrence of accidents. On the other hand, by allocating risk to the party at fault or the party best able to provide against risk, the theory dispenses with terms and concepts inconvenient to the risk of negotiable instrument fraud. The terms plaintiff and defendant in the sense of injured and injurer have no significance in the allocation of risk under the value maximisation theory.

Finally, the cost and benefit analysis could be utilised to fix a general risk allocation rule. By reference to the general average of the particular risk instances, the theory could determine the party best able to provide against risk in a particular setting. Thus, if the party best able to provide against risk was predictable with reference to the setting in question, the competing parties involved in the said setting would be able to determine with certainty the manner of allocating the evolving risk. The need for court settlement would be minimised, transaction cost would then be eliminated and time would be saved. Ultimately, the interest of general commerce and the commercial community would be satisfied.

The Approximation Theory

(i) The negligence theory, it is argued, could be modified to meet the interest of commerce and the commercial community and ultimately, it could be advanced as a mechanism for risk allocation, in instances of negotiable instrument fraud. The essence of this argument is to draw from the general average of negotiable instrument fraud a general rule as to the party most at fault in facilitating the occurrence of fraud. The allocation of the risk of fraud to the said party would then bring about a uniform, predictable and certain risk allocation rule. The need for court settlement would be minimised, transaction costs would be eliminated, time would be saved and ultimately the interest of general commerce and the commercial community would be satisfied.[92]

(ii) In reply, it could be observed that the approximation theory does not suggest a test, the application of which could determine the party most at fault. It does not, on its own, indicate the criterion according to which the fault of the competing parties could be determined.

The value maximisation theory and its cost and benefit analysis, by comparison, suggests a test based on economic analysis, the application of which could determine the party most at fault. It applies the cost and benefit analysis as criteria for determining the existence of fault. The party under the value maximisation theory is deemed at fault if he fails to take measures, the cost of which could be utilised or absorbed by him and the observance of which could avoid the accident i.e. fraud occurrence. However, the value maximisation theory does not contradict the approximation theory, rather it operates as a supplement to it. It devises a proper test, according to which the party most at fault could be determined.

The Manner of Approaching the Considerations Relevant to Risk Allocation in the Context of Negotiable Instrument Fraud

I. The Promotion of the Institution of Negotiable Instruments

The promotion of negotiable instruments will be achieved by the facilitation of their free transferability. To facilitate the free transferability of negotiable instruments they should possess some of the attributes of money, the very thing which they are intended to substitute. In particular, their possession should suffice to create a prima facie ownership in favour of the possessor. If such an attribute is conferred, negotiable instruments would fulfil their economic function. Acquirers would be able to cash their instruments with speed and confidence. Their possession would presume in their favour a prima facie ownership.

In the second place, the establishment of a prima facie title to a negotiable instrument by the mere reference to its apparent possession, renders the instrument freely marketable. Such a document would then circulate in isolation of the independent transaction or transactions giving rise to it. Its validity would not be affected by the invalidity of the said transaction or transactions. Third parties, in the course of their dealing, would not need to enquire beyond the regularity of the form of the instrument. Such application would, firstly, assure the third parties as to the validity of their title to the instrument, regardless of the invalidity of their transferor's title and secondly, it would exempt them from the financial burden of enquiring as to the validity of the independent transaction. In the light of the above mentioned attribute, the acquisition of negotiable instruments would be encouraged and ultimately the free transferability of negotiable instruments would be promoted.

II. The Interest of the Commercial Community

The interest of the commercial community involved in the negotiable instrument transaction will be protected, if, on the one hand, the members of the said community i.e. traders are afforded adequate assurance that their reasonable expectation will be satisfied and, on the other hand, they will be afforded a predictable and speedily enforceable rule. In instances where the reasonable expectations of the parties in question compete, the commercial community is interested to have its members afforded measures, the function of which is to provide against the occurrence of incidents detrimental to their favour.

The creation of a predictable and speedily enforceable rule satisfies the interest of the commercial community because, firstly, it would minimise the need for court settlement and, secondly, time would be saved. If the parties to a negotiable instrument were able to determine with certainty the party to whom risk would be allocated, as far as this work is concerned, they would not need to have recourse to the courts. A direct right of recourse against the party to whom risk is allocated would settle the conflict in question. The party to whom risk is allocated, however, would not normally refuse to abide by the ultimate consequence if its application was determinative and certain. Such refusal would only cost him added expenses, namely, that illustrated by the transaction costs.

Time, in commercial transactions, is of the essence. It is deemed a significant factor in promoting the objective of value maximisation. Within a specified period of time, traders plan to engage in an X number of transactions. Each of these transactions is presumed to satisfy the trader's interests. Each of these interests possess a value to the trader. If, in the specified period of time, a Y number of transactions, less than X were concluded, the trader in question is presumed to have forgone an opportunity to engage in other transactions originally planned. Such would forgo to his disadvantage opportunities whereby value would be maximised.

The increase in court settlement is an illustration of time consumption. Its involvement would forgo an opportunity to maximise value by, firstly, engaging in other transactions and, secondly, by utilising the monetary claim incorporated in the instrument, in funding the said transactions. By contrast, the minimisation of court settlement is compatible with value maximisation. The time saved in the enforcement of the risk allocation rule would enable traders to satisfy other interests.

A predictable and speedily enforceable rule would be achieved by implementing an automatic uniform rule. A uniform application would necessarily suggest, as far as risk arising from negotiable instrument transactions is concerned, that the evolving risk is almost always allocated to a particular party. Naming the party to whom risk is allocated would render the determination of liability predictable and certain. Accordingly, the enforcement of the rule would be speedy. Finally, the need for court settlement would be minimised and time would be saved

III. The Interest of the Public at Large

The interest of the public at large would be protected if the occurrence of fraud was avoided. To avoid the occurrence of fraud, the parties involved in the negotiable instrument transactions should be deterred from not providing adequate precaution, the observance of which could render the perpetration of fraud on the part of the fraudulent person impossible or more onerous.

The deterrence of fraud could be achieved by imposing upon the parties involved a duty to provide against its occurrence. The failure to observe the said care could raise their liability. Accordingly, the loss resulting from the occurrence of fraud would be allocated entirely or proportionately to the negligent party.

IV. Economic Efficiency as a Mechanism for Risk Allocation and the Theory of Value Maximisation

Risk would be allocated in a manner compatible with economic efficiency, if it was allocated to the party best able to provide against it. To determine the party best able to provide against fraud, account should be taken of the ability of the party to prevent the occurrence of fraud in the first place, his ability to detect it should it occur, his ability to provide for insurance and spread the cost of insurance and, in the instance where insurance costs are not recoverable, his ability to derive benefit from the cost assumption. The determination of the party best able to provide against fraud in this manner would result in value maximisation. The cost incurrable in providing against risk would be borne by the party who derives benefit from such costs. The allocation of loss in a manner compatible with value maximisation satisfies the interest of the commercial community.

V. The Notion of Fairness and Justice

Finally, the notion of fairness and equity would be satisfied if, firstly, parties to negotiable instruments were held liable for their misbehaviour and, secondly, the duty to incur costs was allocated to the party who derives value from its assumption. Raising the liability of negligent parties would operate as a deterrent against him to observe the necessary precaution to prevent the occurrence of fraud, whilst the allocation of the duty to incur cost to the party who derives benefit from it would allocate risk to the party best able to provide against it.

Needed to explain exactly what ideal situation is - in a single passage.
Perhaps [illegible] [illegible] & [illegible] position [illegible] of England - & inadequacies of Civil Law

[ie to me: is theory original? Is it workable? is it too elaborate]

CHAPTER THREE

BACK NOTES - (1.-92.)

1. Mistakes may give rise to contract disturbance, in the sense that and as far as the enforcement of monetary claims is concerned, payment could be made to a person not entitled to it, either because the mistaken party has not intended payment to be made to the said person as such or because the mistaken party, due to the intervention of an independent third party, was induced to make payment to the wrong person. In many instances mistake as to the identity of the payee raises the negligence of the mistaken party i.e. payor. An example of such an instance is payment to the impostor. To illustrate, assume that Willy Williams purports to be the sales manager of a firm engaged in retailing electrical goods, operating under the name of Williams Household Electrics. In his capacity as such he contacts John Alex and persuades him to purchase the advertised bargain at a low price. The advertised bargain comprises a fridge, washing machine, cooker and vacuum cleaner. John Alex induced by the bargain decides to purchase the said goods through the sales manager Willy Williams. By way of payment John Alex issues a cheque payable to Williams Household Electrics and delivers it to the purported sales manager. Williams then promises Alex that delivery of the purchased goods (due to heavy work imposed upon the van drivers) will take place three days later. Three days later when delivery fails to take place as promised Alex contacts Williams Household Electrics. Upon enquiry the sales manager of Williams Household Electrics informs Alex that the firm has no recollection of employing Willy Williams or of engaging with Alex. Alex realises that the arrangement with Williams was a fraud and contacts his bank to countermand the cheque. To his surprise the bank replies that the cheque has been met and payment made to David Dove, the holder, to whom the cheque was indorsed in the name of Williams Household Electrics.

The mistake of identity in this example is illustrated in the erroneous impression that Alex was dealing with the sales manager of Williams Household Electrics and ultimately he was engaging with the latter. Due to this mistake Alex mandated to his bank to make payment equal to the face value of the cheque in favour of Williams Household Electrics to which no indebtedness was created. As a result of the said mistake the negotiable instrument transaction, i.e. cheque, is deemed to be disturbed in two respects. In the first place the property of the cheque is transferred to a person not originally intended to possess an interest, i.e. David Dove. In the second place the proceeds of the cheque are delivered in favour of other than the intended holder. Ultimately the proceeds of the cheque were misdirected.

The mistake illustrated above is, as could be noted, a consequence of negligence. The negligence of the issuer of the cheque, i.e. Alex in not making necessary enquiries as to the true identity of Willy Williams is presumed to have facilitated the disturbance of the contract. Willy Williams due to Alex's negligence was able to practise his fraud, negotiate the cheque to a bona fide third party and induce the bank to honour the cheque without raising any suspicion as to the regularity of the cheque. Had the issuer Alex exercised care he would have prevented the occurrence of the fraud.

Too elaborate

2. The perpetration of fraud might not always be the commission of an independent party. Parties to negotiable instruments may also engage in fraudulent practice. An example of such an instance is the payee's unauthorised alteration of the face value of the negotiable instrument. Such act disturbs the negotiable instrument transaction in the sense that it alters the original contract of innocent parties. For example the alteration of the face value of the cheque from £1000, to £21000 makes the instrument as if it were drawn for £21000. Thus if the instrument comes into the hands of a bona fide third party it purports to confer upon him the right to enforce the instrument in its altered form. If the bona fide third party holder was allowed to enforce the instrument to the extent of the altered form, the innocent party against whom enforcement is sought to be made would be frustrated. He would be forced to enforce a contract different in terms from that to which he had consented. If the holder was denied enforcing the instrument in its altered form his reasonable expectation would be frustrated. He would be giving in consideration to its possessor a value higher than that which he would be deriving from it.

3. The only distinction between the present and the preceding hypothetical is that the occurrence of fraud in the preceding hypothetical was facilitated by the issuer's negligence. Its negligence is illustrated by its failure to employ a strict test of selection of employees, strict supervision of their job and a periodic examination of accounts, statements and invoices prepared by them. In the present hypothetical by comparison the occurrence of fraud is presumed to be the sole perpetration of the fraudulent person, i.e. Willy Williams the cashier of the take-away restaurant. No negligence as such could be attributed to David Dove the proprietor of the restaurant. The standard of care which ought to be observed by him is not identical to that which ought to be observed by Alex Euro-Construction. The required standard of care varies according to the size of the business. cf. n.4.

4. It is submitted that the standard of care required to be observed is not uniform. Certain considerations e.g. the size of the business, underlie the formulation of the standard of care. Small businesses are not under a duty to apply strict supervision of their employees or to

engage in a thorough review of invoices and accounts prepared by them. The failure to apply strict supervision or to engage in thorough review need not always raise negligence of the business in question. cf. White and Summers, The Uniform Commercial Code, 2nd Edition, (1984) p.630.

Since as far as the example in the text is concerned, the take-away restaurant is a small business and Willy Williams demonstrated honesty during twenty years of service, David Dove, the proprietor, is not presumed to be negligent in not verifying the restaurant's accounts during his absence; nor is he negligent in not applying strict supervision of Willy Williams' job. His failure to observe both conducts would still place him in the shoes of the reasonable man.

5. For more detail concerning the creation of negotiable instruments see pp.40-44 supra.

6. For more details concerning the interests competing in negotiable instruments see pp. 205-223 infra.

7. However the original true owner may demand payment from the drawee in instances where the instrument comes into the hands of a bona fide third party, satisfying the lawful holder status so far as the true owner provides an indemnity to the drawee. The purpose of the indemnity is to compensate the drawee against claims of payment made by the lawful holder. In effect the indemnity operates as a means of protecting the drawee from incurring double liability where no blame could be attributed to him as to the disturbance of the normal currency of the instrument.

8. cf. Section 3(1) B.E.A., Article 3-104 U.C.C. and Articles 1 G.U.L.(Bills) and 1 G.U.L.(Cheques).

9. Although the law functions as the means of formulating the particular risk allocation rule, it enables the parties in question to shape the risk allocation rule in a manner suitable to their particular transaction. In the case of the contract of sale the law enables the parties to reshape the risk allocation rule underlying their transaction. They may, as far as it is fair and reasonable, stipulate that the risk arising from the delivery of a defective product shall always be allocated to the seller in instances where the said defect is patent.

authority

In the context of negotiable instruments the parties in question may also be allowed to formulate the risk allocation rule for their particular transaction as far as the said rule is fair and reasonable. In the United States, by virtue of Article 4-103 banks are allowed by a special arrangement to derogate from the provisions of the said article. Bankers in the United States in light of the delegated discretionary power utilise Article 4-103 to stipulate in their contracts with their customers, clauses

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the effect of which is to shift the risk of wrongful payment to the customer. An example of such clauses are those which shorten the period of time within which the customer should report improper payment and ultimately avoid the risk arising from the forgery of signatures, or the clauses the effect of which is to exempt the bank from the duty to give a timely notice of dishonour.

On the Continent, banks are also allowed to shape the risk allocation rule as between themselves and their customers.
cf. the remark of the German delegate to the Geneva Conference on the Unification of the Laws Relating to Bills of Exchange, Promissory Notes and Cheques, 2nd session, L.N. Document No. C628 M249 1931 11, p.309.
In France banks utilise the said power to shift the risk of payment upon a forged instrument to the customer. By way of a special clause they enable themselves to charge erroneous payments, made upon a forged instrument to their customers.
cf. Farnsworth, Cheques in France and the United States, a Comparative Study, (1962), 36 Tulane L. Rev.

For the parties in question to shape the applicable risk allocation rule, they should confine the impact of the said rule to their personal relationship. If the proposed risk allocation rule was meant to have an overall impact, they should bring it home to the remote third party whose involvement in the negotiable instrument transaction is foreseeable. The manner in which the proposed risk allocation rule could be brought home to the third party is to negative or restrict the negotiability attribute of the negotiable instrument in question. Such step alerts the third party to safeguard his interest. It warns him of the risk inherent in the acquisition of such document.

In instances where the proposed risk allocation rule is meant to have a general impact and where the said rule is not brought home in the above mentioned manner to the bona fide third party, the application of the doctrine of party autonomy might be inconsistent with the nature of negotiable instruments. Negotiable instruments are meant to possess some of the attributes of money. In particular they are meant to be freely marketable. Accordingly their possession might come into many hands before their final payment.

Text

Because of the special nature of negotiable instruments the establishment of the immediate parties' autonomy to choose the applicable risk allocation rule to the negotiable instrument transaction might restrict the free transferability of such instruments. It might divest the instrument in question of its practical value. The bona fide third party to whom the instrument is offered for a valuable exchange, might need, in instances where the drawer and the initial payee stipulate that the holder shall bear the risk arising from the forgery of a

Text

signature, or the risk arising from the interposition of personal defences, to shop for information concerning the status of the instrument and the status of its possessor, i.e. the party from whom the third party intends to acquire the instrument.

Because of the involvement of time and cost in information shopping, third parties might be deterred from the acquisition of negotiable instruments. The objective of promoting the free transferability of negotiable instruments would ultimately fail.

If the third party was made to shop for information concerning the status of the offered instrument and the status of its possessor, he might need to enquire beyond the four corners of the instrument. He might need to enquire as to the circumstances which led to the issuance of the initial acquisition of the instrument. Such enquiry on the one hand restricts the free transferability of negotiable instruments and on the other hand it restricts the instrument's fulfilment of its economic function.

For a negotiable instrument to be freely transferable it should flow in the stream of commerce independent of any extraneous elements. In other words, it should pass from hand to hand as a **"courier without luggage"** and in order to facilitate the negotiable instrument's fulfilment of its economic function, i.e. as a payment device, it should be capable of being liquidated into money immediately. The making of enquiry beyond the four corners of the instrument restricts the instrument's fulfilment of its economic function because it involves time. The instrument's liquidation into money would not occur unless and until the enquiry is completed.

10. The determination of the paramount interest becomes difficult in instances where the competing parties were innocent. The interest of each competing party qualifies for protection. In instances where the two interests conflict, the protection conferred upon either interest would necessarily impair the other interest. In such an instance, it would be appropriate to subscribe to the comparative impairment approach to determine the paramount interest, the protection of which is favoured and ultimately determine the party to whom risk would be allocated.

The gist of the comparative impairment approach is to compare the gravity of hardship created to the competing interests by the risk allocation rule. It determines the interest to which the most hardship is created as paramount. It accordingly allocates the risk evolving from the activity in question to the party whose interest suffers the least hardship from the risk allocation rule.

11. Merchants in the early ages recognised the risk involved in the transmission of cash money. Because the theft of money created a windfall against the original true owner, merchants were in favour of creating an instrument that could satisfy the function of money as well as the interest of the original true owner.

12. cf. Section 29 B.E.A., Article 3-305, 3-306 U.C.C. and Article 17 G.U.L.(Bills) and Article 22 G.U.L.(Cheques).

13. See pp.256-259 and 330-361 infra.

14. cf. p.616 infra.

15. cf. Section 29 and 60 B.E.A., Articles 16, 17 and 40 G.U.L.(Bills).

16. The American Law Institute, (A.L.I.) and the National Conference of Commissioners on Uniform State Laws, (N.C.C.U.S.L.), are currently working on a special article on wire transfers. The proposed Article 4A of the U.C.C. intends to regulate the rules relating to wire transfers. The proposed article is intended to be considered for final approval in the second half of 1990. The official text of the said article is not available; however, an outline of the proposed Article 4A could be obtained from the A.L.I.

17. cf. Walden and Savage, Legal Problems of Paperless Transactions, (1982), J. Bus. L. 102.

18. Rosenthal, Negotiability, Who Needs It?, (1971), 71 Col. L. Rev. 375.

19. per Vaughan Williams L.J. in Smith v Prosser [1907] 2 KB 741,
and per Warrington J. in Vinden v Hughes [1905] 1 KB 799.

20. cf. Sections 54, 55 B.E.A. and Articles 9, 15 and 32, G.U.L.(Bills).

21. In Mead v Young (1790) 4 TR 33, Buller and Grase J.J. expressed the necessity to punish the wrongdoer i.e. the forger. Grase J. was of the opinion that punishing the wrongdoer is more significant than putting an insuperable clog on the negotiability of negotiable instruments. He observed that ...
"If this decision will prove a clog on the circulation of bills of exchange, I think it will be less detrimental to the public, than permitting persons to recover through the medium of a forgery."

Furthermore, in Buller's and his view the bringing about of the forger's punishment would be facilitated, once the risk of forged signatures is allocated to the immediate taker from the forger. Because of his direct engagement with the forger, the acquirer, i.e. taker is presumed to be in the best position to trace the forger.

Grase J. observed ...
"I agree also with my brother Buller, that this decision will be more convenient to the public, because then the plaintiff will prosecute the person, who indorsed to him, for the forgery."

Buller J. held ...
"Independently of these reasons, I think that convenience requires that a determination should be in favour of the defendant. I have no difficulty in saying that this H. Davis, knowing that the bill was not intended for him, was guilty of a forgery; for the circumstance of his bearing the same name with the payee cannot vary this case, since he was not the same person. Then if the plaintiff cannot recover on this bill, he will be induced to prosecute the forger; and that would be the case even if it had passed through several hands, because each indorser would trace it up to the person from whom he received it, and at last it would come to him who had been guilty of the forgery: whereas if the plaintiff succeed in this action, he will have no inducement to prosecute for the forgery; the drawer, on whom the loss would in that case fall, might have no means of discovering the person who committed the forgery, and thus he would probably escape punishment."

However, there are other theories in legal philosophy, the gist of which is to determine the function of the criminal law. Some are of the view that the function of the criminal law is to deter the wrongdoer. Others are of the view that the function of the criminal law is to rehabilitate the wrongdoer and finally, others in light of the rise of the economic analysis approach are of the view that the function of the criminal law is to allocate to the wrongdoer the cost arising from his wrong doing.
cf. Klevorick, Legal Theory & the Economic Analysis of Torts & Crimes, (1985), 85 Col. L. Rev. 905.

22. Under the English common law, due to the rigidity and inconvenience of the remedies provided by the Kings courts, litigants petitioned the King to decide their disputes according to his conscience. The King, in the early stages clothed his Chancellor with judicial authority. He was empowered to resolve the disputes filed to the King's office. Since the Chancellor's basic education was that of the canon law, he based his decisions on the said law. The rules of the canon law were in accord with the principles of fairness and equity. Because of the increase of petitions to the King, a special court was set up to decide the filed disputes. The name applied to it was derivable from the man whom the King authorised in the early stages to decide the petitioned disputes i.e. the chancellor. Since the court of chancery was recognised as independent from the King's courts, it was not bound by the decisions of the latter.

Tate

The court ultimately had to develop its own rules. As there were no judicial precedents, the court of chancery resorted to the canon law and the principles of equity i.e. fairness and justice. Every decision then became a binding precedent for similarly circumstanced cases. Due to the presence of the King's courts and the courts of chancery, two conflicting and independent rules of law were in application, namely, the rules of the common law and the rules of the law of equity. Gradually, and in order to attract litigation in its courts, the King's court i.e. the courts of the common law relaxed their procedures and remedies. In the 16th century, the **lex mercatoria** was admitted as part of the common law and later the common law judges took account of the principles of equity. The principles of equity then became binding on the common law courts. It was not before the 19th century, when the two systems of courts were abolished, that the courts of common law were elected to serve as the only court of law in England. Nevertheless, equity was incorporated as part of the common law. At present, judges must take into account the rules of equity in deciding the cases before them.

The doctrine of fairness and equity however has been incorporated in various principles such as good faith unconscionability and reasonableness. The various legal systems, due to the ambiguity of the doctrine under consideration might not incorporate it in their laws. Nevertheless, they approach its application through the principles of good faith unconscionability and reasonableness. The U.C.C. is an example of such law. Throughout its various articles it sanctions the above-mentioned principles.

In France, the doctrine of fairness and justice has been utilised to fill the gaps left by the legislator. The rules of unjustified enrichment are an example of such an instance. The Code Civil does not comprehensively regulate the rules of unjustified enrichment. In particular, it does not regulate the instance where the property of one party finds its way into the property of another through the intervention of a third party. Courts, however, managed with the aid of the doctrine of fairness and justice to regulate the said instance.
cf. R. David, French Law, Its Structures Sources and Methodology, (1972), p.199.
Zweigert and Kötz, Vol.II, An Introduction to Comparative Law, (1977), p.208 and following.

23. The comparison between the competing interests as to their vulnerability to the hardship created by the applicable risk allocation rule is known as the comparative impairment. For a brief outline of the comparative impairment approach see n.10.

24. As to the manner of determining the party who suffers the least hardship from the applicable risk allocation rule see p.175 infra. As to the party who suffers the least hardship in the above illustration see pp.601-605 infra.

25. cf. Burrows and Veljanovski, The Economic Approach to Law, (1981), pp.3 and 4.

26. cf. Arts. 3-6 and 107-114 B.G.B. Cohn, Vol.I Manual of German Law, (1968), pp.135-138, 150, 614.
For a general view of the German Law and Civil legal systems see Zweigert and Kötz, Vol.II, An Introduction to Comparative Law, (1977), pp.19-27.

27. The marrying of economics and law is not new. "Economic" approaches can be found in the works of Beccaria-Bonesara (1764), Bentham (1789), Marx (1867), and in the turn of the century work of the American Institutionalist school, particularly the writing of Commons (1924).
cf. Burrows and Veljanovski, The Economic Approach to Law, (1981), p.2.

28. For a general view as to the significance of economic analysis in formulating legal rules:
cf. Posner and Kronman, Economics of Contract Law (1979).
Posner, Economic Analysis of the Law, 2nd Edtn. (1972).
Ogus and Veljanovski, Readings in the Economics of Law and Regulation, (1984).
Burrows and Veljanovski, The Economic Approach to Law (1981).
Calabresi and Melamed, Property Rules, Liability Rules and Inalienability, (1972), 85 Harv. L. Rev. 1089.
Coleman, Efficiency Exchange and Auction Philosophic Aspects of the Economic Approach to Law, (1980), 68 Cal. L. Rev. 221.

29. cf. Posner, Theory of Negligence, (1972), 1 J. Leg. Stud. 29.
Brown, Toward an Economic Theory of Liability, (1973), 2 J. Leg. Stud. 323.

30. cf. Calabresi, The Cost of Accidents (1970).

31. cf. Keeton, Products Liability, some Observations about Allocation of Risks, (1966), 64 Mich. L. Rev. 1329.
Note, Economic Loss in Products Liability Jurisprudence, (1966), 66 Col. L. Rev. 917.
Kessler, Products Liability, (1967), 76 Yale L. J.

32. Sykes, The Boundaries of Vicarious Liability, an Economic Analysis of the Scope of the Employment Rule, (1988), 101 Harv. L. Rev. 563.

33. cf. Cooter and Rubin, Theory of Loss Allocation for Consumer Payments, (1987), 66 Texas L. Rev. 63.
Dean Joel Kitchens, The FTC's Holder in Due Course Rule - An Ineffective means of achieving Optimality in the Consumer Credit Market, (1978), U.C.L.A. L. Rev. 821.
Note, Implied Consumer Remedy under FTC Trade Regulation Rule, (1977), U.PA L. Rev. 876.
Goldstein, The Buyer Secured Party Conflict and Section 9-307(1) U.C.C., (1982), Ford. L. Rev. 657.
Note, Credit Cards - Distributing Fraud Loss, (1968), 77 Yale L. J. 1418.

34. Ibid. n.24-29.

35. Richard A. Posner is Professor of Law at the University of Chicago Law School and Senior Research Staff at the National Bureau of Economic Research. Later he served as a Judge for the Seventh Circuit of theUnited States Court of Appeals. Some of his works on the law of economics are:-
The Economics of Justice, (1981), Cambridge London Harvard University Press.
The Economics of Contract Law, 1979, Little, Brown & Co.
The Economic Analysis of Law, 1972, Little, Brown & Co.
An Economic Theory of Intentional Torts, (1981), International Review of Law and Economics, 127.
Joint and Multiple Tortfeasers, (1980), An Economic Analysis, 9 J. Leg. Stud., 517.
Impossibility and Related Doctrines in Contract Law, (1977), 6 J. Leg. Stud., 83.
Strict Liability - a Comment, (1973), 2 J. Leg. Stud., 205.
Theory of Negligence, (1972), 1 J. Leg. Stud., 29.

36. Posner, Economic Analysis of the Law. Ibid. p.18.

37. Kelman, Misunderstanding Social Life - A Critique of the Core Premises of Law and Economics. J. Leg. Educ. 274.
Baker, The Ideology of Economic Analysis of Law, (1975), 5 Philos. & Publ. Aff. 3.

38. Another defect of the Posnerian version of the value maximisation theory is that it could give rise to a situation of inflation. Since the value of the property, the entitlement of which is in conflict, is measured by reference to the willingness of the richer party to pay more to obtain it, it may run higher than the actual value. The increase in the value of the property in question might then be reflected in the market. Accordingly, the value of similar properties would then rise.

39. Ronald H. Coase is a Professor of Law at the University of Virginia. Some of his main works on Law and Economics are:-
The Problem of Social Cost, (1960), 3 J. Law & Econ. 1.

Economics and Contiguous Disciplines, 7 J. Leg. Stud. 2, 201-211.
His contributions played a significant role in launching the law and economics movement. His insights have been used extensively by the law and economics movement as authority and inspiration for the development of an essentially right leaning approach to law.
cf. P. Schlag, An Appreciative Comment on Coase's The Problem of Social Cost: A View from the Left. (1986), Wis. L. Rev. 919.
Veljanovski and Burrows, The Economic Approach to Law, (1981), 10.

40. R.H. Coase, The Problem of Social Cost, (1960), 3 J. Law & Econ., pp.2-8.

41. Coase, The Problem of Social Cost, (1960). Ibid. p.15 and following.
Veljanovski and Burrows, The Economic Approach to Law, (1981), pp.129-131.

42. See authorities cited on n.37.

43. Another difficulty confronting the allocation of entitlements by negotiation is that its application is restricted to situations where the competing parties are firstly related and secondly they are well-informed of their respective entitlements and the risk arising from their acceptance of the proposed solution. In instances where either of the competing parties was ill-informed, the proposed solution might not be efficient in the economic sense. Due to his ignorance of the risk arising from the proposed solution or due to his ignorance of what is the most efficient way of protecting his interests, the party in question would not be in the position to bring about a favourable solution. Ultimately he might be misled into accepting a disadvantageous solution.

In instances where the competing parties are not related the enforcement of their interests would likewise not be related. Accordingly, the initial allocation of the entitlement in conflict to either competing party would finally settle the conflict in question. Such a party would not have to involve himself in negotiation with his adversary. The attempt to be involved in a negotiation with the latter would result in a less favourable solution to him. He might have to give up a portion of his entitlement in favour of his adversary.

An example of the instance where the competing parties are not related is that arising from the theft and the fraudulent negotiation of a negotiable instrument in favour of a bona fide third party. The original true owner of such a document, i.e. the person from whom it has been stolen and the bona fide third party acquirer are not normally related. In such an instance, the instrument in conflict fraudulently leaves the hands of the former party and comes into the possession of the bona fide third party. There is no actual intention on the part of the original true owner to transfer the property right of such a document to the latter party or his transferor, i.e. the thief. The initial application of the property right to the stolen negotiable instrument to either of the competing parties satisfies the interest of such a party. It establishes in his favour the entitlement inherent in the negotiable instrument. Firstly, it entitles him toenforce its value in his own name. Secondly, it releases him from the burden of establishing his claim and, thirdly, it establishes to his favour an unimpeachable title. The involvement in negotiation with the other competing party might impair the interest of the party to whom the property right to the negotiable instrument is initially allocated. It might require him to give up a portion of the face value of the said document in favour of his adversary. In other words, the involvement in negotiation with the other competing party impairs the party's interest to a full and unimpeachable title to the negotiable instrument.

44. The blocking of payment of a negotiable instrument by issuing a stop payment order initially allocates the entitlement to such a document in favour of its original true owner. It defeats the bona fide third party acquirer's right of enforcement of the instrument's credit against the drawee. In practice it initially allocates the entitlement to the proceeds of the instrument in favour of its original true owner. Finally, it allocates the burden of litigation to the bona fide third party acquirer.

45. See pp.332-339 and 606-610 infra.

46. For a substantially similar critical remark see, Kennedy, Cost Benefit Analysis of Entitlement Problems - a Critique, (1981), 33 Stan. L. Rev., pp.401-410.

47. Ibid. 391.

48. Bruce Ackerman, until 1971, was Assistant Professor of Law, University of Pennsylvania. His main work on Law and Economics is,
Regulating Slum Housing Markets on Behalf of the Poor; of Housing Codes, Housing Subsidies and Income Redistribution Policy. (1971), 80 Yale L. J. 1093.

49. Until 1972 Jon Hirschoff was an Assistant Professor of Law, Indiana University School of Law. His main work on Law and Economics is -
Toward a Test for Strict Liability in Torts, (1972), 81 Yale L.J., 1055.

50. Until 1972 Guido Calabresi was a Professor of Law at Yale University. His main works in Law and Economics are:-

The cost of Accidents, (1970).
Toward a Test for Strict Liability in Torts, (1972), 81 Yale L.J., 1055.
Property Rules, Liability, Rules and Inalienability, One View of the Cathedral. (1972), 85 Harv. L. Rev., 1089.

51. Until 1980 Frank Michelman was a Professor of Law at the University of Harvard. His main works on the Law and Economics are:-
Are Property and Contract Efficient? (1980), 8 Hofstra L. Rev., 711.
Pollution as a Tort: A Non-Accidental Perspective on Calabresi's Costs. (1971), 80 Yale L.J., 647.
Property, Utility and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law. (1967), 80 Harv. L. Rev., 1165.

52. cf. Heller, The Importance of Normative Decision-Making. The Limitations of Legal Economics as a Basis for a Liberal Jurisprudence - As Illustrated by the Regulation of Vacation Home Development. (1976), Wis. L. Rev., 442.

Markovits, The Causes and Policy Significance of Pareto Resource Misallocation: A checklist for Micro-Economic Policy Analysis. (1975), 28 Stan.L. Rev., 1, 2.

Baker, The Ideology of the Economic Analysis of Law, (1975), 5 Philos & Publ. Aff., pp.13-22.

53. cf. Kennedy, Cost Benefit Analysis of Entitlement Problems: A Critique. (1981), 33 Stan. L. Rev., pp.393-398.

54. See pp. 83 and 84 above.

55. cf. n.52 with accompanying text.

56. cf. pp.351-359 infra.

57. cf. Coase, The Problem of Social Cost. (1960), 3 J. Law & Econ., pp.8-15.
Kennedy, Cost-Benefit Analysis of Entitlement Problems: A Critique. (1981), 33 Stan. L. Rev., 395.

58. See pp.125-128 supra.

59. cf. pp.596-598 infra.

60. cf. pp.126-127 supra.

61. cf. Authorities cited on n.52.

62. The rule of allocating the property right to a stolen negotiable instrument in favour of its bona fide third party acquirer is actually enforced in the Continental Geneval legal systems. This could be inferred from the application of Article 16 G.U.L.(Bills)

and Articles 19, 21 G.U.L.(Cheques). For a detailed analysis of the above mentioned rule - cf. pp.237-240 infra.

63. cf. pp.332-339 and 606-610 infra.

64. The negligence theory is borrowed to allocate the risk evolving from negotiable instrument fraud. Article 3-406 U.C.C. clearly manifests the operativeness of the negligence theory as a risk allocation technique. It provides that the drawer of a negotiable instrument would be precluded from challenging the bona fide acquirer's title to the vitiated instrument and he would be precluded from challenging the drawee's act of payment in instances where his negligent behaviour contributed to the occurrence of the forgery of a signature.
cf. pp.448-459 and 517-521 infra.

65. The term contributory negligence is used in the text in its traditional common law sense. It differs from the modern English application which resembles the term comparative negligence as understood in the United States. The contributory negligence theory in its Common Law sense determines the negligence of the injured, notwithstanding its severity as the decisive factor in risk allocation. That is to say, the injured's negligence bars him from the right of recovery, regardless of the injurer's status. For the application of the contributory negligence theory see - Schwartz, Contributory and Comparative Negligence - A Reappraisal. (1978). 87 Yale L. J. 703.

66. The comparative negligence theory has been subject to variant applications. The decisive factor which divides the variant applications is the degree of the injured's fault i.e. negligence, according to which the problem of risk allocation is determined. The pure version illustrates the extreme application of the comparative negligence theory. According to it, the risk arising from an accident occurrence is allocated to the negligent parties. The accident loss is apportioned between them, in proportion to their fault. The slight and gross negligence version illustrates the other extreme application. The risk of loss according to this version is allocated to the injured, when his severity of negligence i.e. fault, is more than slight. Between these two extreme applications, there is the modified comparative negligence version. According to it, the risk is allocated to the injured when the degree of his fault is more or equivalent to the injurer's. As could be seen, the pure comparative negligence version demonstrates the most remote application of the comparative negligence theory from the contributory negligence theory discussed below. For this reason, it has been decided to examine the implication of the comparative negligence theory in its pure version. For the application of the comparative negligence theory see - R.D. Cooter, T.S. Ulen, An Economic Case for Comparative Negligence - (1986), N.Y. U. L. Rev. p.1071 et seq.

Schwartz, Contributory and Comparative Negligence - A Reappraisal. (1978), 87 Yale Law J. 703.
Schwartz, Comparative Negligence. 2nd Edit. (1986).

67. The insurance theory is relied upon extensively in the allocation of the risk evolving from fraud in the consumer industry. The current tendency is in favour of denying the application of the holder in due course concept to negotiable instruments used as finance devices in consumer transactions. The defrauded consumer may set up against the associated financer, defences and claims which the former owns against the defaulting or fraudulent merchant. The financer may not claim as against the defrauded consumer the advantages of the holder in due course.
cf. The authorities cited in n. 29 supra.

The insurance theory is also imported as a risk allocation technique in instances of negotiable instrument fraud. The U.C.C. is submitted to be the legal system most influenced by the insurance theory.

Article 3-417 together with its official comment indicates that the collecting bank, due to its capacity to provide for insurance effectively is the best risk bearer in instances of forged indorsements.

68. cf. J.P. Brown, Toward an Economic Theory of Liability. (1973). J. Leg. Stud., 340.

69. cf. The celebrated case of Donoghue v Stevenson [1932] AC 562.
As to the essentiality of the existence of a specific duty of care to another in the context of negotiable instruments, see -
Swan v North British Australasian Co. (1863) 2H & C 175.
Bank of Ireland v Evans' Charities Trustees (1855) 5 HLC 389, and,
London Joint Stock Bank v Macmillan & Arthur [1918] AC 777.

70. cf. Zweigert & Kötz, Vol.II, Introduction to Comparative Law, 264 et seq.
and Von Mehren, The Civil Law System. 2nd Edit. (1977), 567 et seq.

71. cf. Farnsworth, The Cheque in France and the United States a Comparative Study. (1962). 36 Tulane L. Rev. pp.263-65.

72. London Joint Stock Bank v Macmillan & Arthur [1918] AC 777.

73. Phillips v Eyre (1870) LR 6 QB 1.

74. Boys v Chaplin [1971] AC 356.

75. cf. White and Summers, The Uniform Commercial Code 2nd Edition. (1984), pp.629-630.

76. For the inconvenience of court settlement as to commerce in general see pp.172-174 infra.

77. 159 F 2d 169 (2nd Cir.1947).

78. Ibid.

79. For detailed account of Learned Hand's formula see - J.P. Brown, Toward an Economic Theory of Liability. (1973). J. Leg. Stud., 323.

80. J.P. Brown, Toward an Economic Theory of Liability. Ibid. 340.

81. The above hypothetical is borrowed from the facts of Lipkin Gorman & Karpnale Ltd. v Lloyds Bank [1987] 1 WLR 987.
Lipkin Gorman & Karpnale Ltd. (formerly Play Boy Club London) and another, Court of Appeal (Civil Division) 139 NLJ 76 (Transcript Assoc.) Oct. 1988.

82. J.P. Brown, Toward an Economic Theory of Liability. (1973), J. Leg. Stud., 340.

83. See pp.148-151 infra.

84. J.P. Brown, Toward an Economic Theory of Liability. (1973), J. Leg. Stud., 340.

85. See n. 56 and relevant text.

86. Sections 54-55 B.E.A. and Articles 9 and 15 G.U.L.(Bills).

87. For a detailed account of the illustration under examination see p.157 supra.

88. The comparative negligence theory could however be borrowed to formulate the risk allocation rule in instances where the property right to the negotiable instrument in question is not the subject matter of conflicting claims. Such an instance occurs when the dispute in question arises between the drawee/payer and the drawer as to the validity of the act of payment. An example of such an instance is the payment of a blank forged stolen cheque in favour of other than the purported drawer in a jurisdiction where the forgery of negotiable instruments is booming.
cf. National Westminster Bank Ltd. v Barclays Bank International and Another [1975] QB 654.

In such an instance, the property right to the blank forged stolen cheque does not form the subject matter of conflicting claims. The drawee, by making payment, does not intend to establish in his favour a property right to the paid instrument. The purpose of his acquisition is merely to evidence the act of payment. The paid instrument remains, it is submitted, the exclusive property of its maker or drawer.

The factor most relevant to the problem of formulating the risk allocation rule in this instance, would be the establishment of the liability for the evolving risk. The apportionment of risk seems to be the most proper test for risk allocation. Its application could motivate the competing parties to exercise a high standard of care and ultimately avoid or mitigate the occurrence of accidents e.g. negotiable instrument fraud. As far as the above example is concerned, the payment of a blank forged stolen cheque would, under the comparative negligence theory, be allocated in its entirety to the drawee payor or it would be apportioned between himself and the purported drawer, the party from whom the blank cheque was stolen and whose signature was forged, in instances where the theft of the blank cheque was attributed to the purported drawer's own misconduct, such as if the blank cheque was left unattended on the desk of the purported drawer.

In both the Anglo-American and the Continental Geneva legal systems, the payment of a blank forged instrument to other than its purported drawer in suspicious circumstances, amounts to a wilful abstinence from enquiry. Such conduct ultimately may raise the liability of the party so conducting himself.
cf. May v Chapman (1847) 16 M&W 355, 361 approved in Raphael v Bank of England (1855) 17 C.B 161, 174.

In the Continental Geneva Legal systems, the wilful abstinence from enquiry amounts to gross negligence cf. Giles, Uniform Commercial Law. (1970), pp.167-169.

By virtue of Article 40 G.U.L. (Bills), gross negligence disqualifies the drawee payor from claiming the protection incorporated in the said article. In the instances where he acts with gross negligence, he may not claim the discharge of his obligation towards the drawer.

Finally, in the Continental Geneva legal systems, the placement of a blank cheque in a place where its vulnerability to theft is probable amounts to negligence. cf. Farnsworth, Cheques in France and the United States - A Comparative Study. (1961-62), 36 Tulane L. Rev., p.265. If however, such negligence was materialised, the arising risk may, in its entirety or a portion of it, be allocated to the negligent party.

89. p.77 et seq.

90. See Article 3-417 U.C.C. together with its Comment.

91. In the context of economic analysis the rule which gives rise to careless behaviour is expressed in the terms that it gives rise to the problem of moral hazard. The problem of moral hazard, i.e. careless behaviour arises in instances of a fixed liability rule such as the doctrine of absolute strict liability. Its application conclusively presumes against the defendant injurer a liability for the damage arising from his behaviour. It denies him any defence the application of which could rebut his liability and establish it either in its entirety or proportionately to the plaintiff victim. cf. Veljanovski, The Economic Approach to Law, (1981), pp.142-143.

The insurance theory is submitted to be an application of the absolute strict liability doctrine. It conclusively allocates to the party in the best position to provide for insurance the risk arising from the occurrence of a particular accident. Its literal application establishes against the best insurer, an absolute liability for the evolving risk.

92. For the application of the approximation theory see Comment, Allocation of Losses from Cheque Forgeries under the Law of Negotiable Instruments and the U.C.C. (1953). 62 Yale L. J., p.439, and,
Forged Indorsements under the UNCITRAL Draft Convention on International Cheques. (1981). 21 Col. J. Transnat'l L., p.860.

CHAPTER FOUR

THE PROBLEM OF RISK ALLOCATION IN INSTANCES OF FORGED SIGNATURES

INTRODUCTION

(i) The forgery of a signature is a ~~form of~~ fraud perpetrated by an independent party. It is an example of a situation in which risk may arise. The forgery of a signature, on the one hand, involves the attributing of a promise or an undertaking to an innocent party. Such act would raise the liability of the innocent party, in particular when the forged signature purports to confer benefit in favour of a bona fide third party. An example of such an instance is the forgery of the payee's indorsement in favour of the fraudulent person and the negotiation of the instrument to a bona fide third party unaware of the forgery.[1]

The fixing of a signature on a negotiable instrument constitutes a contract.[2] The signatory or purported signatory, be he the drawer, indorsor or acceptor, promises or undertakes to pay the holder of the instrument its face value. Where the drawee does not pay the instrument, the holder, on the basis of the contractual promise or undertaking created by the signature may, by way of recourse, raise the liability of the signatory or purported signatory in question.[3] Thus, the bona fide third party, into whose favour the instrument is fraudulently indorsed, may, as far as the above example is concerned, in his capacity as the holder and on the basis of the payee's purported indorsement, raise the liability of the latter.

(ii) The forgery of a signature, on the other hand, may involve the diversion of the normal currency of the instrument.[4] The issuing or indorsing of an instrument signifies the transfer of the property of the instrument. It is presumed to confer upon the payee or indorsee a property right to the instrument, whereby the latter may satisfy the holder status. In his capacity as such he may confer a good title in favour of subsequent acquirers. The latter may, accordingly, satisfy the holder status. The satisfaction of the holder status confers upon the acquirer, i.e. the party, to whose favour the said status is established, the rights inherent in **"the negotiability doctrine".** He may accordingly enforce the instrument against any or all prior parties and he may retain its proceeds in instances of payment.

The forgery of the drawer's issuance or the payee's indorsement affects the normal currency of the instrument, in the sense that, it purports to attribute to the prima facie drawer or payee, the intention to transfer the property of the instrument to a subsequent party. It, accordingly, purports to confer upon the latter, the holder status. It finally purports to enable the subsequent party, i.e. the party to whose favour the instrument is prima facie issued or indorsed, to procure a valid transfer in favour of another. The transfer of the instrument in favour of the ultimate bona fide third party, purports to confer upon the latter, the holder status. Accordingly it purports to establish in his favour, the right to enforce the instrument and the right to retain its proceeds in instances of payment. Such transfer affects the normal currency of the instrument, in the sense that it purports to dispossess the original true owner, i.e. the party from whom the instrument was originally stolen or the party whose signature was forged, of his property right to it, and it purports to establish the said right in favour of a bona fide third party.

(iii) Finally, the risk evolving from the forgery of a signature is not confined as between the party against whom the forgery is immediately directed, i.e the party whose signature is forged, and the party to whose favour the fraudulent person negotiates the instrument. Rather its effect runs to parties remote to the forgery. Examples of such parties are, the drawer, in instances where the indorsement of the payee is forged, and the subsequent acquirer, i.e. the party to whose favour the initial bona fide acquirer negotiates the instrument. The risk evolving from the forgery in this instance is of a contractual and proprietary nature. On the one hand, the forgery raises the liability of the remote signatory e.g. the drawer, in favour of the subsequent acquirer as the holder, on the basis of the undertaking incurred by the issuance of the instrument. On the other hand, it raises the acquirer's entitlement as the holder, to enforce the rights incorporated in the instrument, exclusively in his favour, and his entitlement to retain the proceeds of the instrument in instances of payment.

Definition and Scope of Application — [illegible]

The term **"forgery"** is nowhere defined in the respective codes regulating the laws relating to negotiable instruments. Presumably it is left to be regulated by the penal law of the jurisdiction in question. By reference to the penal codification in general, forgery could broadly be defined as the fraudulent destruction of the genuineness of an instrument, with the intention that it shall be used to induce another person to accept it as genuine.[5]

The destruction of the genuineness of an instrument could be perpetrated by signing in the name of another without securing the latter's authority. Such act would fraudulently attribute to the purported signatory the intention to incur liability and the intention to transfer the property right to the instrument.

Signatures appearing on negotiable instruments are of two types as to their order of incorporation; namely, those incorporated at the time of making, such as the signature of the drawer, and those incorporated subsequent to the making e.g. the signature of the payee or indorsee and the signature of the drawee. Normally signatures superceding the making occur subsequent to the issuance of the instrument. Issuance occurs when the maker of the instrument places his signature on the instrument and delivers it to the intended payee.[6] Thus, the forgery vitiates the making of the instrument if it occurs prior to the issuance, whilst it vitiates the negotiation or acceptance if it occurs subsequent to the issuance.

(i) The most obvious form of the forgery in the making is the instance where a person attributes the making of a negotiable instrument to another. This occurs by the former's use of the latter's name in signing the instrument as maker or drawer. An example of such instance is the signature by Willy Williams in the name of John Alex as the drawer. The fraudulent attribute of such form of forgery is illustrated by the intention of the fraudulent person, Willy Williams, to use the instrument as if it had been drawn by John Alex. Similar to this example is the instance where the fraudulent person signs in a representative capacity without authority, such as the signature per pro John Alex made by Willy Williams. The fraudulent attribute of such signature is illustrated by the intention of Willy Williams to clothe himself with a representative capacity.

The making of an instrument in the name of a fictitious person and the making of an instrument by an agent in misuse of his authority are not, by comparison, illustrations of forgery in the making. An example of the former is the making of a negotiable instrument by Willy Williams in the name of Gullible Grocer, a non-existent person. Such form of making is not deemed to be a form of forgery because the maker does not intend to create anxiety by virtue of his making, to another party.[7] The party in whose name the making is made is a non-existent person. Accordingly, no anxiety could be suffered by him.

As far as the agent's misuse of authority is concerned, it is submitted, in the U.C.C. as well as the G.U.L., that the agent's misuse of authority in the making is not a form of forgery. A signature is presumed to be a forgery, if it was made without actual, implied or apparent authority.[8] To illustrate, assume that Willy Williams is appointed as the President of Alex Euro-Construction. In his capacity as such he is authorised to settle the firm's account by issuing and indorsing cheques in its own name. Thus if Williams misuses his authority, and issues, in the name of the firm, cheques for his own interest, he would not be deemed to be involved in the fraudulent making of cheques. His issuance of cheques in the firm's name is well within his actual authority. His misuse of the firm's proceeds in satisfying his own interest, does not raise the validity of the act of issuance. It, by comparison, raises his entitlement to use the proceeds for his own interest.

By virtue of Section 24 of the 1861 English Forgery Act,[9] the agent's signature in the company's name and in misuse of his authority, did not invalidate the instrument signed in the said capacity. The instrument remained valid if it came into the hands of a bona fide acquirer. In **Morison v London County & Westminster Bank Ltd.**,[10] the court applied Section 24 of the 1861 Act. The case involved an agent authorised to sign cheques in the name of his principal i.e. the company. In fraud of his principal, the agent signed the cheques in his representative capacity, for his own purpose. The bank on which the cheques were drawn, paid the proceeds of the cheques to a bona fide third party. The company sought to recover the proceeds from the third party recipient. The court held, that an instrument cannot be validated for one purpose and invalidated for another. It cannot be **genuine** in one hand and a **forgery** in another.[11] Since the cheques were valid, as far as the payor bank was concerned, they would be valid in the hands of the third party acquirer.

In **Kreditbank Cassel v Schenkers Ltd.**,[12] the court of first instance followed the decision in the Morison case. Kreditbank, Cassel v Schenkers involved an agent's misuse of authority. The Articles of the company (Schenkers) authorised the local managers of the company to indorse and issue bills of exchange in the company's name. Clarke, a local manager of the company, was however, delegated the power of issuing and indorsing cheques only. Nevertheless he, in misuse of his authority, drew bills of exchange in the company's name for his own purpose. The bank, accordingly, paid the bills and charged the company's account with the face value of the bills. The court found that the bills were valid and gave judgment in favour of the bank.[13]

The Court of Appeal overruled the decision of the lower court. They interpreted the bills of exchange drawn in the name of the company and for the purpose of the local manager, as a forgery. They defined forgery as it was then applicable in the 1913 Forgery Act.[14] An instrument is presumed to be a forgery when it tells a lie about itself.[15] Since the bills of exchange involved in the case under consideration purport, contrary to the fact, to be drawn in favour of the company, they are deemed to be a forgery. The court then subjected the concept of forgery as incorporated in the B.E.A., to the definition found in the 1913 Forgery Act.[16] By reference to Section 24 B.E.A., the court held that the signature in a representative capacity in the name of the company and in fraud of the latter is inoperative for the purpose of discharging the payor.[17] Finally, the court gave judgement in favour of the company.

The significance of determining the status of a signature of a representative in the name of his principal and in fraud of the latter, lies in the construction attributable to the instrument in which such signature is incorporated. The construction of the instrument in the light of the fraudulent practice, in one way or another, determines the entitlements evolving from it. The manner in which the said entitlements are determined raises, due to the occurrence of fraud, the problem of risk allocation.

(ii) The forgery of an indorsement occurs when the fraudulent person signs the instrument in the name of the payee or indorsee. An example of such an instance is the signature in the name of David Dove, the payee of an instrument, by Willy Williams. Of course, such an instance would not occur unless the fraudulent person, Willy Williams, intercepts the normal currency of the instrument, or misappropriates it in fraud of his principal. The theft of the instrument, from the post box of the payee, illustrates the interception of the instrument, whilst the indorsement in the name of the payee by his trustee, for the latter's own purpose, illustrates the misappropriation of the instrument. The forgery in both instances is illustrated by attributing the indorsement to the payee, David Dove.

(iii) The forgery of an acceptance occurs when the fraudulent person signs in the name of the drawee. An example of such an instance is the signature by Willy Willams in the name of Jimmy Johnbow, the party upon whom the instrument is drawn. The forgery in this instance is illustrated by attributing the acceptance to Jimmy Johnbow. Although the acceptance is not related to the transferability of the instrument, the purpose of forging the drawee's acceptance is to give rise to a direct relationship between the acceptor and the holder. It attributes to the former the promise to pay the instrument on its day of maturity.[18] In other words, such a signature establishes a contractual liability against its purported maker and in favour of the holder, of the instrument in which it is incorporated.

Forms of Instrument Vulnerable to Forgery

Negotiable instruments could, as to their form of drawing, be divided into bearer, inchoate and order instruments. Bearer instruments are defined as those drawn originally to bearer or those the last indorsement on which is an indorsement to bearer or in blank.[19] Inchoate instruments are defined as those instruments signed in blank with the intention that they shall circulate as negotiable instruments.[20] Order instruments are defined as those instruments which are originally drawn payable to a specified person or to his order, or the last indorsement on which is a special indorsement i.e. which stipulates a specified person to whom or to whose order it shall be payable.[21] Examples of such instruments are, the instrument which on the face of it stipulates, pay David Dove, or, pay David Dove or order, and the instrument, the last indorsement on which stipulates pay Billy Barnes, or, pay Billy Barnes or order. The special indorsement may appear on either an instrument drawn originally to order, or it could appear on an instrument drawn originally to bearer. In both situations, with one exception,[22] the special indorsement renders the instrument bearing it, an order instrument.

An order instrument is the most vulnerable form of negotiable instruments to the risk of the forgery of signatures. It may be vitiated as to its making, as well as to its negotiation. Indorsements are essential for the transferability of order instruments. For a fraudulent person to facilitate his fraud, he must forge the indorsement of the payee or indorsee.

Bearer instruments, by comparison, are transferable by mere delivery. They do not stipulate the payee or indorsee to whose favour they shall be payable. Any possessor, be he a thief or a finder, could qualify as the purported holder. Thus, the fraudulent person need not forge the signature of the party from whom he intercepts the instrument, to facilitate his fraud. He may negotiate the stolen instrument to a bona fide third party by the mere delivering of it.

Inchoate instruments, due to their incompleteness, do not stipulate to whose order they shall be payable. The space allotted for the name of the payee is left unfilled. Thus, if an inchoate instrument in its status as such, comes into the hands of a fraudulent person, be he the trustee, or a thief, there would not be a payee or indorsee whose signature is required to be forged, for the purpose of negotiating, i.e. transferring the instrument. The fraudulent person need only fill in his name or the word bearer in the space designated, to facilitate his fraud

Competing Interests

The competing interests arising from instances of the forgery of signatures vary. Generally speaking, the number of competing interests is dependent on the parties involved in the negotiable instrument transaction. The more hands the instrument comes into, the more interests will compete. The examination of the validity of all relevant interests is essential for the purpose of determining the risk allocation rule. In order to make concrete the significance of the relevant interests, three hypotheticals are provided. They all involve situations in which negotiable instruments are negotiated to a bona fide third party for value.

Hypothetical 1

Willy Williams breaks into John Alex's office. He forces open a locked drawer, steals a cheque from the latter's cheque book, forges Alex's signature and issues the cheque in his, i.e. Williams', favour. Willy Williams then negotiates the cheque for value to Billy Barnes, by indorsing it in his own name to the latter.

Hypothetical 2

John Alex draws up a cheque, making it payable to the order of Dove and Co., a Mail order business, as consideration for ordered goods. Due to postal miscarriage, the cheque comes into the hands of Willy Williams, the manager of a grocery shop operating under the name of Dove and Co., and situated in the same postal locality as the mail order business. Willy Williams, aware of the misdelivery, decides to misappropriate the cheque. He purports to act as the intended payee, signs the cheque in the shop's name and indorses it for value to Billy Barnes.

Hypothetical 3 In application?

John Alex issues a cheque to the order of David Dove. David Dove delivers the cheque to his servant, Willy Williams, for deposit. Willy Williams, in twenty years of service, has shown devotion and honesty; nevertheless, due to his financial difficulty, he decides to misappropriate the cheque. He forges his principal's signature and makes the cheque indorsable in his own favour. Willy Williams then negotiates the cheque to Billy Barnes for valuable consideration.

The interests involved in the first hypothetical are two in number, the interest of the purported drawer, John Alex, and the interest of the bona fide third party acquirer, Billy Barnes. The interest of the acquirer, Barnes, is related to the negotiable instrument transaction, i.e. cheque, whilst the interest of the purported drawer, Alex, is related to the contractual undertaking incorporated in the instrument, cheque. The purported drawer does not possess an interest in the instrument. The cheque, as far as the hypothetical under consideration is concerned, does not possess an enforceable right in relation to Alex. It is considered to be a mere sham. It operates as a piece of paper, qua piece of paper.[23]

The interests involved in the second hypothetical are, by comparison, three in number; the interest of the drawer, John Alex, the interest of the purported indorsor, Dove and Co., and the interest of the bona fide third party acquirer, Billy Barnes. Unlike the first hypothetical, the interest of the drawer, Alex, and the interest of the acquirer, Barnes, are both related to the instrument i.e. cheque. Since the instrument, cheque, in the hypothetical under consideration does not come into the possession of the payee, Dove and Co., the property right to the cheque does not pass to it. Dove and Co. accordingly, does not possess an enforceable right on the cheque. Its interest, by comparison, is related to the contractual undertaking purported to be assumed on the cheque, in its own name.

The interests involved in the third hypothetical are, also, three in number; the interest of the drawer, John Alex, the interest of the purported indorsor, David Dove, and the interest of the bona fide third party acquirer, Billy Barnes. Unlike the second hypothetical, the property right to the instrument, cheque, passes to the intended payee. The forgery, in the hypothetical under consideration, materialises whilst the cheque is in the possession of its payee. Thus, the three interests involved are all related to the negotiable instrument transaction, i.e. cheque.

The competing interests may increase if the instrument in question is accepted or paid by the drawee. The interest of the acceptor/payor in this instance, would be involved. His interest is always related to the negotiable instrument transaction.

Other Parties

(i) A negotiable instrument, for the purpose of securing payments, may pass in the chain of collection. It may need to pass through more than one pair of hands before it can be presented for payment. The instrument may pass through the hands of a depository agent and an intermediary agent, in order to facilitate the presentment of the instrument for payment. The reason for having more than one agent involved in the collection of negotiable instruments could be explained on two grounds. The acquired instrument could be deposited with an agent for collection, the jurisdictional operation of which does not cover the jurisdiction where the instrument is intended to be payable, or it could be deposited with an agent not recognised in the jurisdiction where the instrument is payable as a member of the Clearing House Association.

In the first instance, the agent with which the acquired instrument is deposited for payment, should, for the purpose of collecting the proceeds of the deposited instrument, arrange with another agent, the jurisdictional operation of which covers the jurisdiction where the instrument is payable, to present the said instrument to the drawee for payment. This instance normally arises in the interstate instruments where the acquisition and the deposit of a negotiable instrument occurs in one jurisdiction, whilst its payment is intended to be made in another. An example of such an instance is the instrument, the acquisition and deposit of which occurs in Louisiana, whilst its payment is intended to be made in Chicago. If the jurisdictional operation of the bank with which the instrument was deposited for collection was confined to the state of Louisiana, such as the National First State Bank of Louisiana, it, for the purpose of collecting the proceeds of the deposited instrument, would have to arrange with another bank, the jurisdictional operation of which covers the state of Chicago, such as the Federal Reserve Bank, to present the deposited instrument for payment. For this purpose, the former should transfer to the latter the deposited instrument so as to enable the intermediary agent, the Federal Reserve Bank, to present the said instrument for payment, through its counterpart in the jurisdiction where the instrument is payable, e.g. Chicago.

In the instances where the acquired instrument is deposited with an agent not recognised in the jurisdiction where the instrument is payable, as a member of the Clearing House Association, the said agent would have to arrange with a member of the Clearing House Association to present the deposited instrument for payment. Unlike the first instance, the acquired instrument need not be an inter state instrument so as to justify its involvement in a chain of collection. Inland instruments may need to pass through more than one agent for the purpose of collection. An example of such an instance is the deposit of a cheque, issued acquired and payable in England with a post office. The Post Office, in the

English legal system, is not a member of the Bankers Clearing House Association. It cannot directly procure the collection of the deposited instrument. Thus, in order to facilitate the collection of the deposited cheque, it must arrange with a member of the Bankers Clearing House Association such as Barclay's or the National Westminster Bank to collect the proceeds of the cheque. To facilitate the said purpose, it should transfer the deposited cheque to the bank in question.

(ii) The involvement of the interest of the depositary as well as the intermediary agent in the competing interest situation depends on the status of the said agent. If the depositary or the intermediary agent acts in its capacity as a collecting agent, that is to say it holds the credit of the deposited instrument until final payment, the interest of the collecting agent in question would not be impaired. In instances of dishonour, it may return the dishonoured instrument upstream until it reaches the ultimate acquirer/depositor. If the depositary or intermediary agent provisionally credits the proceeds of the deposited instrument to the account of the immediate transferor, i.e. the depositor of the depository agent, the crediting agent may in instances of dishonour, reverse the provisional credit.

If, however, the depositary or intermediary agent allows its immediate transferor to withdraw the proceeds of the deposited instrument before final payment, the agent in question would not be acting in its capacity as a collecting agent. By conferring upon the transferor the right to withdraw the proceeds of the deposited instrument before final payment, the depositary or the intermediary agent would be deemed to have acquired the deposited instrument from the immediate transferor. The cashing agent will then stand in the shoes of the bona fide acquirer. Its interest would be identical to that of the bona fide acquirer. It would be related to the property right to the deposited instrument.

The status of the depositary and the intermediary agent is also the decisive factor in determining the involvement of the interest of the said agent in the competing interest situation, in instances of payment. If the depositary or the intermediary agent receives payment in its capacity as a collecting agent, from the drawee, its interest as such would not be impaired. If the depositary or intermediary agent was compelled to account for the paid proceeds which it holds for its immediate transferor, the reverted proceeds would be charged to the transferor. If, however, the paid proceeds were credited to the transferor there would be nothing which the depositary or the intermediary agent would have to account to the payor.[24]

If, by comparison, the depositary or intermediary agent holds the paid proceeds for its own use, it would be deemed to stand in the shoes of the bona fide recipient. As will be shown below[25] the interest of the bona fide recipient in instances of payment is related to the property right to the paid proceeds.

(iii) Finally, the forger may be involved as a party to the negotiable instrument transaction. In instances where he misrepresents himself to another as the purported signatory and negotiates the forged instrument in his capacity as such to the third party, the U.C.C.[26] and the G.U.L.[27] expressly provide that the forger occupies the status of the party whom he purports to represent. Accordingly, the bona fide acquirer, the party to whom the instrument was fraudulently negotiated, may enforce the acquired instrument against the forger by way of recourse.

Under the English legal system, the forger does not occupy the status of the signatory, the party whom he purports to represent. Nevertheless, the law imposes on every transferor a chain of warranties. The transferor warrants to his immediate transferee, amongst other things, that he is deemed to be the party whom he purports to represent.[28] Since the forger is presumed to be the immediate transferor of the bona fide acquirer, he is deemed to warrant to the latter that he is the purported signatory. If the forger was found guilty of misrepresenting his actual status to his immediate transferee, the latter may raise the former's breach of warranty liability. Ultimately he may enforce the face value of the acquired instrument against him.

The involvement of the forger as a party to the forged instrument becomes more apparent in instances where he purports to negotiate the forged instrument in his own name. Examples of such an instance could be gathered from the hypotheticals mentioned above.[29] In the first hypothetical the forger, Willy Williams, fraudulently issued the cheque in his favour, whilst in the second and third hypotheticals he fraudulently indorsed the cheque in question to his order. In his capacity as payee and indorsee he perpetrated his fraudulent practice. By way of indorsing or re-indorsing the intercepted cheque, he facilitated the transfer of the cheque to a bona fide third party e.g. Billy Barnes. As indorsor, the forger engages on the instrument. He undertakes to pay its face value, should the drawee fail to honour it on its day of maturity.[30] In instances of dishonour, the bona fide acquirer may then enforce the instrument against the forger by way of recourse.

Although the forger may be a party to the negotiable instrument transaction, the liability created by his engagement on the instrument is not of a practical value. Its enforcement is almost always unavailing, either due to his insolvency or to his unavailability.

Since the involvement of interests in the competing interest situation may vary according to the dishonour or payment instance, the following discussion will examine in detail the interest of the competing parties in the said settings separately.

Competing Interests in Instances of Dishonour

The interests involved in the event of dishonouring an instrument vitiated by a forged signature vary according to the legal status of the competing parties. The competing parties could generally be divided into two categories, namely those involved **"prior"** to the forgery and those involved **"subsequent"** to it. The first category encompasses the drawer of the instrument in question, e.g. John Alex in the second and third hypotheticals and in many cases the payee, such as David Dove in the third hypothetical. The second category of parties by comparison, encompasses the bona fide acquirer for value and without notice of the forgery e.g. Billy Barnes, in the first, second and third hypothetical. The person upon whom the instrument is drawn, may of course be a party to the instrument, but his interest as an acceptor does not compete with the remaining interests i.e. the interest of the drawer, payee, and the bona fide acquirer. The acceptor may dishonour the instrument when presented to him for payment.

(i) The interest of the first category of parties depends on the remoteness of the party in question from the act of forgery. The payee, i.e. David Dove, in the third hypothetical illustrates the immediate party to the forgery. In that hypothetical, the cheque was stolen from the payee soon after it came into his possession. The same hypothetical illustrates the remoteness of the drawer i.e. John Alex, from the forgery. The forgery of

Dove's signature occurred when the bill intentionally left the drawer's hand and reached its intended payee. The second hypothetical is a border-line situation. The drawer in this hypothetical is neither as immediate as the payee in the third hypothetical, nor is he as remote as the drawer in that case. The forgery in the second hypothetical occurred subsequent to the intentional transfer of the cheque, but before it reached its intended payee. The forger, Willy Williams, intercepted the bill before it came into the possession of the intended payee i.e. Dove and Co., the mail order business.

The interest of the immediate party is submitted to be two-fold. It is associated with the special nature of negotiable instruments as a **"chose in action"**. In the first place, the immediate party, e.g. David Dove, in the third hypothetical is interested to have his property to the instrument in question protected. In the second place he is interested to have himself unaccountable for the contractual undertaking fraudulently attributed to him. That is to say that, the stolen cheque should not be enforced against him, even if it comes into the hands of a bona fide third party.

(ii) The interest of the remote party, e.g. John Alex, in the third hypothetical, is to have himself protected against double liability. He would be subject to double liability if he was made liable on the instrument to the bona fide acquirer, i.e. Billy Barnes as well as on the underlying obligation in favour of the original payee i.e.

David Dove. On the one hand and as a general rule, the appearance of a negotiable instrument in the hands of a bona fide third party, raises the significance of the contractual obligation incorporated in the instrument. The signatory, by engaging on the instrument in question, promises or undertakes to pay the holder of the instrument when dishonoured.[31] The person who satisfies the status of a holder avails himself of the right of enforcing the instrument by way of recourse. On the other hand the engagement on a negotiable instrument presupposes the existence of an independent transaction giving rise to a creditor/debtor relationship. The latter undertakes to discharge the evolving obligation by way of issuing or negotiating a negotiable instrument. Nevertheless, the act of issuance or negotiation and indorsement does not discharge the underlying obligation absolutely. It suspends the operativeness of the said obligation until the day of maturity of the instrument. If the instrument was paid to the creditor or to the party to whose favour the payment is directed to be made, the discharge of the instrument would retroactively discharge the underlying obligation. If, however, the instrument was dishonoured, the underlying obligation revives.[32] The theft of the instrument from the payee/creditor would necessarily prevent him from demanding payment from the drawee. His status would be tantamount to that of the creditor of a dishonoured instrument. His right of action on the underlying obligation would then revive.

In order to protect John Alex against double liability, his liability should be confined to that arising from the negotiable instrument transaction. That is to say that his liability should run in favour of the holder of the instrument i.e. cheque. Thus, the interest of the drawer to be accountable for a single payment would be achieved by determining the party who qualifies as the holder of the instrument i.e. the party to whose favour the property right to the stolen instrument is established. If the holder status was established in favour of Billy Barnes, David Dove should forfeit his right of recourse on the underlying obligation against John Alex. If, however, the holder status was established in favour of David Dove, Billy Barnes should forfeit his right of action on the negotiable instrument against John Alex.

(iii) The interest of the party in the borderline situation, e.g. John Alex in the second hypothetical, is illustrated in establishing in his favour the property right to the stolen instrument. Since the instrument in question does not reach its intended payee, the drawer transferor is interested to have the property right to the instrument restored to him. The transferor in question accepts to transfer the property in the instrument provided that it reaches the intended transferee. When the instrument comes into the hands of a party other than the intended transferee, the intention of the transferor would fail once the property in the instrument is established in favour of the said party. If, however, the said property was established in favour of the third party, the transferor would be subject to double liability. The first would be related to his undertaking incorporated in the instrument, whilst the second cause of liability would be related to the underlying obligation vis-à-vis himself and the intended transferee.[33]

(iv) The interest of the second category of parties, namely the bona fide acquirer is illustrated in the right to have his reliance protected. The bona fide acquirer should be assured that the transactions in which he engages, in reliance on their prima facie genuineness, are valid. The failure to uphold the validity of the transactions in question, will disturb the whole of the market's dealings. Thus, if the bona fide acquirer obtains through his dealings, a negotiable instrument, in reliance on its prima facie regularity he should be reasonably protected against defences and claims of which he could not reasonably be expected to know.

The main application of the reliance protection, as it will be noted, is the upholding of the bona fide acquirer's right of property to the purchased instrument. The bona fide acquirer would obtain no practical value from the negotiable instrument had his right to the property been denied. No payment could be obtained through it and, more importantly, no right could be enforced upon it. The instrument in this state would be a worthless piece of paper.

Competing Interests in Instances of Payment

The interests involved in the payment of an instrument vitiated by a form of forgery also vary according to the status of the competing parties. The categorisation of parties adopted in the course of discussing the dishonour instance is applicable.[34] The category of prior parties encompasses, as is the case in the dishonour, the drawer and the payee, whilst the category of subsequent parties encompasses the bona fide acquirer and the drawee, payor. The latter, however, may engage in the instrument prior to the occurrence of the act of forgery. This could be illustrated by the assumption whereby the party on whom the instrument is drawn places his acceptance before the forger intercepts the instrument.[35] Nevertheless, the interest of the drawee-acceptor does not materialise until the instrument is paid or when he is denied the right of refusing payment. This obviously occurs subsequent to the forgery only, i.e. when the instrument in question comes into the hands of a bona fide acquirer to whom payment is made or in whose favour the right of payment is established.

(i) The interest of the first category of parties is also dependent on the remoteness of the involved party. The drawer, John Alex, in the first hypothetical, illustrates the immediate party to the forgery. The blank cheque in that hypothetical was stolen from the purported drawer. The purported drawer is interested to have the cheque invalidated as a negotiable instrument and ultimately have his credit with the drawee-payor restored to its original estate. In other words, the purported drawer is interested not to have himself charged for the payment.

Like the drawer in the first hypothetical, the payee i.e. David Dove, in the third also illustrates the immediate party to the forgery. Nevertheless, the payee's relevant interest is that related to the property right to the instrument. He is interested to establish his holder status to the stolen instrument. Once this is satisfied, the payment is deemed to be improperly paid if it was made in favour of a party other than the payee or the party to whose favour the payment is directed. Ultimately, the drawee would not be discharged as between himself and his customer i.e the drawer. The payee may then demand proper payment to his favour in his capacity as the holder of the instrument.

(ii) The interest of the remote party, e.g. the drawer John Alex in the second and third hypotheticals, is identical to that mentioned in the course of discussing the competing interests in the event of dishonour. The drawer is interested to have himself protected against double liability. This is achieved by establishing the holder status to either the original payee, i.e. David Dove, or the bona fide acquirer, i.e. Billy Barnes, as far as the third hypothetical is concerned. If the holder status was established in favour of the payee, the protection against double liability would be maintained by challenging the payment made to the bona fide acquirer. If the holder status was established in favour of the bona fide acquirer, the protection against double liability would be maintained by denying to the payee his right of recourse against the drawer.

By comparison, the protection against double liability, as far as the second hypothetical is concerned, could be maintained by denying the holder status to the bona fide acquirer. Ultimately, the payment to the latter would be deemed improper; accordingly, the drawee payor may not charge the drawer with the improper payment.

(iii) As to the second category of parties, the interest of the bona fide acquirer is illustrated in establishing in his favour a good title to the paid proceeds. His interest in the paid proceeds arises firstly, from his reasonable expectation that the acquired instrument shall establish in his favour the holder status and secondly, from his reliance on the finality of payment. If the drawee was allowed to recover the erroneously paid proceeds from the bona fide acquirer recipient, the latter would be placed in a state of uncertainty as to his financial situation. The said uncertainty would either prevent him from carrying on his business or it would impair his status as to subsequent engagements.

(iv) The interest of the drawee payor is manifested in his right of protection against double payment. This is achieved either by validating his act of payment, or by allowing him the right of recovering the proceeds of the improper payment from the recipient. In both instances, his interest is related to the status of the bona fide recipient i.e. the party to whose favour payment was erroneously made. If the holder status was established in favour of the recipient, the drawee would be protected against double payment by validating his act of payment. His customer or the party from whom the instrument was stolen would be denied the right to challenge the drawee's payment. If, however, the recipient was denied the holder status, the protection against double payment would be achieved by establishing in favour of the drawee/payor the right of recovering the erroneous payment from the recipient.

The Attitude of the Anglo-American and the Continental Geneva Legal Systems in Allocating Risk arising from the Forgery of Signatures

(i) Traditionally, the Anglo-American and the Continental Civil legal systems adhered to a substantially similar risk allocation rule, in instances of forgery of signatures. They were of the opinion that negotiable instruments are transferable by, or on behalf of, the designated payee or indorsee only. Any transfer purporting to be made by a person lacking the necessary authority, was deemed inoperative. The property right to the vitiated instrument remained with the party from whom the instrument was stolen or misappropriated. The bona fide transferee for value could not qualify as the lawful holder. Accordingly, he could not derive enforceable rights on the instrument. Finally, payment to him did not discharge the payor from his obligation to the maker of the instrument. The former could not charge the latter with the payment.

In a 1752 French case,[36] a payee entrusted another to arrange for the drawee's acceptance on a bill of exchange. After the acceptance was secured, the entrusted agent forged the payee's indorsement. He made the bill payable to his accomplice, a stockbroker. The latter indorsed the bill for value to a bona fide third party. The court held, that, the forgery of the payee's indorsement did not transfer the property of the bill of exchange. It remained vested in the latter. In a similar case,[37] the French court extended the inoperativeness attribute of forged signatures, to the drawee payor. It denied him the right of charging the maker of a negotiable instrument with its payment, in instances where the instrument in question was vitiated by forgery of a signature.

In England, the courts approached an identical application. In **Mead v Young,**[38] the court held, that for an indorsement to be effective for the purpose of procuring a valid transfer, it must be made in the hand of the intended payee or indorsee. This case involved a bill of exchange issued in favour of Henry Davies. Due to postal misdelivery, the bill came into the hands of another Henry Davies. The latter fraudulently indorsed the bill for value to a bona fide third party. The bona fide acquirer then sought to enforce the bill against the acceptor. The latter, due to the forgery, refused payment. The majority of the court held that, since the indorsement by which the third party acquired the bill, was not made in the hand of the intended Henry Davies, it was a forgery. Accordingly, the acquirer could not qualify as the holder of the bill of exchange.[39]

In **Smith v Sheppard,**[40] Lord Mansfield, before whom the case was heard, determined the effect of forgery on the drawee/payor. His Lordship observed ...

> "... He that takes a forged bill must abide by the consequences, for the man whose name is forged knows nothing of it."

Smith v Sheppard involved a bill of exchange drawn on a buyer, as consideration for sold goods. The bill was made payable to a third party. The buyer accepted the bill and paid its proceeds to an indorsee. The bill then turned out to have been stolen from its payee. The indorsement in the name of the latter was proved to be a forgery. The payee then sought to demand the proceeds of the stolen instrument from the drawee. The latter refused on the grounds that payment was made in favour of a bona fide acquirer. Lord Mansfield defeated the drawee's argument. He was of the opinion that the indorsement, to be valid, must be made in the hand of the payee. The drawee was under a duty to enquire whether the indorsement was made in the hand of the intended payee.[41] Since the purported indorsement was a forgery, it could not procure a valid transfer. Payment to the transferee did not ultimately discharge the payor.

(ii) The similarity between the Anglo-American and the Continental Civil legal systems, in allocating the risk evolving from the forgery of signatures, was due to the uniform origin of the rules relating to negotiable instruments. In the 14th century, and probably in the second half of the 13th century, the institution of negotiable instruments, as illustrated in its ancient form, i.e. bill of exchange, functioned in the **"Italian community"** only.[42] With the aid of the Roman **"Cambium"**,[43] the Lombards utilised the bill of exchange to facilitate the transmission of money, as well as foreign exchange transactions. When a London merchant bought on credit goods from a Venetian merchant, the former wrote an acknowledgement of the debt, and promised to pay it on its day of maturity. The London merchant then arranged with a bona fide banker travelling to a fair in Europe and authorised him to pay the former's debts. The Venetian merchant likewise arranged with a Venetian banker travelling to the same fair and authorised him to receive due payments. At the fair, bankers met to settle their accounts. When the debts of two bankers could not be extinguished by set off, the banker with the adverse balance drew upon another banker with whom the former possessed a favourable balance, an order directing the latter to pay the banker in credit the balance. When business in Europe expanded, bankers appointed permanent agents at the major fairs and cities. Thus the banker did not have to travel himself. If the London merchant, as far as the above example is concerned, intended to pay the Venetian merchant the face value of the purchased goods, he arranged with a London banker to effect payment in favour of the Venetian merchant. The London banker then advised his correspondent, a Venetian banker, to make payment in favour of the Venetian merchant.[44]

By the same token, when a London merchant intended to travel to a European fair or city for business, he, for the purpose of remitting money, arranged with a London exchanger to provide the former with money in the currency of the locality to which the merchant intended to travel. On receipt of the money intended to be exchanged, the exchanger wrote an acknowledgement of the debt and promised to pay it on its day of maturity. The exchanger then arranged with a merchant travelling to the same fair or city to which the first merchant intended to travel, to pay the latter a sum of money equal to that deposited with the exchanger. On arrival, the London merchant could, by presenting the drafted letter, enforce the face value of the draft in the required currency.[45] When business expanded, exchangers appointed permanent agents in the major fairs and cities. Thus, the exchanger did not have to arrange with a merchant travelling to a particular fair or city to make payment in favour of a third party. The remitting exchanger advised his correspondent, based at the fair or city to which the depositor intended to travel, to pay the latter a sum of money equal to the money deposited with him for the purpose of remittance.

From these orders and letters of advice, the form of the bill of exchange developed. And from the fairs where merchants met to do business, the bill of exchange was introduced to Europe. Due to the uniform practice featured at the fairs, the rules relating to negotiable instruments, when first introduced to Europe, were similar. Due to the involvement of negotiable instruments in international trade, the practice relating to such instruments witnessed a parallel evolution. For an example, when indorsements to order first appeared on the Continent in the beginning of the 17th century,[46] Marius wrote his advices acknowledging the existence of similar practice in England.[47] Malynes in his **"Lex Mercatoria"** in 1622, did not, by comparison, mention the existence of such practice.[48] In the beginning of the 18th century, when, on the Continent, the concept of **"abstract"** was applied,[49] Lord Mansfield, in **Miller v Race,**[50] firmly established its application as to English Law.

As a further illustration of the uniform attribute of the practice relating to negotiable instruments, courts frequently cite juristic interpretations for jurists of other legal systems, so far as the said interpretations have a bearing on the subject matter in question, and so far as they do not violate the established general principles of the forum.

For an example, in **Young v Grote**[51] Best J. cited Pothier's proposition as to the effect of the drawer's negligence in drawing up his instrument, on his right against the defrauded payor. **Young v Grote** involved a bill of exchange signed in blank. The drawer, Young, left the blank signed bill with his wife for the purpose of enabling her to settle the business's account as appropriate. The wife, due to her inexperience, caused the bill to be drawn in a manner that the amount to which it was payable could be raised without exciting suspicion. She delivered the bill to a clerk of Young, instructing him to fill in the bill for the amount of fifty pounds, two shillings and threepence. The clerk returned the bill to Mrs. Young. It was established that, the amount for which the bill was drawn was written in the middle of the space designated for the amount payable in words. The letter f in fifty pounds was written as a small letter. The figure 5 was removed from the £ sign. Mrs. Young instructed the clerk to cash the bill to pay wages due to two of Young's employees. The clerk fraudulently inserted the words three hundred before the word fifty, in the space designated for the amount in words. He next inserted the figure 3 before the figure 5 and after the pound sign. He presented the bill to Grote for payment. The latter, unaware of the fraud, paid the bill in its altered form.

Best J., in finding against the drawer, Young, cited Pothier's proposition as authority. He found that since Young was negligent in drawing up his instrument, he could not recover against the defrauded drawee payor, who was, due to the drawer's negligence, made to pay the bill in its fraudulent status.[52] Pothier's proposition read as follows:

> "Cependant si c'était par la faute du tireur que le banquer eut été induit en erreur, le tireur n'ayant pas eu le soin d'écrire sa lettre de manière à prévenir les falsifications; puta s'il avait écrit en chiffres la somme tirée par la lettre, et qu'on eut a jouté zero, le tireur serait en ce cas tenu d'indemniser le banquier de ce qu'il a souffert de la falsification de la lettre, à laquelle le tireur par sa faute a donné lieu; et c'est à ce cas qu'on doit restreindre la décision de Scacchia.".[53]

(iii) The similarity between the Anglo-American and the Continental civil legal systems did not last long. From the 19th century, the dispute as to the effect of the forgery of signatures started to materialise.[54] The attitude of the legal system in question as to the manner of risk allocation in instances of forged signatures was incorporated in the codifications as well as the courts' findings, relating to negotiable instruments. As has been shown above,[55] the competing interests involved may vary according to the particular setting. Accordingly, the determination of the interest less favourable for the purpose of allocating risk and ultimately, the determination of the party to whom risk is to be allocated, may also vary. The following discussion will outline the attitude of the legal systems under consideration as to allocating risk in instances of the forgery of signatures in two separate settings, namely, that of dishonour and payment.

The Attitude of the Anglo-American and the Continental Geneva Legal Systems in Allocating Risk of Forged Signatures in Instances of Dishonour

In determining the effect of forged signatures, the legal systems under consideration distinguish between two categories of parties, viz. parties **"immediate"** to the forgery and parties **"remote"** from the forgery. The first category of parties encompasses the party whose signature was forged. He could be the purported drawer, the payee, the indorsee or the drawee. The second category of parties, i.e. those remote from the forgery, encompasses parties whose signature was not forged. Nevertheless their involvement in the negotiable instrument transaction either precedes or supercedes a forged signature. Examples of such parties are, the drawer, in instances where the payee's indorsement was forged, the indorsor subsequent to the forgery and the bona fide acquirer.

The Effect of Forgery on the party whose signature was forged

The Anglo-American and the Continental Geneva legal systems are in agreement, that the forgery of a signature does not bind the party whose signature was forged. The acquirer of the instrument vitiated by a forged signature may not enforce his instrument against the party whose signature was forged.

Article 7 G.U.L.(Bills) reads:

> "If a bill of exchange bears signatures of persons incapable of binding themselves by a bill of exchange or forged signature, or signatures of fictitious persons or signatures which for any other reason cannot bind the persons who signed the bill of exchange or on whose behalf it was signed, the obligations of the other persons who signed it are none the less valid."[56]

Section 24 B.E.A. reads:

> "Subject to the provisions of this Act, where a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorised signature is wholly inoperative, and no right to retain the bill or give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under that signature."[57]

Thus, as far as the hypotheticals mentioned earlier are concerned,[58] Billy Barnes, the bona fide third party acquirer, may not enforce the cheque in the first hypothetical against the purported drawer, John Alex. The signature of the latter is forged: it could not establish any liability against him. As to the second and third hypotheticals, Billy Barnes may not enforce the cheque in question against the payee Dove and Co. the mail order business or David Dove. His indorsement is forged; ultimately no liability could be established against him.

As could be noted, the **"non binding"** attribute of a forged signature rendered by Article 7 G.U.L.(Bills) and the **"inoperative"** attribute rendered by Section 24 B.E.A. are not synonymous. The effect of inoperative signatures has a wider impact than the non binding signature. Every inoperative signature is not binding but the reverse is not true. This is discussed in the section immediately below.

The Effect of Forgery on Remote Parties

(i) As to the effect of forged signatures on remote parties, the legal systems under consideration are in disagreement whether the forged signature should be given a **"personal"** or **"general"** impact. That is to say that the Anglo-American and the Continental Geneva legal systems disagree on whether the non binding attribute of forged signatures should be confined to the party whose signature was forged or should it run to remote parties.

If the non binding attribute of a forged signature was to be given a wide application signatures prior to the forgery would forfeit their significance. Parties engaged prior to the forgery would be discharged as against the bona fide third party into whose hands the vitiated instrument may come. The latter would be left with a worthless piece of paper which conveys no enforceable rights.

If, however, the non-binding nature was to be given a limited application, i.e. confined to the party whose signature was forged, the liability incurred by parties prior to the forgery would remain valid in favour of the bona fide third party acquirer. Despite the forgery, the acquirer would be able to enforce his instrument against parties prior to the forgery.

(ii) The signature, the forgery of which may have an impact on remote parties, is the signature which, firstly, is essential for the transferability of a negotiable instrument and secondly, it supercedes a valid signature. The forgery of a signature essential for the transferability of an instrument causes the acquisition of the instrument by a bona fide third party. Accordingly, the problem of competing interests and ultimately the problem of allocating risk would then arise. The forgery of a signature not related to the transferability of the instrument, such as the forgery of the drawee's acceptance, would not, by comparison, involve a competing interests situation as between parties remote from the forgery, unless the forgery of the drawee's acceptance accompanies the forgery of a signature essential for the transferability of the instrument. The competing interest situation evolving from such an instance would be attributed to the forgery of the latter's signature. The liability of the remaining signatories on the instrument remains, despite the forgery of the drawee's acceptance, operative in favour of the bona fide acquirer, provided that no essential signature is forged. The acquirer may, on the basis of the instrument, enforce the liability of the signatory in question.

On the other hand and in order to examine the impact of the forgery of a signature it is essential for the forged signature to supercede a valid signature or signatures. If the forged signature was the first signature as to its order of incorporation, there would be no signature or signatures preceding the forged signature, the examination of the operativeness of which is required. Thus, if the forged signature was that of the purported drawer, such as the case in the first hypothetical,[59] there would not be other signatures the operativeness of which is required to be established. The signature of the drawer is normally presumed to be the first as to the order of signatures appearing on negotiable instruments.

From the foregoing it appears that the signature, the forgery of which could create a competing interest problem is that of the payee or indorsee, as is the case in the second and third hypotheticals.[60] Its involvement raises the operativeness of prior signatures and ultimately the liability of parties prior to the forgery, in favour of the bona fide third party acquirer into whose hands the instrument may come. In other words, the forgery of the payee's or indorsee's signature, i.e indorsement, raises the problem of risk allocation. The determination of the party to whom risk would be allocated would necessarily indicate the interest, the protection of which is less favourable in allocating risk.

The Attitude of the Legal Systems under consideration as to the Effect of Forgery on Remote Parties

(i) The Anglo-American legal systems, in determining the effect of the forgery of signatures (indorsements) on prior parties, adhere to the pre-codification traditional attitude. The decision in **Meade v Young**[61] has been incorporated in the B.E.A. as well as the U.C.C. They both deny the operativeness of the forged signature.

Section 24 B.E.A. reads:

> "Subject to the provisions of this Act where a signature on a bill is forged or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorised signature is wholly inoperative and no right to retain the bill or give a discharge therefor or to enforce payment thereof against any party thereto, can be acquired through or under that signature."

Repetitive

Article 3 - 404 U.C C. reads:

> "1) Any unauthorised signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it; but it operates as the signature of the unauthorised signer in favour of any person who in good faith pays the instrument or takes it for value."

Since forged signatures are not operative, they would not effect a valuable transfer of the negotiable instrument in question. If a bona fide third party acquires an instrument through a forged signature, he would not be deemed to have established his right to the instrument through a valid transfer. The property right to the instrument would not, accordingly, be established in his favour. He would not, due to the forgery, qualify as the holder of the instrument. In the last analysis he would not be able to enforce his instrument against parties prior to the forgery. The instrument which comes into his possession through a forged signature, forfeits its significance as **"a negotiable instrument"**, it operates in his hands as a piece of paper qua piece of paper.

Since forged signatures do not effect a valid transfer, the property of the piece of paper as a negotiable instrument remains with the party from whom it was stolen. He remains the holder of the instrument. The rights incorporated in it run to his favour. The loss of the instrument does not dispossess him of the enforceable rights incorporated in it. He may claim the surrender of the instrument or its proceeds from its bona fide acquirer/recipient. He may, as a general rule,[62] compel the drawee to make payment to him, notwithstanding the fact that the latter had paid a bona fide third party.

(ii) The Continental Civil legal systems, by comparison, shifted from the traditional attitude. By the end of the 18th century,[63] Germany took the initiative in limiting the impact of forged indorsements.[64] With the aid of the **"abstract doctrine"**, the Germans were able to confine the non-binding attribute of forged signatures, to the party whose signature was forged. They, in the first place, divorced the validity of each signature from that of the other. They held that the invalidity of one signature did not affect the validity of other signatures. In the second place, the Germans differentiated between the property of the instrument and the transactions incorporated in it. They held that the property of an instrument could prima facie be established in favour of another, even if he established his property to the instrument through a void transaction. As the prima facie owner of the instrument, he could convey the property of the instrument to a third party. The latter could, if he acts bona fide, establish a perfect title to the instrument. The invalidity of the underlying transaction, according to which his transferor established his property to the instrument, did not affect the property of the acquirer. Even when the bona fide acquirer established his property right to the instrument through or from a forger, he could establish a perfect and unimpeachable title.[65]

The German abstract theory was favoured throughout the Continent. In the 1930-1931 Geneva Conferences on the Unification of the Laws relating to Bills of Exchange, Promissory Notes and Cheques, the Continental Civil legal systems expressed their approval of the German rule.[66] The doctrine of abstract has been incorporated in the Conventions on the Uniform Laws The separation between the various signatures has been incorporated in Article 7 G.U.L.(Bills).[67]

Article 7 reads:

> "If a bill of exchange bears signatures of persons incapable of binding themselves by a bill of exchange or forged signatures, or signatures of fictitious persons or signatures which for any other reason cannot bind the persons who signed the bill of exchange or on whose behalf it was signed, <u>the obligations of the other persons who signed it are none the less valid</u>."

Already cited at page 23.

The underlined phrase clearly illustrates the independent status of the various signatures. It reinstates the validity of signatures appearing on negotiable instruments, despite the existence of a superceding forged signature.

The separation between the signatures on the one hand and the property of the instrument on the other has been, however, incorporated in Article 16 G.U.L.(Bills).[68]

Article 16 reads:

> "The possessor of a bill of exchange is deemed to be the lawful holder if he establishes his title to the bill through an uninterrupted series of indorsements even if the last indorsement is in blank. In this connection, cancelled indorsements are deemed not to be written (non écrits). When an indorsement in blank is followed by another indorsement, the person who signed the last indorsement is deemed to have acquired the bill by the indorsement in blank. Where a person has been dispossessed of a bill of exchange in any manner whatsoever the holder who establishes his right thereto in the manner mentioned in the preceding paragraph is not bound to give up the bill unless he has acquired it in bad faith or unless in acquiring it he has been guilty of gross negligence."[69]

The second paragraph of Article 16 illustrates the independent nature of the property of negotiable instruments.[70] Despite the fact that the instrument was dispossessed from its owner, the latter may not compel the surrender of the instrument or its proceeds from the bona fide third party who acquired the instrument through a regular chain of endorsements and in good faith. The forgery of the payee's indorsement does not disentitle the acquirer to the property right of the instrument.

The Continental Geneva legal systems, unlike the Anglo-American, import a valid transfer into the forged indorsement. The third party who acquires the instrument through a forged indorsement may qualify as the lawful holder of the instrument. Accordingly, he possesses an unimpeachable property right to the instrument, he may enforce the instrument against all liable parties, he may enforce the face value of the instrument against the drawee and he may retain the proceeds of the instrument in instances of payment.

(iii) From the foregoing, it could be concluded that, the manner in which the legal systems under consideration allocate the risk arising from the forgery of signatures varies according to the form of the forgery involved. In instances where the forgery takes the form of the forgery in the making, the Anglo-American and the Continental Geneva legal systems are in agreement. Since the forgery of the making does not bind the purported maker/drawer, the evolving risk would be allocated to the acquirer from the forger, e.g. Billy Barnes, as in the first hypothetical. If, however, the forgery takes the form of the forgery in the negotiation, such as the cases in the second and third hypotheticals, the Anglo-American legal systems determine that the evolving risk would be allocated to the acquirer, i.e. Billy Barnes. The Continental Geneva legal systems, by comparison, determine that the evolving risk would be allocated to the original true owner i.e. the drawer, John Alex, in the second hypothetical and the payee David Dove in the third hypothetical.

In the light of the above attitude, it is submitted that the Anglo-American legal systems adhere to a narrow application of the **"negotiability doctrine"**, whilst the Continental Geneva legal systems adhere to a wide application. The negotiability doctrine is the most significant concept in the context of negotiable instruments. Its characteristics differentiate negotiable instruments from other choses in action. The application of the negotiability doctrine comes to the rule that the bona fide acquirer of a negotiable instrument possesses a perfect and unimpeachable title. His title to the instrument may not be defeated by raising defences and claims of which he was not aware. Parties to a negotiable instrument may not disclaim their liability by subjecting the bona fide acquirer to personal defences which they possess against parties from or through whom the acquirer establishes his title to the instrument.[71]

The Anglo-American legal systems approach the narrow application of the negotiability doctrine by narrowing the concept of **"holder"**.

The concept of holder in the context of negotiable instruments, is equivalent to the concept of owner in the law of property. The satisfaction of the holder status avails the bona fide acquirer of the advantages of the negotiability doctrine. The status of a holder in the Anglo-American legal system applies to every party who establishes his acquisition of the instrument through a genuine chain of indorsements. For an indorsement to be genuine it must be made by or on behalf of the intended payee or indorsee i.e. the party to whose favour the instrument was initially issued and indorsed and to whose favour it was delivered for the purpose of transferring the property of it.[72] The thief of a negotiable instrument and the trustee or agent such as Willy Williams, in the second and third hypotheticals above, are not the intended payee or indorsee. They cannot by way of indorsement transfer the property of the instrument. The bona fide third party who takes the instrument from the said thief, trustee or agent does not qualify as the holder.

The Continental Geneva legal systems approach the wide application of the negotiability doctrine by broadening the concept of "holder". The holder status in the said legal systems applies to every possessor who establishes his title to the instrument through a regular chain of indorsements.[73] The forgery of an indorsement, contrary to the Anglo-American legal system does not interrupt the chain of signatures. Thus the possessor may qualify as the lawful holder of the instrument, even if a forgery vitiates the said instrument.

The Impact of Forged Signatures Under the UNCITRAL Convention Relating to International Bills of Exchange and International Promissory Notes on the Rights and Liabilities of Parties to Vitiated Negotiable Instruments in Instances of Dishonour[74]

Like the Anglo-American and the Continental Geneva legal systems,[75] the UNCITRAL Convention on International Bills of Exchange and International Promissory Notes, in determining the effect of forged signatures on the rights and liabilities of parties to a negotiable instrument which such signatures vitiate, distinguishes between parties who are immediate to the forgery i.e. the persons whose signatures were forged and those who are remote from the forgery. As far as the issue is related to determining the effect of the forged signature on the liability of the party immediate to the forgery and its effect on the rights of the party claiming an interest in the negotiable instrument, the Convention incorporates the well established rule in the Anglo-American as well as the Continental Geneva legal systems. As a general rule, it provides that a person is not liable on a bill of exchange or a promissory note unless he signs it.[76] The forgery of his signature does not render him liable on such a document. Article 33 of the Convention reads in this context:

> "1) Subject to the provisions of articles 34 and 36, a person is not liable on an instrument unless he signs it."

Like the Anglo-American and the Continental Geneva legal systems, the Convention does not render a forged signature binding on the person whose signature it purports to be. It divests such a signature of any legal significance, as between the person whose signature it purports to be and the party who intends to establish in his favour the entitlements incorporated in the negotiable instrument which it vitiates. On the one hand, it holds the former unaccountable for the promise or undertaking attributed to him by the forged signature. On the other hand, it denies to the party who intends to establish in his favour the entitlements incorporated in the vitiated instrument, the right of enforcing the promise or undertaking arising from the forged signature against the person whose signature was forged. Ultimately, it denies him the right of enforcing the face value of the vitiated instrument against the latter.

In the light of the foregoing, it could be noted that the convention does not render the indorsement by Willy Williams in the name of Dove and Co., the mail order business, i.e. the payee, binding upon the latter.[77] It does not establish liability on the bill of exchange or the promissory note against the payee. Furthermore, it denies to Billy Barnes, i.e. the party who intends to establish in his favour the entitlements incorporated in the bill or note, the right of enforcing the undertaking arising from the forged indorsement against the payee i.e. Dove and Co. the mail order business. Ultimately, it denies to Billy Barnes the right of claiming the face value of the bill or note from the latter.

As to the determination of the effect of forged signatures on the rights and liabilities of remote parties, the Convention incorporates a unique rule. On the one hand, it states that the holder status and ultimately the protected holder status may be satisfied even if the bill or note in question was vitiated by a forged indorsement, provided that the person claiming the satisfaction of such status establishes his title to the bill or note through a regular chain of indorsements.

Article 15 in this context reads:

1) A person is a holder if he is:

a) The payee in possession of the instrument; or

b) In possession of an instrument which has been endorsed to him, or on which the last endorsement is in blank, and on which there appears an uninterrupted series of endorsements, even if any endorsement was forged or was signed by an agent without authority.

should it?

From the foregoing, it could ~~be~~ concluded that the taker from the forger, in instances where the latter purports to behave as an indorsee and purports to transfer the bill of exchange or promissory note in his capacity as such in favour of the former, would satisfy the holder status. In his status as such, he may claim in his favour all the rights conferred upon the holder of a bill or note. In particular, he may enforce all promises and undertakings incorporated in the bill or note against any or all signatories. The signatory against whom the bill or note is intended to be enforced may not challenge the holder's right of action by reason that the said party took the bill or note in question from the forger.

On the other hand, the Convention states that the person whose signature was forged and any prior party who would suffer a loss as a result of the forgery may claim from the forger, or from the party immediately following him, a compensation equal to the loss suffered by such a person or party. Article 25 reads in part:

1) If an endorsement is forged, the person whose endorsement is forged, or a party who signed the instrument before the forgery, has the right to recover compensation for any damage that he may have suffered because of the forgery against:
a) The forger;
b) The person to whom the instrument was directly transferred by the forger;
c) A party or the drawee who paid the instrument to the forger directly or through one or more endorsees for collection. ......
4) Except as against the forger, the damages recoverable under paragraph 1) of this article may not exceed the amount referred to in article 70 or 71.

The foregoing article seems to suggest that the satisfaction of the holder status and even the satisfaction of the protected holder status does not necessarily confer upon the person satisfying such a status the entitlements inherent in the acquisition of a negotiable instrument. In instances where such a person establishes his title to the bill of exchange or promissory note in question directly from the forger, he would be liable to the person whose signature was forged i.e. the person from whom the bill or note was stolen or misappropriated and to any prior party for the loss suffered as a result of the forgery by such a person or party. He would have to compensate the said person or party for the resulting loss. His liability in this context is strict. It may not be discharged by establishing his bona fides, his unawareness of the invalidity of his transferor's title or that his behaviour in acquiring the bill or note conformed with that of the reasonable man.

Apparently, the liability established against the taker from the forger in favour of the original true owner or any prior party is off the instrument,[78] in instances where he behaves bona fide and without being aware of the invalidity of his transferor's title. In his status as the holder, he may enforce the promise or undertaking incorporated in the bill or note. Accordingly, he may satisfy the face value of the bill or note from the person making such a promise or undertaking.[79] The latter party may not refuse the payment of the bill or note in favour of its holder by reason that he established his title to it directly from the forger. By virtue of Articles 28 and 30 of the Convention, the party against whom the bill or note is intended to be enforced may not set up against the holder defences of which he had no knowledge, nor can he set up against the holder defences in instances where the latter did not obtain the bill or note in question by fraud or theft and he did not participate in a fraud or theft concerning it.[80]

Furthermore, the Convention applies the foregoing rule in instances where the party against whom the bill or note is intended to be enforced intends to defeat the holder's right of action by setting up counter claims against him. By virtue of the above mentioned Articles, the party in question may not set up counter claims against the holder unless the latter had knowledge of their existence when he obtained the bill, or note or participated in a fraud or theft concerning it.[81] Thus if the party against whom the bill or note was intended to be enforced sets up against the bona fide holder his right to obtain compensation for the loss that he would suffer had he been forced to pay the face value of the document in question, his action as such would fail. It would be successful if it was brought in a separate action only.

In the light of the foregoing, it could be noted that the Convention allocates the loss resulting from Willy Williams' fraudulent practice, as far as the second and third hypotheticals are concerned,[82] to Billy Barnes i.e. the immediate taker from the forger. It does not approach such a rule directly through the negotiable instrument's right of action, rather it approaches the said rule on the basis of a separate action. This is due to the fact that it establishes the holder status in favour of the taker from the forger such as Billy Barnes. Accordingly, it entitles him to enforce the face value of the bill or note against prior signatories such as John Alex. The latter party may not, by reason that Billy Barnes obtained the bill or note in question from Willy Williams, discharge his liability on the instrument to him i.e. Barnes. Furthermore he may not defeat the latter's right of action unless he can establish that the said party knew of the invalidity of Willy Williams' title or that he obtained the document in question by fraud or theft or that he participated in such a practice.

However, Billy Barnes' satisfaction of the holder status does not establish in his favour the entitlements inherent in the negotiable instrument. Despite his ability to enforce the face value of his bill or note against John Alex, he remains liable to him as well as to the original true owner, such as David Dove in the third hypothetical, for the loss resulting from the payment of the bill or note to him. Either John Alex or David Dove can recover from Billy Barnes in a separate action the loss suffered by them.

The above solution was adopted as a compromise between the solution found in the Anglo-American legal systems and that found in the Continental Geneva legal systems.[83] It was contended that the determination of the effect of forged signatures on the rights and liabilities of remote parties in the said manner would accommodate the advantages inherent in the risk allocation rule as enforced in the Anglo-American as well as the Continental Geneva legal systems.[84] By establishing the holder status in favour of every person who derives his title to the bill or note through an uninterrupted chain of indorsements, even if any of the relevant indorsements was forged, the proposed solution, like that found in the Continental Geneva legal systems, purports to encourage the acquisition of bills and notes and ultimately it purports to further the function of the institution of negotiable instruments as a finance device. This is due to the fact that the establishment of the holder status in favour of every person who derives his title to the bill or note in question through an uninterrupted chain of indorsements, prima facie confers upon such a person the entitlements inherent in the negotiable instrument. In particular, it enables him to enforce the face value of his document against any or all signatories without being subject to defences and claims of which he had no knowledge.

On the other hand, by establishing that the immediate taker from the forger is liable to the person whose signature was forged and any prior party for the loss resulting from the forgery, the Convention purports to incorporate the rule enforced in the Anglo-American legal systems. In effect, it purports to suggest that forged signatures are of no practical value in favour of the immediate transferee. They do not establish in favour of the said party a conclusive and final property right to the proceeds of the acquired instrument. He would have to account to the person whose signature was forged and any prior party for the obtained proceeds in order to repair the damage caused to the latter by the forgery of the signature.[85]

To state the obvious, the solution adopted in the convention does not achieve, in an efficient manner, the result arising from the risk allocation rule enforced in the Anglo-American legal systems or that arising from the risk allocation rule enforced in the Continental Geneva legal systems. By establishing liability for the loss resulting from the forgery of a signature against the immediate taker from the forger, the Convention is submitted to have failed to afford a potential competing party a reasonable protection. In most instances the immediate taker from the forger is not in a better situation than that of his successors to detect the forgery and ultimately provide against its occurrence.

The four corners of the offered bill or note and the circumstances surrounding its acquisition do not normally reveal to the immediate taker from the forger the existence of any irregularity in the document in question or the existence of any irregularity in the title of its possessor. If he was made to shop for information concerning the issues in question, he would incur expenses in a detrimental manner. That is to say that he would be made to incur cost without being in the position to derive an enforceable value from it or even absorb it. His satisfaction of the holder status moreover, would not afford him a practical value. Due to his liability for the loss resulting from the forgery in favour of the person whose signature was forged and any prior party, he would not be able to retain the face value of his document. He would have to repay it to the said party as compensation for the resulting loss.

From the foregoing, it could be concluded that the establishment of liability against the taker from the forger could deter the commercial community from engaging with strangers. Accordingly, it could deter the said community from acquiring negotiable instruments from such persons. In the last analysis, the solution proposed in the Convention could restrict the function of the institution of negotiable instruments as a finance device.[86]

Finally, by establishing the holder status in favour of the immediate taker from the forger, the Convention is submitted to have failed to allocate the ultimate loss in an efficient manner. It allocates the loss arising from the forgery of an indorsement to the immediate taker from the forger in a circuitous way. In the first place, it entitles the said party to enforce the face value of his document against a prior signatory. It prevents the latter from defeating the holder's right of action by setting up personal defences and claims. In the second place, it entitles the signatory against whom the bill or note is enforced to claim in a separate action the loss sustained by him as a result of the forgery and the subsequent payment of the face value of the document in question in favour of the immediate taker from the forger.

As could be noted, the establishment of the holder status in favour of the immediate taker from the forger on the one hand and the establishment in favour of the signatory against whom a negotiable instrument is enforced of the right to claim in a separate action from the former on the other hand, involves multiple law suits in allocating the loss arising from the forgery of indorsements to the taker from the forger. Firstly, it gives rise to the right of action on the bill or note in favour of the immediate taker from the forger against the signatory. Secondly, it gives rise to a separate right of action in favour of the signatory in question against the immediate taker from the forger. The involvement of law suits is both costly and time consuming. The increase in their rate is inconvenient in commerce. The cost and time arising from their involvement could prevent the enforcement of value in an economically efficient manner.[87] Such an inconvenience becomes more apparent when the need for law suits could be avoided or minimised. In such an instance, the cost and time that would be involved in an unnecessary law suit would be utilised to satisfy other urgent interests.

A situation where law suits could be avoided or minimised is that demonstrated by the allocation of the loss resulting from the forgery of indorsements to the immediate taker from the forger. By entitling the signatory against whom the bill or note is enforced to defeat the immediate taker from the forger's right of action on the document in question, the need for a separate right of action would have been avoided. Accordingly, unnecessary cost and time would be saved whereas the resulting loss would be allocated to the party to whom the Convention indicates as the risk bearer, namely the immediate taker from the forger.

The Impact of Forged Signatures Under the UNCITRAL Draft Convention Relating to International Cheques on the Rights and Liabilities of Parties to Vitiated Negotiable Instruments in Instances of Dishonour[88]

The draft Convention on International Cheques incorporates a rule substantially similar to that enforced in the Convention. Like the latter, in determining the effect of forged signatures on the rights and liabilities of parties to a cheque which such a signature vitiates, it distinguishes between parties immediate to the forgery and parties remote from it. As far as the issue is related to determining the effect of forged signatures on the liability of the person whose signature was forged, the draft Convention incorporates the well-established rule. It expressly provides that any person is not liable on a cheque unless he signs it.[89] By necessary implication the foregoing rule suggests that a forged signature does not bind the person in whose name it is fraudulently made. It does not attribute to him any promise or undertaking. Ultimately, it does not establish in favour of the person to whom the cheque in question is transferred by the forged indorsement, the right of enforcing its face value against the person whose signature was forged.

As far as the above hypotheticals are concerned, it could be noted that the Draft Convention does not establish liability against Dove and Co. or David Dove, the payees in the second and third hypotheticals respectively,[90] for the undertaking fraudulently attributed to them by the forged indorsements. Such indorsements do not bind the payees and ultimately, the taker from the forger such as Billy Barnes or any subsequent transferee may not rely on them to exercise his right of recourse against the purported signatories i.e. Dove and Co. and David Dove.

As far as the issue is related to determining the effect of forged signatures on the rights and liabilities of remote parties, the Draft Convention approaches a result substantially similar to that found in the Convention. It allocates the loss arising from the forged signature i.e. indorsement, to the immediate taker from the forger. Unlike the Convention, it enables the signatory against whom the cheque is intended to be enforced to defeat the holder's right of action, by setting up all defences and claims even if the latter had no knowledge of their existence or had acted free from negligence in his acquisition.[91] Thus, if the immediate taker from the forger intended to enforce his cheque against a prior party i.e. signatory, the latter may raise in the same action as a counter claim his entitlement to recover from him compensation equal to the loss that he would sustain as a result of the forgery had he been made to pay the face value of the cheque in question.[92] Such a rule avoids the situation of multiplicity of actions in allocating the risk arising from the forgery of an indorsement to the immediate taker from the forger. Despite his satisfaction of the holder status, it renders him subject on the cheque to the prior party's claim for compensation. Accordingly, it dispenses with the need for a separate action whereby the right for compensation could be claimed.

As far as the above hypotheticals are concerned,[93] the Draft Convention allocates the loss resulting from Willy Williams' fraudulent practice to Billy Barnes. It renders him liable to John Alex and David Dove respectively for the loss suffered by them as a result of the forged indorsement. It entitles either of them to set up against Billy Barnes i.e. the immediate taker from the forger as a counter claim, the right to recover from him the loss that would result to them from the forgery and their payment of the cheque in his favour. Ultimately, it entitles the said parties to defeat Billy Barnes' right of action on the cheque against them.

The Attitude of the Anglo-American and the Continental Geneva legal systems in Allocating the Risk of Forgery in Instances of Payment

The payment of a negotiable instrument involves the interest of the drawee. Its involvement gives rise to a competing interest situation. On the one hand, it competes with the interest of the party whose signature was forged, as well as the interest of parties prior to the forgery. On the other hand, it competes with the interest of the party to whose favour the proceeds of the forged instrument were paid. In order to determine the attitude of the legal systems under consideration, in relation to the manner of allocating the risk of forged signatures, it is essential to compare the interest of the drawee/payor with the interest of the party whose signature was forged as well as the interest of prior parties, on the one hand, and to compare it with the interest of the bona fide recipient on the other.

The Right of the Drawee Payor to Charge to his Customer Payments made upon a Forged Instrument

The Anglo-American and the majority of the Continental Geneva legal systems are in agreement that the drawee who pays a fraudulently made instrument is not entitled to charge the purported maker or drawer with the payment. If the drawee erroneously debits the purported maker's or drawer's account with the face value of the forged instrument, he must recredit the said account with the debited amount. The relevant provision from which the above rule could be inferred is Section 24 B.E.A.,[94] as far as the Anglo-American legal systems are concerned. The said section denies the operativeness of forged signatures. It expressly provides that payment upon a forged signature does not avail the payor a valid discharge.

Section 24 reads in part:

> "Subject to the provisions of this Act, where a signature on a bill is forged or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorised 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 ..."

Thus, the drawee who erroneously pays a forged instrument may not charge the purported maker or drawer with the erroneous payment. Such act would be tantamount to a discharge of his obligation as between himself and the purported maker or drawer.

At the Geneva Conference on the Unification of the Laws relating to Cheques, the delegates of the represented states agreed to leave issues relating to risk allocation outside the concerns of the Convention.[95] They were not able to propose a common and uniform rule in this context.

Nevertheless, the minutes of the Conference illustrate, as far as the drawee payor's right to charge the erroneous payemt to the purported maker or drawer in instances of forged instruments is concerned, that the majority of the Continental Geneva legal systems were in agreement that the drawee payor may not charge to the purported maker or drawer, erroneous payments.[96] In determining the above rule, reference was made to the general principles of the civil law. There it was accepted that debtors may not be discharged from their obligation as to their creditors unless the former comply with the latter's mandate. Since no mandate could be attributed to the creditor, the debtor may not debit the latter's account.[97]

Some of the Continental Geneva legal systems such as France and Belgium allow the drawee payor, in instances of paying a forged instrument to charge to the purported maker or drawer, the proceeds of the erroneous payment. This is achieved not as a matter of principle but by way of special arrangements between the drawee and his customer, i.e. the purported maker or drawer whose signature was forged. The drawee, at the time of opening an account, stipulates against the customer that, in the absence of the former's negligence in detecting forgery, the customer shall bear the risk evolving from the forgery of his signature. If the forgery passes undetected, the drawee may charge to the customer the erroneous payment.[98] Nevertheless, as a matter of principle and in the absence of a like stipulation, it is submitted that the drawee may not charge against his customer payment made in reliance on forged instruments.[99]

Finally the rule that drawee payors may not charge to the purported maker or drawer erroneous payments made in reliance on forged instruments, could be inferred from an elaborate reading of Article 7 G.U.L.(Bills).[100] The saod article denies any binding attribute of forged signatures. Since the forgery of the purported maker's or drawer's signature does not bind the purported maker or drawer, the unauthorised use of his name should not prejudice him. No liability should, in light of the forgery, be established against the purported maker or drawer. As a direct application of the non binding attribute of the maker's or drawer's forged signature, the drawee should not be allowed to charge the maker or drawer with the payment. Any application to the contrary would indicate that the purported maker or drawer is held liable for the unauthorised use of his name.

<u>The Right of the Drawee Payor to Recover Payments made upon a Forged Instrument from the Acquirer/Recipient</u>

As to the drawee payor's right of recovery against the bona fide acquirer/recipient, the Anglo-American and the Continental Geneva legal systems are in agreement that the drawee payor is not entitled to recover from the bona fide acquirer/recipient erroneous payments made in favour of the latter. The legal systems under consideration, however, impose to variant degrees limits upon the said rule.

(i) As a general rule, in the Anglo-American legal systems, the mistaken payor may recover from the recipient money paid under the mistaken impression that the latter was entitled to it, where in fact and in conscience he is not entitled to retain it. The leading case applying the said rule is **Kelly v Solari.**[101] It involved the erroneous payment of a life insurance policy. Mr. Solari before his death purchased a life insurance policy from Argus Life Assurance Co. His wife Mrs. Solari was appointed as executrix. She, after her husband's death sought to enforce the policy. Due to the failure to pay the due premium, the actuary informed a director of the insurance company that according to the terms of the insurance contract, the policy was deemed to have lapsed. The director wrote the word lapsed in pencil on the policy. Mrs. Solari later demanded amongst other due payments the face value of the insurance policy. The directors at the relevant time failed to notice the pencilled word on the policy. They, accordingly, paid Mrs. Solari the due payment. Parke B. gave a ruling in favour of Kelly, one of the directors who brought the case on behalf of the insurance company. Since Mrs. Solari was aware of the lapse of the policy and she did not suffer a detriment because of the erroneous payment, it was not against conscience to compel her to return the erroneously paid proceeds to the company.[102]

As an exception to the general rule, it is submitted that payors are not allowed to recover erroneous payments from bona fide recipients. Price v Neale[103] is submitted to be the celebrated case in which the said exception was firmly established. Price v Neale involved two bills of exchange, purported to be drawn by Sutton on John Price for £40 each. The two bills bore several indorsements, the last of which was an indorsement to Neale. The payment of the first bill was offered by Price, the drawee, to Neale, the indorsee, without prior acceptance. The drawee sent his servant to the indorsee and procured payment upon receipt of the bill. The second bill was paid by Price after he had accepted it. Price shortly after had learned that the two bills were forgeries. A forger named Lee had forged the drawer's signature on the two bills. The drawee brought an action on the case, claiming that Neale was indebted to him for a sum of money had and received for the plaintiff's, Price's, use. Lord Mansfield, before whom the case was heard, stated the rule that,

> "It is an action for money had and received for the plaintiff's use, in which action the plaintiff cannot recover the money unless it be against conscience in the defendant to retain it; and great liberality is always allowed in this sort of action. But it can never be thought unconscientious in the defendant to retain this money when he has once received it, upon a bill of exchange indorsed to him for fair and valuable consideration, which he had bona fide paid without the least privity or suspicion of any forgery."[104]

The rule in **Price v Neale** was subject to judicial scrutiny. Courts attempted to infer a general proposition from the above rule. They attempted to determine the ratio upon which Price v Neale was based, whereby the mistaken payor would be denied the right of recovery against the bona fide recipient.

Cocks v Masterman[105] is the next relevant case. It involved a bill of exchange drawn by T. Dutton on a firm operating under the name of Sewell and Cross. The bill of exchange purported to be accepted by the said firm, payable at the plaintiff's Cocks, bankers in London with whom Sewell and Cross opened an account. The said bill of exchange bore several indorsements, the last of which was to the order of Sanderson and Co. who had an account with Masterman, another banker. The former deposited the bill with the latter for collection. The latter presented the bill to Cocks who paid accordingly. On the next day, Cocks learned that the bill was a forgery and the drawer had forged their customer's acceptance. Upon this fact, they demanded the return of the paid proceeds from the defendant bankers.

Bayley J. observed that it would be against conscience to claim the erroneously paid proceeds from the bona fide recipient if the latter, due to the payor's right of recovery against him, would suffer an alteration in position to his detriment. The recipient is deemed to suffer an alteration in position to his detriment once the drawee fails to inform him on the day when the instrument falls due that it shall be paid or dishonoured. In such an instance the drawee would be preventing the recipient from claiming the enforcement of the instrument on its day of maturity.

Bayley J. in this connection observed that,

> "the holder of a bill is entitled to know on the day when it becomes due whether it is an honoured or dishonoured bill and that if he receives the money and is suffered to retain it during the whole of that day, the parties who paid it cannot recover it back."[106]

London and River Plate Bank v Bank of Liverpool[107] involved a bill of exchange purchase in Monte Video from the plaintiff's branch making it payable to a company in Havana. This bill of exchange came into the hands of a thief who forged two indorsements, that of the payee and that of the purchaser. The latter indorsement was made in favour of the thief who offered it for a discount. The discounting company accepted to discount the bill subject to its acceptance. The bill was dispatched to the correspondent of the said company requesting the former to obtain acceptance. Having done that, the company discounted the bill. Later, the London correspondent credited the bill into their account with the Bank of Liverpool. The latter through its agent presented the bill for payment to London and River Plate Bank who paid accordingly. When the forgery was discovered, the plaintiff sought to recover the proceeds from the defendants, i.e. the Bank of Liverpool.

Mathew J. in delivering the decision of the court applied the principle laid down by Bayley J. in **Cocks v Masterman.** He observed that the failure to give notice of dishonour on the day when the instrument fell due was the ratio for denying the right of recovering erroneous payments made in favour of the holder. The Judge held that:

> "the simple rule laid down in clear language for the first time that when a bill becomes due and it is presented for payment, the holder ought to know at once whether the bill is going to be paid or not. If the mistake is discovered at once, it may be that the money can be recovered back. But if it be not and the money is paid in good faith and is received in good faith and there is an interval of time in which the position of the holder may be altered the principle seems to apply that money once paid cannot be recovered back."[108]

By way of dictum it is said that Mathew J. in considering the ratio of **Price v Neale** held that:

> "It seems to me the principle underlying the decision is this! that if the plaintiff in that case so conducted himself as to lead the holder of the bill to believe that he considered the signature genuine, he could not afterwards withdraw from that position."[109]

The above dictum gave rise to an uncertainty among legal writers and judges alike[110] as to the payor's right of recovery against the recipient. It prima facie suggests that the payor would be denied recovery against the recipient, even if the latter establishes his title to the instrument in question through forged signatures.

The Privy Council in **The Imperial Bank of Canada v the Bank of Hamilton**[111] refuted the broad interpretation of Mathew J.'s dictum. The Imperial Bank of Canada case involved a cheque. Although validly drawn, the amount for which it was payable was fraudulently raised by another. The cheque bore the plaintiff's certification.

The fraudulent person deposited the cheque with the defendant for collection. The depository bank i.e. the Bank of Hamilton, allowed the fraudulent person to withdraw the proceeds of the cheque in its altered form before final payment. The Privy Council held that the plaintiff drawee/acceptor was not bound by the altered cheque. The defendant was not allowed to rely on the plaintiff's certification and enforce the cheque. Since the cheque did not bear a valid indorsement, in favour of the defendant bank, it was a forgery in toto. It, accordingly, could confer no entitlements in favour of the bank acquirer.[112]

The court in **National Westminster Bank Ltd. v Barclays Bank International Ltd. and Another**[113] settled the uncertainty. It held that in instances where the paid instrument was a forgery from beginning to end the drawee payor may recover the erroneously paid proceeds from the recipient. The case under consideration involved the forgery of a customer's signature on a cheque. Robert Bill, a retired Navy Commander had a current account with the National Westminster Bank in London. The bank issued to him successive cheque books and a spare cheque book. Commander Bill used to leave his spare cheque book in Nigeria, where he spent most of his time after retirement. One day, Commander Bill received from his bank, a statement showing that a substantial amount had been debited from his account. He had no recollection of the said debt. Upon inquiry, it was established that a cheque was missing from his spare cheque book. His signature was forged and the cheque was made payable to Mr. M. Ismail. The cheque was presented for special collection through Barclays Bank International. National Westminster then paid the cheque proceeds. National Westminster acknowledged that Commander Bill's account had been erroneously debited. It agreed to recredit his account with the debited amount. National Westminster sought to recover the erroneous payment from the first defendant Barclays Bank International and the second defendant, Mr. M. Ismail.

Mr. M. Ismail was a member of the Lebanese community living in Nigeria. He owned a large fleet of tankers and lorries. Shortly after the war with a neighbouring country, Nigeria, due to the financial crisis, introduced strict currency control regulations. It required that foreign companies operating in Nigeria must be 40% owned by Nigerian nationals. Mr. Ismail and the rest of the Lebanese community thought that the new regulations were discriminatory. They took every opportunity to transfer money out of Nigeria. Mr. Ismail had an account with the first defendant. He, from time to time, remitted sterling to his account in London. He exchanged on the black market Nigerian pounds for pounds sterling. Due to the boom in the currency black market, the rate of cheque forgery increased. Mr. Ismail was once himself a victim of forgery. Nevertheless, his bank recredited his account.

One day, Ismail needed spare parts for his fleet which were of English manufacture. Mr. Haider, the general manager of Ismail's business assured Mr. Ismail that his brother R. Haider could secure for him pounds sterling. Later, R. Haider presented a cheque, the amount of which was written in figures only. It bore the signature of Commander Bill as drawer, nevertheless it did not stipulate the name of the payee. R. Haider falsely told Mr. Ismail that he took the cheque from its purported drawer whom he met at the club. Mr. Ismail accepted to exchange the cheque with Nigerian pounds if the cheque was paid. Ismail deposited the cheque with the first defendant for collection. The latter collected the proceeds of the cheque and deposited it with its customers account. Mr. Ismail then paid R. Haider the equivalent in Nigerian currency. The cheque afterwards proved to be a forgery.

Kerr L.J. distinguished the case of **London and River Plate Bank v the Bank of Liverpool.**[114] The decision of Mathew J., in the opinion of his Lordship was concerned with determining the ratio of **Price v Neale,** as to the position of the drawee acceptor. His finding that the drawee guarantees the genuineness of the drawer's signature was a mere application of Section 54 B.E.A. Section 54 reads:

"The acceptor of a bill by accepting it

1) Engages that he will pay it according to the tenour of his acceptance.

2) Is precluded from denying to a holder in due course:
(a) The existence of the drawer, the genuineness of his signature and his capacity and authority to draw the bill ..."[115]

His Lordship observed that the reason according to which the above quoted ratio was extended to the drawee payor as to the first bill of exchange which involved the payment of the drawee, only, is that it could not be taken in isolation from the second bill of exchange which involved the drawee's acceptance and payment.[116] His Lordship distinguished the rule of **Price v Neale** because of its particular facts and reinforced the rule that drawees in general do not by the mere payment of the instrument represent to the payees recipients the genuineness of the instrument or the genuineness of the purported drawer's signature.[117]

Nevertheless, Kerr L.J. observed that if the party upon whom the instrument was drawn erroneously pays a forged instrument in favour of a bona fide acquirer who establishes his title to the instrument through a genuine signature, he may not recover the erroneously paid proceeds from the latter. His Lordship, in making his findings, cited with approval the rule laid down by Bailey J. in **Cocks v Masterman**. The basis for denying the drawee payor's right of recovery against the bona fide acquirer recipient is to prevent the change in position to the acquirer recipients detriment. The drawee payors right of recovery would be detrimental to the acquirer recipient because it might disable the latter from the exercise of the right of recourse against his transferor from whom he acquired the instrument on the day when the instrument falls due.

Finally, Kerr L.J. made the rule that for the acquirer recipient to retain the erroneously paid proceeds, he must establish his title to the instrument through a genuine signature i.e. indorsement. If the only signature or all incorporated signatures through which the acquirer establishes his title to the instrument were forgeries, the piece of paper to which the acquirer establishes his title would not be interpreted as a negotiable instrument. No interests could then be claimed under it.[118] Since no genuine signature through which the acquirer recipient establishes his title could be established, there would not be a party against whom the acquirer recipient can enforce his instrument. Thus, in instances where the drawee payor was allowed to recover erroneous payments, the acquirer recipient would not suffer a change in position to his detriment.[119] There would not be a right of recourse that could be forfeited.

Goff J., in **Barclays Bank v Simms Son and Cooke, (Southern) Ltd. and Sowman,**,[120] reinforced the ratio laid down in **Cocks v Masterman.**[121] He considered the change of position in a detrimental manner as a relevant basis for disentitling the mistaken drawee payor of the right of recovery of erroneous payments from the bona fide acquirer recipient.[122] In the absence of such change, it would not be against conscience to compel the acquirer recipient to revert the proceeds of the erroneous payment to the mistaken drawee payor.

The head notes of the case provide:

> "Where a person paid money to another under a mistake of fact which caused him to make the payment, he was prima facie entitled to recover it as money paid under a mistake of fact. His claim might however fail if
> 3) the payee had changed his position in good faith or was deemed in law to have done so."[123]

(ii) As far as the U.C.C. is concerned, the provision of Article 3-418 denies to the drawee/payor acceptor the right of recovering erroneous payments made in favour of a bona fide acquirer and the right of refusing payment to him in instances of acceptance.

Article 3-418 U.C.C. reads:

> "Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for the liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favour of a holder in due course or a person who has in good faith changed his position in reliance on the payment."

Unlike the rule in the English legal system, the U.C.C. does not require that the acquirer recipient should establish his title to the instrument through a genuine signature, in order for him to retain the erroneously paid proceeds. The acquirer recipient may satisfy the holder in due course status, even if he was the first transferee on the instrument. By virtue of Article 3-302, the payee of a negotiable instrument may qualify as the holder in due course.[124] Thus, if the only signature appearing on the instrument through which the acquirer establishes his title was a forgery, he may qualify as the holder in due course as between himself and the drawee payor.

Accordingly, the latter may not compel the former to revert the proceeds of the erroneously paid instrument to him.

(iii) At the Geneva Conference on the Unification of the Laws relating to Cheques, although it was agreed to exclude questions as to risk allocation from the concerns of the conventions, it is submitted that in the major Continental Civil legal systems, the bona fide third party who establishes his title to the instrument through a **"regular"** chain of indorsements and who receives payment from the drawee, shall not be compelled to revert the erroneously paid proceeds to the drawee payor.[125] The above rule goes back to the days when the drawing of a bill of exchange was accompanied by a letter from the drawer to the drawee advising the latter of the drawing. If the drawee accepted or paid without having received this confirmatory letter, there would be some grounds for treating him like a drawee who accepted without having sufficient funds of the drawer.[126]

Like the English legal system, the Continental Geneva legal systems establish a good title in favour of the bona fide acquirer recipient as to erroneous payments, if and only if he establishes his title to the instrument through a chain of indorsements. Apparently, if the acquirer recipient was the first transferee and the only signature appearing on the instrument through which he establishes his title was a forgery, such as in the case of **National Westminster v Barclays Bank International and Another,**[127] the acquirer recipient would not be entitled to retain the erroneous payment. He would not be deemed to have his title to the instrument established through a chain of indorsements. The drawee would then be entitled to recover the said payment from the recipient.

Nevertheless, unlike the English legal system, the Continental Geneva legal systems do not require the indorsement, through which the acquirer/recipient establishes his title, to be genuine. The regularity of the chain of indorsements is submitted to be the essence of the acquirer's establishment of the lawful holder status.[128] The regularity of the chain of indorsements requirement is deemed to be satisfied when the signatures incorporated in the negotiable instrument purport to be made in the name of the intended payee or indorsees. Thus, if the fraudulent person who forges the purported drawer's signature makes the instrument payable in favour of another and impersonates the said party and indorses the instrument in the latter's name in favour of a bona fide third party, the third party acquirer would be purported to have established his title to the instrument through a regular chain of indorsements. If the drawee pays the acquirer in his status as such, he would be denied the right of recovering the erroneous payment from him.

<u>The Effect of Payment upon a Forged Indorsement</u>

(i) As to the payment of an instrument vitiated by a forged indorsement, the legal systems under consideration determine the effect of such forgery by reference to the status they establish to the acquirer to whose favour the payment is made. Since the Anglo-American legal systems deny the holder status to the acquirer who establishes his title to the instrument through a forged indorsement,[129] they deny to the drawee payor the right of charging to the drawer the proceeds of the erroneous payment. Such payment to the said acquirer would not discharge the payor from his obligation. The drawer may compel the drawee to re-credit his account as if payment had not occurred. The payee or indorsee, the party from whom the instrument was stolen and whose indorsement was forged, may force the drawee to make fresh payment in his favour.

The traditional precodification rule as laid down in **Smith v Shepperd**[130] has been incorporated in the B.E.A. as well as the U.C.C. Section 59 B.E.A. sets out the requirements necessary to discharge the drawee in instances of payment. In order for the drawee payor to be discharged, he must pay **"the holder"** of the instrument.

Section 59 reads:

"A bill is discharged by payment in due course by or on behalf of the drawee or acceptor. 'Payment in due course' means payment made at or after the maturity of the bill to the holder thereof in good faith and without notice that his title to the bill is defective."

It is submitted that the term holder appearing in the above quoted section is interpreted narrowly. It denotes the party who acquires the instrument through a genuine chain of indorsements.[131] If a forgery vitiates the instrument, the acquirer would not qualify as the holder. Accordingly, payment to him would not discharge the payor.

The U.C.C. approaches the above application in an identical manner. The drawee would not be discharged unless payment is made to the holder. The term holder is defined narrowly. It applies to the party who establishes his title to the instrument through a genuine chain of signatures.[132] If the chain of signatures was interrupted by a forgery, the acquirer would not qualify as the holder. Payment to him would not discharge the payor. By virtue of Article 3-419 U.C.C., the drawee payor is deemed to have converted the proceeds of the instrument.[133] The original true owner may accordingly compel him to make fresh payment to the former in his favour.

(ii) The B.E.A. and the 1957 Cheques Act make an exception to the above stated rule. By virtue of Section 60 of the B.E.A. and Section 1 of the 1957 Cheques Act, the drawee banker, in instances of cheques and other analogous demand instruments,[134] need not observe the genuineness of indorsements in order to establish a valid discharge in his favour. The payment in good faith to the purported holder and in reliance on a regular chain of indorsements suffices to discharge the drawee banker from his obligation. He may debit his customer's i.e. drawer's account, with the payment. The original true owner, i.e. the party from whom the instrument was stolen and whose signature was forged, may not demand fresh payment from the drawee payor.

Section 60 B.E.A. reads:

> "When a bill payable to order on demand is drawn on a banker and the banker on whom it is drawn pays the bill in good faith and in the ordinary course of business, it is not incumbent on the banker to show that the indorsement of the payee or any subsequent indorsement was made by or under the authority of the person whose indorsement it purports to be and the banker is deemed to have paid the bill in due course, although such indorsement has been forged or made without authority."[135]

The purpose underlying the above rule is to enhance the business of banking. Due to the large volume of instruments processed daily, banks are not able to enquire as to the genuineness of indorsements appearing on such instruments. Such enquiry would, firstly, disturb the business of banking and secondly, it would prevent the instrument deposited for payment from being transmitted into money immediately. Its economic function as a substitute for money would accordingly fail.[136]

(iii) The drawee in the Continental Geneva legal systems is not under a duty to observe the genuineness of indorsements, in making payments. His duty of enquiry is confined as to the regularity of the chain of indorsements only. Thus if the drawee pays an instrument vitiated by a forged indorsement, the drawee would be discharged from his liability so far as he acts bona fide and without gross negligence.

Article 40 G.U.L.(Bills) reads in part,

> ".... He who pays at maturity is validly discharged unless he has been guilty of fraud or gross negligence. He is bound to verify the regularity of the series of indorsements but not the signature of the indorsers."[137]

Since payment upon a forged indorsement may discharge the drawee payor, the drawer may not compel the drawee payor to recredit his account. The party from whom the instrument was stolen and whose indorsement was forged, may not compel the drawee payor to make fresh payment to him. The above application is a pre G.U.L. rule. Its import in the Continental Civil legal systems was due to business necessity and the maintenance of consistency in the law.[138]

Because drawees do not keep on file counterfoils of the payees' and indorsee's signatures, they would not be able to detect the forgery of their signatures. The imposition of a duty to make enquiry to that effect would disturb the business of the drawee, especially bankers, and it would disturb the function of negotiable instruments.

On the other hand, bona fide third parties who acquired instruments vitiated by forged indorsements could, as business practice required, demand payment from the drawee and in instances of payment they could retain the erroneously paid proceeds.[139] It was felt that the drawee should, as between himself and the drawer and the original true owner be afforded a similar protection. He is in no better position than the acquirer to detect forged indorsements, thus his act of payment should be upheld.

The extension of the protection to the bona fide drawee payor conforms with the application of the "abstract doctrine" which characterises the Continental Geneva legal systems.[140] The limitation imposed upon the drawee as to the enquiry of the regularity of the chain of indorsements only, the duty of enquiry is consistent with the tendency of construing the instrument with reference to its four corners only. The only information from which the genuineness of the instrument could be gathered by consulting its four corners is the regularity of the instrument and the regularity of the signatures incorporated in it. Once the regularity of the instrument is satisfied, the inquirer is presumed to have discharged his duty of enquiry. Any enquiry beyond the four corners would be inconsistent with the application of the abstract doctrine.

The Right of Recovery of Payments made upon Forged Indorsements

(i) As to the drawee's right of recovery from the bona fide acquirer recipient, the applications adhered to by the legal systems under consideration are dissimilar. The English legal system as a general rule allows drawee payors to recover erroneous payments from the bona fide acquirer recipient.[141] By reference to the authorities cited earlier,[142] the English legal system makes an exception in instances where the acquirer recipient may, due to the drawee payor's right of recovery, suffer a detriment whereby his position may be altered as between himself and prior parties. As it has been established by the decision in **National Westminster Bank Ltd. v Barclays Bank International and Another**[143] and as reinforced by Goff J. in **Barclays Bank v Simms Son and Cooke (Southern) Ltd. and Sowman,**[144] for the above exception to apply, the acquirer recipient should establish his title to the instrument through a genuine indorsement.

The right of the drawee payor of recovery would not arise in instances where the drawee payor is a banker. By virtue of Section 60 B.E.A., the drawee payor banker would be availed a valid discharge, even if he pays upon a forged indorsement.[145] Since neither his customer nor the original true owner may contest the payment, the drawee payor banker need not recover the proceeds of the erroneous payment from the acquirer recipient.

Next to be considered, is the acquirer recipient's entitlement to retain the proceeds as against the original true owner. The English legal system determines the entitlement to the proceeds of the erroneous payment, by reference to the status it establishes to the acquirer of an instrument vitiated by a forged indorsement. By virtue of Section 24 B.E.A., the acquirer of an instrument vitiated by a forged signature, does not satisfy the holder status. He does not possess to his advantage enforceable interests. He may not retain proceeds erroneously paid to him.[146] The proceeds which he receives as payment are deemed not to be his property. They are deemed to be the property of the holder. Since the holder status is confined to the original true owner, the property right to the proceeds is deemed to be established in favour of the latter. Should payment be erroneously made in favour of the acquirer, the said party holds the paid proceeds in trust in favour of the original true owner.[147] Ultimately, he would have to account for the said proceeds in favour of the latter. He would have to restore the said proceeds in favour of the original true owner in instances where the latter party so demands. If he fails to comply with such a duty he would be liable to the original true owner for money had and received.

(ii) The U.C.C. by comparison, allows the drawee payor to recover in all instances from the bona fide acquirer recipient, erroneous payments made upon forged indorsements. The U.C.C. approaches the above application by imposing upon the acquirer recipient a **"warranty of good title"** to the instrument.

Article 3-417 U.C.C. reads in part,

> "Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that
> a) he has a good title to the instrument or is authorised to obtain payment or acceptance on behalf of one who has a good title."[148]

The term **"good title"** in the above quoted subsection, denotes the acquisition of the instrument through a genuine chain of indorsements. If the chain of indorsements was interrupted by a forgery, the title which the acquirer intends to establish in his favour would not be good. If he receives payment from the drawee payor, he would be deemed to have breached the warranty of good title imposed upon him.

(iii) Finally, the drawee payor's right of recovery against the acquirer recipient would not arise in the Continental Geneva legal systems. Like Section 60 B.E.A., Article 40 G.U.L.(Bills) affords the drawee payor a valid discharge against the drawer, as well as the original true owner,[149] provided that he acts in good faith and without gross negligence. Nevertheless, unlike the English legal system, the original true owner, the party from whom the instrument was stolen and whose signature was forged, may not claim the proceeds from the bona fide acquirer recipient, provided the latter establishes his title to the vitiated instrument through a regular chain of indorsements. By virtue of Article 16 G.U.L.(Bills), the said acquirer may satisfy the lawful holder status.[150] The forgery of an indorsement does not disqualify him from holder status. As the lawful holder, he may retain the proceeds of the erroneous payment.

<u>Summary</u>

(i) From the foregoing, the risk evolving from the payment of an instrument vitiated by a forged signature could be summarised as follows. The Anglo-American and the Continental Geneva legal systems are in agreement that the party upon whom the instrument was drawn may not, in instances of paying a forged instrument, charge the purported maker/drawers account with the erroneous payment. The risk of forgery is initially allocated to the drawee payor.

As to the drawee's right of recovery against the bona fide acquirer recipient, the legal systems under consideration are also in agreement in denying to the drawee payor the right of recovery against the acquirer recipient, so far as the latter establishes his title to the paid instrument through a genuine indorsement. Where the acquirer recipient establishes his title to an instrument forged in toto, the legal systems under consideration disagree as to the drawee payors right of recovery. The English legal system allows the drawee payor the right of recovery. The Continental Geneva legal systems apparently disentitle the drawee payor the right of recovering erroneous payments from the acquirer recipient so far as the latter establishes his title to the vitiated instrument through a regular chain of indorsements, whilst the U.C.C. disentitles the drawee payor to recover, in all instances the erroneous payment from the acquirer recipient.

As a matter of practice, the fraudulent person, in order to facilitate his fraud, would not impersonate the purported drawer or the purported payee. To induce a bona fide third party to take the instrument in question, he purports to behave as the intended payee or indorsee. Thus where he intends to steal somebody's cheque, he issues the cheque in his favour as the intended payee.

An example of such an instance could be gathered from the first hypothetical mentioned above.[151] There, Willy Williams made the cheque payable to his order. In his capacity as the payee, he negotiated the cheque to Billy Barnes, a bona fide third party.

Thus, in the light of the presumed practice, it could be concluded that since the bona fide acquirer recipient normally establishes his title to the vitiated instrument through a genuine indorsement, the risk of forgery in the making as far as the Anglo-American and the Geneva legal systems are concerned, would be allocated to the mistaken drawee payor.

(ii) In instances where payment is made upon a forged indorsement, the legal systems under consideration disagree as to the manner of allocating the evolving risk. In the English legal system, so far as the drawee payor is not a banker, he may not charge the drawer with the erroneous payment. The original true owner, the party from whom the instrument was stolen, and whose signature was forged, may demand fresh payment from the drawee payor. The risk is initially allocated to the latter. Since bona fide acquirer recipients establish their title to the vitiated instrument through a genuine indorsement, the drawee payor would be disentitled to recover erroneous payments from them. The risk evolving from forged indorsements would, in practice, be allocated to the drawee payor.

If the drawee payor was a banker, payment by him upon a forged indorsement could avail him a valid discharge. The original true owner may not demand fresh payment from him. The risk evolving from the payment of an instrument vitiated by a forged indorsement, would be initially allocated to the original true owner. Nevertheless, the original true owner may recover the erroneously paid proceeds from the acquirer recipient. The latter does not possess a property interest to the proceeds of the erroneous payment. The risk, accordingly, is shifted to the bona fide acquirer recipient.

The U.C.C. disentitles the drawee payor in general to charge to the drawer erroneous payments made upon a forged indorsement. The original true owner may demand the drawee payor to make fresh payment in his favour. The risk evolving from the payment upon a forged indorsement is initially allocated to the drawee payor. Nevertheless, the latter may shift the evolving risk to the bona fide acquirer recipient. The acquirer of an instrument vitiated by a forged indorsement does not possess a good title to the erroneously paid proceeds. The drawee payor may recover the erroneous payment from the recipient. The risk evolving from the payment upon a forged indorsement would finally be allocated to the acquirer.

The Continental Geneva legal systems allow the drawee payor to charge erroneous payments to the drawer when payment is made upon a forged indorsement. The original true owner may not contest the validity of the payment, nor may he demand afresh payment. The risk evolving from the payment upon a forged indorsement is initially allocated to the original true owner. However, the latter is not entitled to recover the proceeds of the erroneous payment from the bona fide acquirer recipient. The said acquirer qualifies as the lawful holder of the instrument. He may establish a good title to the erroneously paid proceeds. The risk evolving from the payment upon a forged indorsement finally rests with the original true owner.

The Allocation of the Risk Arising from the Payment of an Instrument Vitiated by a Forged Signature Under the UNCITRAL Convention Relating to International Bills of Exchange and International Promissory Notes[152]

In regulating the rule of allocating the risk arising from the payment of an instrument vitiated by a forged signature, the Convention on International Bills of Exchange and Promissory Notes distinguishes between situations where the paid instrument was vitiated as to its making and those situations where the paid instrument was properly issued but it contained a forged indorsement. As to the former situation, the Convention does not regulate the problem of risk allocation in an express term. However, it could be inferred from the reading of several articles that it allocates the risk of paying a vitiated bill or note to the drawee payor. This is approached firstly, by denying to the said party the right of charging his customer i.e. the person whose signature was forged with the paid amount and secondly, by denying to him the right of recovering his erroneous payment from the bona fide recipient.

The rule that the drawee payor may not charge his customer with the erroneous payment of a forged bill or note could be inferred from two sources. On the one hand, the establishment in favour of the drawee payor of the right to charge his customer with the erroneous payment of a forged bill or note would necessarily attribute liability on the document in question to the latter i.e. the person whose signature was forged. As could be noted, such an application is incompatible with the well established rule in the Convention. By virtue of Article 33, no person may be made liable on a bill of exchange or a promissory note unless he signs it.[153] That is to say that the forgery of somebody's signature does not bind the person whose signature it purports to be. It does not attribute to him any enforceable promise or undertaking. It does not attribute to him the making of a payment order and it does not authorise the person to whom it is purported to be directed to act upon it.

On the other hand, the Convention enumerates the instances in which the drawee payor could validly be discharged on the bill or note in those instances where the payment is made in favour of the holder of the "instrument". In such instances only, the maker of the bill or note and the original true owner may not force the drawee payor to recredit the erroneously debited amount or make a fresh payment in favour of the original true owner. Article 72, in this context, reads:

> "1) A party is discharged of liability on the instrument when he pays the holder, or a party subsequent to himself who has paid the instrument and is in possession of it, the amount due pursuant to Article 70 or 71. ......
> 3) A party is not discharged of liability if he pays a holder who is not a protected holder, or a party who has taken up and paid the instrument, and knows at the time of payment that the holder or that party acquired the instrument by theft or forged the signature of the payee or an endorsee, or participated in the theft or the forgery."

In this context, the term instrument is defined rigidly. By virtue of Article 5 c), it denotes the bill of exchange or promissory note.[154] By virtue of Article 3, for a document to qualify as a bill or note it must be signed by its drawer or maker.[155] Thus the document which does not bear the genuine signature of its drawer or maker does not qualify as a bill of exchange or promissory note. Accordingly, it does not satisfy the concept of instrument as utilised in the Convention. Since Article 72 enumerates the instances in which the drawee payor could validly be discharged on the bill or note in those instances where the payment is made in favour of the holder of an instrument only, it could, by way of negative implication, be concluded that the payment of a forged bill or note does not, under the Convention, discharge the drawee payor. This is due to the fact that a paid document in such an instance does not satisfy the definition of an instrument the payment of which could discharge the drawee payor.

The rule that the drawee payor may not recover the proceeds of the erroneous payment from the bona fide recipient could be inferred from the sections on liability. In this context, the Convention confines the extent of the liability of the taker from the forger, for the loss resulting from the forgery of a signature and his subsequent receipt of the proceeds of the vitiated instrument, to liability towards the person whose signature was forged and any prior party.[156] Article 25 does not extend such liability in favour of the drawee payor. Accordingly, the latter may not claim from the bona fide recipient compensation equal to the loss suffered by him as a result of his erroneous payment.

The rule that the bona fide recipient is not liable to the drawee payor for the loss suffered by the latter as a result of his erroneous payment is reinforced by the fact that the warranties attributable to the holder of a bill or note, the breach of which could render him liable for the loss resulting from the forgery of the signature of the drawer or maker, run in favour of the subsequent holder only i.e. the person to whom the property right to the bill or note in question is intended to be transferred. Article 45 reads in this context:

"1) Unless otherwise agreed, a person who transfers an instrument by endorsement and delivery or by mere delivery, represents to the holder to whom he transfers the instrument that:

a) The instrument does not bear any forged or unauthorised signature;

b) The instrument has not been materially altered;

c) At the time of transfer, he has no knowledge of any fact which would impair the right of the transferee to payment of the instrument against the acceptor of a bill or, in the case of an unaccepted bill, the drawer, or against the maker of a note. ......"

The Working Group on International Negotiable Instruments expressed the view that the holder of a bill or note does not, by presenting his instrument for payment, intend to transfer its property right to the drawee for the purpose of establishing the holder status in favour of the latter. Accordingly, the drawee does not benefit from the warranties attributable to the recipient. In the last analysis, the recipient would not be liable to the drawee payor for the breach of the warranty that the document in question does not bear any forged signature,[157] in instances where the disputed paid proceeds were those of an instrument vitiated by such a signature.

As far as the first hypothetical is concerned,[158] it could be noted that the Convention allocates the risk arising from the payment of the fraudulently made bill or note to the drawee payor. Due to the fact that the bill or note is not made by John Alex, it denies to the drawee payor the right of charging the erroneous payment to him. It entitles John Alex to demand a recredit of his account with the drawee as if payment had not been made. And due to the fact that the erroneous payment is not made in favour of the fraudulent person or the thief or to a person participating in a fraudulent practice or the theft of the erroneously paid instrument, the drawee payor may not recover the proceeds of the erroneous payment from Billy Barnes. The latter is not accountable to the drawee payor for the obtained proceeds and ultimately he may establish a perfect title to them.

As to the situation where the risk arises from the payment of a genuine bill or note but which nevertheless contains a forged indorsement, the Convention allocates the resulting loss to the immediate taker from the forger. This is approached firstly, by establishing a valid discharge on the bill or note in question in favour of the drawee payor who acts without knowledge of the forgery, and, secondly, by establishing in favour of the person whose signature was forged and any prior party who would suffer a loss as a result of the forgery and the subsequent payment of the document vitiated by it, the right to recover the resulting loss from the immediate taker from the forger.

The rule that the drawee who pays a vitiated bill or note in favour of its holder without knowledge of the forgery vitiating it would be afforded a valid discharge on the document in question, is incorporated in Article 25 as well as Article 72. The former Article expressly exonerates the drawee who behaves in the above manner from liability to the person whose signature was forged and to any prior party for the loss resulting from the forgery and his subsequent payment. By necessary implication, it disentitles the original true owner i.e. the person whose signature was forged as well as any prior party, such as the drawee's customer, to claim from the latter compensation equal to the loss resulting from the forgery and his subsequent payment. Accordingly, the customer may not demand the drawee to recredit his account with him as if payment had not been made, nor may the original true owner demand from him a fresh payment in his favour. Article 25(3) reads in this context:

> "(3) Furthermore, a party or the drawee who pays an instrument is not liable under paragraph 1) of this article if, at the time he pays the instrument, he is without knowledge of the forgery, unless his lack of knowledge is due to his failure to act in good faith or to exercise reasonable care."

Article 72 reinforces the rule expressed in the above quoted Article. It expressly provides that the drawee who pays a bill or note in favour of its "**holder**" without knowledge that the title of the said party is void, would obtain a valid discharge on the instrument. That is to say that neither his customer nor the original true owner may challenge the drawee's right of payment. The customer may not demand a recredit of his account from the drawee, whereas the original true owner may not demand from the latter a fresh payment in his favour. Article 72 reads in part:

> "1) A party is discharged of liability on the instrument when he pays the holder, or a party subsequent to himself who has paid the instrument and is in possession of it, the amount due pursuant to Article 70 or 71.
>
> 3) A party is not discharged of liability if he pays a holder who is not a protected holder, or a party who has taken up and paid the instrument, and knows at the time of payment that the holder or that party acquired the instrument by theft or forged the signature of the payee or an endorsee, or participated in the theft or the forgery."

In this context, the concept of holder is defined loosely. By virtue of Article 15, it applies to every person who is in possession of a regular bill or note. A bill of exchange and a promissory note are deemed to be regular when they do not bear an uninterrupted chain of indorsements. The genuineness of the incorporated signatures is not a requirement for the regularity of the instrument. Article 15 reads:

"1) A person is a holder if he is:
a) The payee in possession of the instrument or
b) In possession of an instrument which has been endorsed to him, or on which the last endorsement is in blank, and on which there appears an uninterrupted series of endorsements, even if any endorsement was forged or was signed by an agent without authority.
2) If an endorsement in blank is followed by another endorsement, the person who signed this last endorsement is deemed to be an endorsee by the endorsement in blank.
3) A person is not prevented from being a holder by the fact that the instrument was obtained by him or any previous holder under circumstances, including incapacity or fraud, duress or mistake of any kind, that would give rise to a claim to, or a defence against liability on, the instrument."

Thus, in theory, the forger of a bill or note may qualify as its holder. This could be conceived in instances where he fraudulently indorses the bill or note in question in his favour. In such an instance, the lawful indorsee purports to establish his title to the bill or note through a regular indorsement. In his capacity as the purported indorsee he can, by indorsing the bill in his own name in favour of a third person, establish the holder status in favour of the latter. In such an instance, the ultimate transferee establishes by virtue of the forger's indorsement to him, his title to the bill or note in question through a regular indorsement. Since the forger could and the taker from the forger does, in such an instance, satisfy the holder status, the payment of the face value of the bill or note could discharge the drawee payor of his obligation towards his customer and the original true owner. Neither the former nor the original true owner may challenge the drawee's act of payment by arguing that it is made on a forged signature. The payment of the bill or note in favour of its holder immunises the payor against liability notwithstanding the holder's entitlement to the paid proceeds.

The rule that the person whose signature was forged and any prior party can claim from the immediate taker from the forger, compensation equal to the loss suffered by them as a result of the forgery and the subsequent payment of the bill or note vitiated by it, is incorporated in Article 25. By virtue of the said Article, the immediate taker from the forger despite his satisfaction of the holder status, is liable to the person whose signature was forged and any prior party for the loss resulting from the forgery and the payment of the vitiated bill or note to him.[159] He would have, in the last analysis, to account to the original true owner i.e. the person whose signature was forged and any prior party such as the maker or drawer for the paid proceeds.

As far as the second and third hypotheticals are concerned,[160] it could be noted that the Convention allocates the loss arising from Willy Williams' fraudulent practice and the payment of the bill or note in favour of Billy Barnes to the latter. On the basis that the proceeds of the bill or note are paid to the holder i.e. Billy Barnes, the Convention discharges the drawee payor on the document in question. It disentitles either John Alex or David Dove to challenge the drawee's act of payment. Neither may the former demand the drawee to recredit his account with him; nor may David Dove, as far as the third hypothetical is concerned, demand a fresh payment from him. However, the payment of the face value of the bill or note to Billy Barnes does not establish a conclusive property right to the paid proceeds. He is accountable for them to John Alex and David Dove. Either of them can demand the surrender of the proceeds as compensation for the loss resulting to them from the forgery and the subsequent payment of the bill or note vitiated by it.

The Allocation of the Risk Arising from the Payment of an Instrument Vitiated by a Forged Signature Under the UNCITRAL Draft Convention Relating to International Cheques[161]

The Draft Convention on International Cheques allocates the risk arising from the payment of a cheque vitiated by a forged signature in a manner substantially similar to that enforced in the Convention on International Bills of Exchange and International Promissory Notes. Like the former, it allocates the risk under consideration to the drawee payor in situations where it arises from the erroneous payment of a forged cheque. This is approached firstly, by denying to the drawee payor the right of charging to his customer (i.e. the person whose signature was forged) the payment of the face value of the forged cheque, and secondly, by denying to the said party the right of recovering the proceeds of his erroneous payment from the bona fide recipient.

The rule that the drawee payor may not charge his customer with the payment of the forged cheque could be inferred from Articles 1 and 61. By virtue of the latter Article, for the payor to be discharged he must make the payment in favour of the holder of the cheque.[162] By virtue of Article 1, for a document to qualify as a cheque it must be signed by its maker.[163] Thus, if the document in question did not bear the genuine signature of its purported maker it does not satisfy the definition of a cheque. Accordingly, it does not discharge per se its payor in instances where it was forged. Ultimately, the person whose signature was forged i.e. the drawee payor's customer, may demand the former to recredit his account as if payment had not been made.

The rule that the drawee payor may not recover the proceeds of his erroneous payment from the bona fide recipient could be inferred from the articles on liability. By virtue of Article 25, the taker from the forger's liability for the loss resulting from the forged signature and the subsequent payment of the cheque vitiated by it is established in favour of the person whose signature was forged and any other party.[164] By virtue of Article 6, for a person to be a party to a cheque he must sign it.[165] The drawee of a cheque does not normally engage on it. That is to say that the drawee is not a party to a cheque. Accordingly, he does not establish in his favour the right to recover from the taker from the forger compensation equal to the loss suffered by his payment of a cheque vitiated by a forged indorsement.

In situations where the risk arises from the payment of a cheque vitiated by a forged indorsement the draft Convention allocates it to the immediate taker from the forger. This is approached firstly, by establishing a valid discharge on the cheque in favour of the drawee payor provided that he behaves without knowledge of the forgery,[166] and secondly, by establishing in favour of the original true owner (i.e. the person whose signature was forged) and any prior party the right to recover from the immediate taker from the forger, compensation equal to the loss resulting from the forgery and subsequent payment of the vitiated cheque.

The rule that the drawee who pays a cheque vitiated by a forged indorsement without knowledge of the forgery, and in favour of its holder, establishes a valid discharge on the cheque, is incorporated in Article 61. The said Article reads in part ...

> "1) A party is discharged of liability on the cheque when he pays the holder or a party subsequent to himself who has paid the cheque and is in possession thereof the amount due pursuant to Article 59 or 60.

> 2) A party is not discharged of liability if he pays a holder who is not a protected holder and knows at the time of payment that a third person has asserted a valid claim to the cheque or that the holder acquired the cheque by theft or forged the signature of the payee or an endorsee or participated in such theft or forgery."

Like the Convention on International Bills of Exchange and Promissory Notes the draft Convention under consideration defines the concept of holder in a broad sense. It applies to every person who establishes or purports to establish his title to the cheque through an uninterrupted chain of indorsements. The forgery of an indorsement does not affect the regularity of the cheque.[167] Accordingly, the forger and the person who derives his title to the cheque from him could qualify as the holder. The payment of the face value of the cheque to such a person would accordingly establish a valid discharge in favour of the payor. In the last analysis, neither the drawee payor's customer nor the original true owner may challenge the former's act of payment. The customer may not demand the payor to recredit his account with him whereas the original true owner may not demand from the latter a fresh payment in his favour.

Finally, the rule that the original true owner (i.e. the person whose signature was forged) and any prior party may recover from the immediate taker from the forger the loss resulting from the forgery and the payment of the cheque vitiated by it is incorporated in Article 25. By virtue of the said Article, the immediate taker from the forger is liable to compensate the person whose signature was forged and any prior party for the loss resulting from the forgery.[168] Notwithstanding his satisfaction of the holder status he is, in the last analysis, accountable to them for the receipted value of the vitiated cheque.

As far as the above hypotheticals are concerned,[169] it could be noted that the Draft Convention on International Cheques allocates the loss resulting from the forgery of John Alex's signature to the drawee payor whilst it allocates it to Billy Barnes in instances where it arises from the forgery of Dove and Co. and David Dove's indorsements. In the former instance it denies to the drawee payor the right of charging John Alex with the erroneous payment of the forged cheque and it denies him the right of recovering the proceeds of his erroneous payment from the recipient, namely Billy Barnes. In instances where the loss arises from the forgery of Dove and Co.'s and David Dove's indorsements, the draft Convention affords the drawee payor a valid discharge as long as he behaves in good faith and with reasonable care. It denies to John Alex the right of demanding a recredit of the debited amount from the drawee whilst it denies to David Dove and Dove and Co. respectively the right of demanding a fresh payment from him. On the other hand, the draft Convention entitles John Alex as well as David Dove to the right to claim from Billy Barnes compensation equal to the loss resulting to them. Notwithstanding Billy Barnes' satisfaction of the holder status, he remains liable for the resulting loss in favour of the original true owner and the prior signatory i.e. David Dove and John Alex respectively.

CHAPTER FOUR

BACK NOTES - (1.-169.)

1. For a hypothetical scenario of such instance see pp.206-207 infra.

2. cf. Section 21 B.E.A.

3. cf. Section 54 and 55 B.E.A. and Articles 9, 15, 43 and 47 G.U.L. (Bills).

4. However not all signatures incorporated on negotiable instruments involve the transfer of the instrument in question. The acceptance of the drawee and the aval of the guarantor are not for example related to the transferability of the instrument. Their incorporation attributes to the signatory in question a promise or undertaking to pay the instrument on its day of maturity only. Thus if the drawee's acceptance or the guarantor's aval was forged the property right of the instrument would not be affected. The liability of parties on the instrument remains operative in favour of the acquirer/holder provided that no essential signature, e.g. indorsement through which the acquirer establishes his title, is forged.

5. Section 1 of English 1981 Forgery and Counterfeiting Act, for example defines forgery as the making of a false instrument with the intention that it shall be used to induce somebody to accept it as genuine,

> "and by reason of so accepting it to do or not do some act to his own or any other person's prejudice."

6. cf. Section 2 B.E.A. and Article 3-102(a) U.C.C. The G.U.L.s by comparison do not require actual delivery for the purpose of issuance or negotiation. A purported delivery on behalf of the signatory suffices to constitute a valid transfer. The acquirer of a negotiable instrument may qualify as the lawful holder of the instrument even if he establishes his title from a party to whom the delivery of the instrument did not occur. cf. Article 16 G.U.L. (Bills) and Article 21 G.U.L. (Cheques).

7. cf. Glanville Williams, Forgery and Falsity, Crim. L. Rev., (1974), p.75.
For a contrary opinion cf. Lewis case (1754), Fost. 116 168 ER. 57.
The court held that since "the act is done in the name of another person" it is a forgery. Thus as far as the above illustration is concerned, since Willy Williams signs in the name of another, i.e. Gullible Grocer, his act in light of the Lewis case would be interpreted as a forgery, even if the party in whose name the signature was made, was a non-existent person.

8. cf. Article 1-201 (43) U.C.C.
As far as the Geneva legal systems are concerned the debate on Article 8 of the G.U.L.(Bills) clearly illustrates the intention of the contracting states, to exclude from the scope of the Article, instances in which the properly appointed agent misuses his actual authority.

Article 8 is concerned with instances in which a person purports to behave as the authorised agent, and the agent who acts in excess of his authority. The theory underlying the intention of the contracting states is the promotion of negotiable instruments as credit or payment devices. To facilitate the said purpose, negotiable instruments should be interpreted by reference to their body only. Acquirers and parties upon whom negotiable instruments are drawn should not in the course of acquisition or making payment, refer to extrinsic evidence. Such reference would involve time and cost. They are both incompatible with the purpose of facilitating the acquisition of negotiable instruments as substitutes for money.

9. Phillimore L.J., in Morison v London County & Westminster Bank Ltd. [1914] 3 K.B. P.380 as to the proper application of Section 24, 1861 Forgery Act 24 and 25 Vict.c98 expressed the view that the impression that the said Section extended to cover instances in which the agent misuses his actual authority was an error. The correct interpretation of that instance his lordship thought was, with deference to the White case 1 Den CC 208, a false pretence. The signature of an agent in the name of his principal and a misuse of the former's actual authority although indictable did not constitute a forgery.

10. [1914] 3 KB 356.

11. Ibid.

12. [1927] 1 KB 826.

13. Ibid.

14. Section 1 1913 Forgery Act contained a substantially similar provision to that of the 1981 Forgery and Counterfeiting Act. For the defnition of forgery as provided in the latter enactment see note 5 above.

15. cf. R v Dodge [1972] 1 QB 416
R v Harris [1971] 2 ALL ER 1523.

16. Kreditbank Cassel Gmb H v Schenkers [1927] 1 KB 826.

17. Ibid.

18. cf. Section 54 B.E.A. and Article 28 G.U.L. (Bills).

19. cf. Section 8 (3) B.E.A.

20. cf. Section 20 B.E.A.

21. cf. Sections 8 (4) and 34 B.E.A.

22. In the Continental Geneva legal systems cheques originally drawn to bearer may not be converted into order cheques. The special indorsement appearing on a bearer cheque does not make the cheque payable to the named indorsee. Any possesor may qualify as the holder.
cf. Article 20 G.U.L. (Cheques).
In the Anglo-American legal systems by comparison, instruments drawn originally to bearer e.g. cheques, may be converted into order instruments. A special indorsement is capable of rendering the said effect.
cf. Section 34 B.E.A.

23. The Imperial Bank of Canada v the Bank of Hamilton [1903] A.C. 49 per Lindley L.J. and The National Westminster Bank v Barclays Bank International and Another [1957] Q.B. 654 per Kerr L.J.

24. The Anglo-American and the Continental Geneva legal systems are in agreement that as a matter of general principle, a collecting agent who bona fide passes the proceeds of the collected instrument to its principal, i.e. depositor, is not liable to the original true owner in instances where the depositor, i.e. the party to whom the proceeds of the collected instrument were credited, established his title to the collected instrument through a forged indorsement.

Section 4 of the English 1957 Cheques Act and Article 3-419 U.C.C. illustrate the application of the above rule in the Anglo-American legal systems. The former section affords the depository agent e.g. the collecting bank, a valid discharge against the drawer of the negotiable instrument, and its original true owner, if the collecting bank acts in reliance on the regularity of the instrument. He is under no duty to examine the genuineness of the chain of indorsements.

Article 3-419 by comparison approaches the above application by excluding the enforcement of the tortious cause of action of conversion against the collecting agent.

As to the Continental Geneva legal systems the rule that collecting agents are not liable to the original true owner in instances where the collected instrument was vitiated by a forged indorsement stems from the application of the rules of unjustified enrichment. It is submitted in the Continental Civil legal systems that for an agent to be accountable for the conversion of the property of another, he must be enriched as a result of the conversion. If however the said agent bona fide alters his position to his detriment in reliance on the prima facie validity of the transaction in which he engages on behalf of his principal he would not be liable to the party with whom he transacted. The agent would not be deemed to have been enriched once he alters his position. Accordingly neither the mistaken party nor his principal, i.e. the party whose property was misappropriated, may recover from the bona fide agent.

In this connection Article 818 BGB reads,

"1) The obligation to return extends to emoluments derived and to whatever the recipient acquires, either by virtue of a right obtained by him or as compensation for the destruction damage or deprivation of the object obtained.
2) If the return is impossible on account of the nature of the object obtained or if the recipient for any other reason is not in a position to make the return, he shall make good the value.
3) The obligation to return or make good the value is excluded where the recipient is no longer enriched..."

And Article 1377 Code Civil reads,

"When a person who through error believed himself to be the debtor, discharges a debt, he has the right to recover against the creditor. Nevertheless this right ceases in the case where the creditor cancelled his rights, as a result of the payment, saving the recourse of him who paid as against the true debtor."

However courts in the United States subjected the proviso in Article 3-419 U.C.C. to a rigid interpretation. One court held that the proceeds of the collected forged instrument are deemed to be in the hands of the collecting agent even if the latter finally credits the account of the depositor. The credited proceeds are deemed to be extracted from the collecting bank's own assets. The reason underlying the rigid interpretation of the courts is two fold. First the courts attempted to reconcile Section 3-419 U.C.C. with other sections of Article 3 as well as the code. By virtue of Article 3-417 and 4-207 the collecting bank warrants to the drawee the genuineness of the chain of indorsements. If the collected instrument was vitiated by a forged indorsement, the drawee may recover from the collecting bank the proceeds of the erroneous payment. Whereas by virtue of Article 3-419 1(c) the drawee is liable in conversion to the original true owner for paying upon a forged indorsement. Since the risk evolving from the payment upon a forged indorsement is indirectly allocated to the collecting bank no inconvenience would result once the risk was allocated to the ultimate risk bearer directly. The establishment of the collecting bank's liability in conversion to the original true owner would avoid the multiplicity of action situation had the rule been otherwise.

Secondly the establishment of the collecting bank's liability in favour of the original true owner, is consistent with the general risk allocation rule adopted in the U.C.C. It determines the bank in general and the collecting bank in particular as the best risk bearer in instances of payment upon a forged indorsement. The collecting bank's ability to provide for insurance is deemed to be the test of determining the best risk bearer, cf. Article 3-417 together with its Official Comment.

To erase the inconsistency and inconvenience caused by the proviso of 3-419 U.C.C. the A.L.I. and the N.C.C.U.S.L. expressly provided in the new Article 3 that collecting banks are liable in conversion to the original true owner in instances of paying in, "conversion upon a forged indorsement". The proviso appearing in subsection 3 of the current 3-419 is eliminated in the revised Article 3, cf. Progress Report of the A.L.I.

25. See p.222 infra.

26. Article 3-404 U.C.C. reads in part,
"Any unauthorised signature is wholly inoperative, as that of the person whose name is signed unless he ratifies it or is precluded from denying it, nevertheless it operates as the signature of the unauthorized signer in favour of any person who in good faith pays the instrument or takes it for value."

27. Article 8 G.U.L. (Bills) reads,
"Whosoever puts his signature on a bill of exchange as representing a person for whom he had no power to act is bound himself as a party to the bill, and if he pays, has the same rights as the person for whom he purported to act."

28. cf. Polhill v Walter (1832) 3 Bd Ad 114.
Maxform S p A v Mariani & Goodville Ltd. [1981] 2 Lloyds Rep 54 C A.
British Airways v Parish [1979] 2 Lloyds Rep 361 and cf. Article 108 (4) of 1948 Company Act
and Section 58 (3) of B.E.A., the latter reads,
"...A transferor by delivery who negotiates a bill thereby warrants to his immediate transferee being a holder for value that the bill is what it purports to be, that he has a right to transfer it, and that at the time of transfer he is not aware of any fact which renders it valueless."

29. See pp.206-207.

30. cf. Section 55 B.E.A. and Articles 9 and 15 G.U.L. (Bills).

31. cf. Section 54, 55 B.E.A. and Articles 9, 15, 28, 32 G.U.L. (Bills).

32. For the relationship between the obligation incurred under the negotiable instrument and that incurred under the independent transaction see pp.42-44 supra.

33. For the drawer's vulnerability to double liability see pp.216-218 supra.

34. See p.215 supra.

35. cf. Baxendale v Bennett (1878) 3 QBD 525.

36. Dénisart, 3 Collection des Décisions Nouvelles (1771) vo. lettre de change. In accord, decision of Feb. 1761 cited in Rogue, Jurisprudence Consulaire 349.

37. Kessler, Forged Indorsements, (1938), 47 Yale L.J., p.869.

38. (1790) 4 Term Rep.28. 3 R.R. 314.

39. Lord Kenyon C.J. was of the opinion that the bona fide acquirer i.e. Mead, should have the property of the bill of exchange conferred upon him. If a contrary application was approached an insuperable clog would be placed on the negotiability attribute of negotiable instruments. As authority, he cited the decision of Lord Mansfield in Miller v Race. It involved the theft of a bank note issued to bearer. The note came into the hand of the plaintiff who acquiried it in good faith and for value. The banker's clerk, Race, upon learning of the theft refused to cash the note or return it to its acquirer, Miller, the plaintiff. Lord Mansfield gave judgement to the plaintiff, in his decision he relied on the money theory. Ibid. p.30.

Ashurst J. disagreed with the Chief Justice's opinion. He was of the view that for an indorsement to be valid, it must be made in the hand of the intended payee or indorsee. A forged signature cannot effect a valid transfer of the property of the instrument in favour of a third party. He distinguished the case at bar from the case of Miller v Race. In the latter case the instrument in question was a bearer instrument whilst the instrument in Mead v Young was an order instrument. Ibid p.31.

Buller and Grase J.J. concurred with Ashurst J. They were of the opinion that the plaintiff, Mead, did not establish good title to the bill of exchange because of the forgery of the indorsement. If he was to escape the loss evolving from the forgery the acceptor Young would not be able to chase the forger and have him punished. Therefore the right of the public to have a criminal punished is superior to putting a clog on the negotiability of the instrument. Ibid p.33.

40. (1776) cited Chitty (11 Edtn) p.278.

41. Ibid.

42. Holdsworth, The Origins and Early History of Negotiable Instruments II, (1915), 31 L. Q. Rev. p173.

Beutel, Development of Negotiable Instruments in Early English Law, (1937-38), 51 Harv. L. Rev., p.813.

Jenks, The Early History of Negotiable Instruments, (1893), 9 L. Q. Rev., p.70 et seq.

43. Cambium is a form of contract whereby one specie of one genus was exchanged for another specie of the same genus. The Lombards borrowed the Roman cambium to exchange money of one currency for money of another, cf. Holdsworth, The Origins and Early History of Negotiable Instruments, I, (1915), 31 L. Q. Rev., pp.16 and 24.
Taha, Alqanun Altijari, (Alawraq Altijaria Waliflas), (1985).

44. The example of the London merchant and his involvement with the Venetian merchant is borrowed from Farnsworth, Commercial Paper Cases and Materials (1984) (3rd Edtn.) pp.42 and following. In the early history of negotiable instruments, the issuance of bills of exchange involved four parties namely, the banker who purported to be the drawer, the agent who purported to be the drawee, the merchant who intended to remit the money to his creditor and the ultimate creditor who purported to be the payee.
cf. Holdsworth, The Origins and Early History of Negotiable Instruments II, (1915), 31 L. Q. Rev., p.173.

45. Holdsworth, The Origins and Early History of Negotiable Instruments II. Ibid. p.173.
Abbas, Al Awraq Altijaria Filtashrea Alkuwaiti, p.21.
Baxter, What is the future of a cheque. Multitudo Legum uis unum, (1973), pp.156-157.

46. The first indorsement to order which appeared on the Continent goes back to 1607,
cf. Jenks, Early History of Negotiable Instruments. (1893), 9 L. Q. Rev., p.170.
Holdsworth, Origins and Early History of Negotiable Instruments II. (1915), 31 L. Q. Rev., pp.182, 183. However, Holdsworth observed that there were attempts in Italy to allow the indorsements to order in the second half of the sixteenth century but they failed, then it appeared in the 17th century. Ibid.

47. Marius published his advices in 1652. For a brief outline see Holdsworth, The Origins and Early History of Negotiable Instruments III. (1915), 31 L. Q. Rev., p.385. And Holden, History of Negotiable Instruments in English Law, (1955), pp.42-52.

48. Ibid.

49. Kessler, Forged Indorsements. (1938), 47 Yale L. J., pp.868, 869.

50. (1758) 1 Burr 452.

51. (1827) 4 Bing 253.

52. Ibid. p.766.

53. Ibid.

54. See pp.237-238 infra.

55. See pp.205-223 supra.

56. Article 10 G.U.L. (Cheques) is the conterpart to Article 7 G.U.L. (Bills). Its provision is a carbon copy of the latter. It substitutes the word cheque for bill of exchange. Article 10 reads:

> "If a cheque bears signatures of persons incapable of binding themselves by a cheque or forged signatures or signatures of fictitious persons, or signatures which for any other reason cannot bind the persons who have signed the cheque or on whose behalf it was signed, the obligations of the other persons who have signed it are non the less valid."

57. Article 3-404 U.C.C. is the counterpart of Section 24 B.E.A. It reads in part ..

> "1) Any unauthorised signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it, but it operates as the signature of the unauthorised signer in favour of any person who in good faith pays the instrument or takes it for value."

58. See pp.206-207 supra.

59. See pp.206-207 supra.

60. See pp.206-207 supra.

61. (1790) 4 Term Rep 28.
For the facts of the case and the decision of the court see pp.224-225 supra.

62. As to the right of the original true owner of recovering against the drawee payor see pp.273-274 infra.

63. Kessler, Forged Indorsements. (1938), 47 Yale L.J., p.870.

64. The New German rule was incorporated in the Allgemeine Deutsche Recht, Sections 36, 74 and 76.

65. For a brief outline of the abstract doctrine see Zweigert and Kötz, I, Introduction to Comparative Law, (1977), p.177 and following.
Cohn, Manual of German Law, Vol.I, (1968).

66. Kessler, Forged Indorsements. (1938), 47 Yale L. J., p.871.

67. For the counterpart of Article 7 in G.U.L. (Cheques) and for the provisions of the said article, see n.56 supra.

68. The counterpart of Article 16 G.U.L. (Bills) are Articles 19, 20 and 21 (Cheques).

69. "19. The possessor of an indorsable cheque is deemed to be the lawful holder if he establishes his title to the cheque through an uninterrupted series of indorsements even if the last indorsement is in blank. In this connection cancelled indorsements shall be disregarded. When an indorsement in blank is followed by another indorsement the person who signed this last indorsement is deemed to have acquired the cheque by the indorsement in blank."

"20. An indorsement on a cheque to bearer renders the indorsor liable in accordance with the provisions governing the right of recourse but it does not cover the cheque with a cheque to order."

"21. Where a person has in any manner whatsoever been dispossessed of a cheque (whether it is a cheque to bearer or an indorsable cheque to which the holder establishes his right in the manner mentioned in Article 19) the holder into whose possession the cheque has come is not bound to give up the cheque unless he has acquired it in bad faith or unless in acquiring it he has been guilty of gross negligence."

70. Article 21 G.U.L. (Cheques) is the counterpart of the second paragraph of Article 16 G.U.L. (Bills). For the reading of Article 21 see note immediately above.

71. For the application of the negotiability doctrine and the rights inherent in it see p.36 supra.

72. cf. Section 2, 21 and 31 B.E.A.
and Article 1-201 (29) U.C.C.

73. cf. Article 16 G.U.L. (Bills) and 19 G.U.L. (Cheques).

74. For the purpose of examining the manner of determining the effect of forged signatures on the rights and liabilities of parties to an instrument vitiated by such a signature under the UNCITRAL Convention relating to International Bills of Exchange and International Promissory Notes and for the purpose of examining its application to the general hypotheticals mentioned on p.206-207 above, assume the following:

1) The instruments involved in the said hypotheticals are bills of exchange or promissory notes,

2) the bill of exchange or the promissory note in question is international. That is to say that it indicates on its face that its place of making, the address beside the name of the maker, the address beside the name of the payee, the address beside the name of the drawee and the place of payment are not all the same, and,

3) assume that the said bill or note incorporates in its title as well as its text a phrase which indicates that the document in question is governed by the provisions of the UNCITRAL Convention on International Bills of Exchange and International Promissory Notes.

The above assumptions are suggested for three reasons. Firstly, the scope of the Convention under consideration is limited to bills of exchange and promissory notes only. cf. Article 1. Secondly, for the bill of exchange and promissory note to be subject to the provisions of the Convention they must be international, cf. Article 2. Finally, the Convention is not mandatory. The parties who wish their bill or note to be governed by the Convention must expressly say that in its title as well as its text, cf. Article 1.

75. See pp.231-242 supra.

76. The counterpart of the above mentioned rule in the Anglo-American and the Continental Geneva legal systems is incorporated in Section 24 B.E.A. Article 3-404 U.C.C., Article 7 G.U.L.(Bills) and Article 10 G.U.L.(Cheques). For the reading of the foregoing sections and articles and their implications see pp.231-233 supra.

77. For a more detailed account of the hypothetical under consideration see p.206 supra.

78. The expression "off the instrument" is borrowed from the commentary to the Convention on International Bills of Exchange and International Promissory Notes UN Doc. A/CN.9/213 1981 P33. It denotes the extrinsic transaction which underlies the engagement on the negotiable instrument such as the contract of sale.

79. cf. Article 69. It reads:
"1) The holder may exercise his rights on the instrument against one party or several or all parties, liable on it and is not obliged to observe the order in which the parties have become bound. Any party who takes up and pays the instrument may exercise his rights in the same manner against parties liable to him.
2) Proceedings against a party do not preclude proceedings against any other party, whether or not subsequent to the party originally proceeded against."

80. Article 28 reads in part:
"1) A party may set up against a holder who is not a protected holder.
a) Any defence that may be set up against a protected

holder in accordance with paragraph (1) of Article 30.
b) Any defence based on the underlying transaction between himself and the drawer or between himself and his transferee but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;
c) Any defence arising from the circumstances as a result of which he became a party, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;".

Article 30 reads in part:
"1) a party may not set up against a protected holder any defence except ....
b) Defences based on the underlying transaction between himself and such holder or arising from any fraudulent act on the part of such holder in obtaining the signature on the instrument of that party;".

81. In this respect Article 28 reads in part:
"2) The rights to an instrument of a holder who is not a protected holder are subject to any valid claim to the instrument on the part of any person but only if he took the instrument with knowledge of such claim or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it."

82. For a detailed account of the hypotheticals under consideration see pp.206-207 supra.

83. cf. The report of the Working Group on Internation Negotiable Instruments U.N. Document No. A/CN.9/249 1984 P7.

84. cf. U.N. Document No. A/CN.9/214, 1981 P40.

85. The original version of how Article 25 had a broader impact on the free circulation of bills and notes. It entitled the person whose signature was forged and any prior party to claim compensation for the loss resulting from the forged signature from the taker from the forger. It did not restrict the original true owner's and any prior party's entitlement to recover compensation from the immediate taker from the forger only, rather it established such an entitlement as against any subsequent taker. The original version of how Article 25 read in part:
"1) A person who acquires an instrument through what appears on the face of the instrument to be an uninterrupted series of endorsements shall be a holder even if one of the endorsements was forged or was signed by an agent without authority provided that such person was without knowledge of the forgery or of the absence of authority.

2) Where an endorsement was forged or was signed by an agent without authority, the drawer or the person whose endorsement was forged or was signed by an agent without authority shall have against the forger or such agent and against the person who took the bill from the forger or such agent the right to recover compensation for any damage that he may have suffered because of the operation of paragraph 1) of this article."

From the foregoing, it could be noted that no matter how many hands the vitiated bill or note passes through, the original true owner i.e. the person whose signature was forged and any prior party may recover from the ultimate holder the loss resulting from the forgery. The latter, notwithstanding his holder status is liable to compensate the person whose signature was forged and any prior party for the loss resulting from the forgery and the enforcement of the bill or note vitiated by it in his favour.

86. For a more detailed account of this argument see pp.617-624 infra.

87. For a more detailed account of this argument see pp.333-334, 337-338 and 608-609.

88. For the purpose of determining the effect of forged signatures on the rights and liabilities of parties to a cheque vitiated by such a signature under the UNCITRAL Draft Convention onInternational Cheques and for the purpose of examining its application to the hypotheticals on pp.206-207 mentioned above, assume the following -
1) the cheque in the hypotheticals under consideration is international and
2) that it contains in its title as well as its text a phrase which indicates that it is subject to the provisions of the UNCITRAL Draft Convention on International Cheques.
This is due to the fact that the Draft Convention under consideration is applicable to international cheques, the parties to which expressly provide that their cheque is subject to the provisions of the Draft Convention.
cf. Article 1.

89. cf. Article 31.

90. See pp. 206-207 supra for a more detailed account of the hypotheticals under consideration.

91. cf. Article 27. It reads in part:
"1) A party may set up against a holder who is not a protected holder:
a) Any defence available under this Convention.
b) Any defence based on an underlying transaction between himself and the drawer or a previous holder or arising from the circumstances as a result of which he became a party.

c) Any defence to contractual liability based on a transaction between himself and the holder.
d) Any defence based onthe incapacity of such party to incur liability on the cheque or on the fact that such party signed without knowledge that his signature made him a party to the cheque provided that such absence was not due to his negligence.

2) The rights to a cheque of a holder who is not a protected holder are subject to any valid claim to the cheque on the part of any person."

92. The rule that the immediate taker from the forger is liable to a prior party to compensate him for the loss that would result to him from the forgery and the enforcement of the cheque against him is incorporated in Article 25 1). It reads -
"If an indorsement is forged, any party has as against the forger and against the person to whom the cheque was directly transferred by the forger, the right to recover compensation for any damage that he may have suffered because of the forgery."

93. For a more detailed account of the hypotheticals under consideration see pp.206-207 supra.

94. For the reading of Section 24 B.E.A. and its counterpart in the U.C.C. see p.131 supra.

95. See Minutes of the Geneva Conference on the Unification of Laws relating to Cheques 2nd Sess., L. N. Document No. C.194 M.77 1931 II B, pp.311-312.

96. Ibid. pp.306-311. However, van Zeeland the Belgian delegate was of the opinion that the risk of paying a forged instrument should be allocated to the purported maker/drawer rather than the drawee payor. The objective of promoting the institution of negotiable instruments would suffer a setback if the risk were allocated to the drawee payor. The allocation of risk to the drawee payor would compel the said party to take extra precautions to insure against it. This would definitely involve the incurrence of cost, not based on sound legal or economic grounds. Since the originator of the negotiable instrument is its maker or drawer, he is presumed to be the party in control of the instrument. The forgery of his signature, prima facie presumes fault on the part of the purported maker or drawer. Ibid. p.308. Percerou the French delegate was of the opinion that no hard and fast rule could be proposed as to risk allocation. The courts should determine on the particular facts of each case the party to whom risk would be allocated. Its determination should be based on the degree of negligence of the parties involved. Where no clear case of negligence could be attributed to either party, the risk should fall on the purported maker/drawer. The forgery of his signature presumes a fault in not safeguarding his property. Ibid. p.311.

Examples of applications of the rule expressed by Percerou at the Geneva Conference cf. decisions of the Court de Cassations cited in -
Farnsworth, The Cheque in France and the United States - A Comparative Study, (1962), 36 Tulane L. Rev., pp.263-265.

97. cf. the German's statement at the Geneva Conference on the Unification of Laws Relating to Cheques, L. N. Document No. C.194 M.77 1931 II B P309.

98. cf. Farnsworth, The Cheque in France and the United States - A Comparative Study. (1962) 36 Tulane L. Rev., pp.264-265.

99. Ames, the Doctrine of Price v Neal, (1891) 4 Harv. L. Rev., p.297.
Kessler, Forged Indorsements. (1938) 47 Yale L. J., p.863, and see in particular, Farnsworth - The Cheque in France and the United States. (1962), 36 Tulane L. Rev., p.263.

100. For the reading of Article 7 G.U.L. (Bills) and its counterpart in G.U.L. (Cheques) see p.131 supra.

101. (1841) 9 M & W 54 [1835-42] All ER Rep 320.

102. Ibid.

103. (1762) 3 Burr 1354.

104. Ibid.

105. (1829) 9 B & C 902 [1824-34] All ER Rep 431.

106. Ibid.

107. (1896) 1 QB 7.

108. Ibid. p.11.

109. Ibid.

110. For an example, the Privy Council in Imperial Bank of Canada v Bank of Hamilton qualified Mathew J.'s dictum. Its application was confined to the instances where the instrument or the proceeds, the property of which, was established through a genuine signature. If the instrument was a forgery in toto, that is to say the only signature or all signatures appearing on it were forgeries, the piece of paper purporting to be a negotiable instrument would be interpreted as a sham. It would forfeit its negotiability characteristic.
[1903] AC 49.

By contrast the Court of Appeal in Morison v London County & Westminster Bank Ltd. refused the qualification made by the Privy Council in Imperial Bank of Canada, case. It reinforced the rule amplified by Mathew J. in London River Plate Bank case. The court was of the opinion that title

to the instrument or its proceeds could be established even if no genuine signature precedes the acquirer recipient's acquisition of the instrument.
[1914] 3 KB 356.

111. [1903] AC 49.

112. Ibid. pp.56,57 per Lindley L.J.

113. [1975] QB 654.

114. (1896) 1 QB 7.

115. National Westminster Bank v Barclays Bank and another. Ibid. p.669.

116. Ibid.

117. Ibid. p.670.
The above mentioned rule was first laid down by the House of Lords in R E Jones Ltd. v Waring and Gillow Ltd. [1926] AC 670.

118. National Westminster Bank Ltd. v Barclays Bank International and another. Ibid. pp.667-674.

119. Ibid. pp.670-674.
cf. decision in Imperial Bank of Canada v Bank of Hamilton [1903] AC 49 and the validity of its application in National Westminster v Barclays Bank International and another, 1975 QB. P.670.

120. [1979] 3 All ER Rep 522.

121. (1829) 9 B & C 902 [1824-34] All ER Rep 431.

122. Barclays Bank Ltd. v W.J. Simms Son & Cooke. Ibid. 541.

123. Ibid. p.522.

124. Article 3-302 U.C.C. reads in part,
"...(2) A payee must be a holder in due course ...".

125. cf. Kessler, Forged Indorsements. (1938) 47 Yale L. J., p.863.

126. It is generally accepted that the drawee may not recover from the bona fide acquirer recipient the proceeds of a payment made in the mistaken belief as to the sufficiency of the customer's i.e. drawer's account.
cf. Barclays Bank Ltd. v Simms, Son & Cooke (Southern) Ltd. & Sowman [1979] 3 All ER 522; and,
White and Summers, The Uniform Commercial Code, 2nd Edtn., p.618.

The payment against insufficient funds does not affect the relationship between the parties in question.

As between the drawer and the acquirer recipient, the payment is deemed to discharge an outstanding obligation. As between the drawee and the drawer, it is deemed to confer upon the latter an overdraft. Accordingly, the latter becomes indebted to the drawee payor for the amount equal to the overdraft. As between the drawee payor and the acquirer recipient, the former is deemed to discharge an outstanding obligation, that of his principal i.e. customer.

The similarity between paying a negotiable instrument without the receipt of a confirmatory letter and paying against insufficient funds, is that the payment in both instances is deemed to be made negligently. The drawee payor is deemed to be negligent because he is presumed to be in the position to provide against the occurrence of the erroneous payment. Due to his status as the party to whom the confirmatory letter is remitted and with whom the credit is deposited, he is presumed to be in the position to collect the relevant information and ultimately avoid the occurrence of the erroneous payment. By the mere reference to the purported customers file, the drawee would be in the position to verify the regularity of the mandate and verify the existence and sufficiency of the credit.

127. [1975] QB 654. For the facts of this case see pp.265-269 supra.

128. cf. Article 16 G.U.L. (Bills) and Article 19 G.U.L. (Cheques). For the reading of the said Articles and their implication see p.87 and following, above.

129. For the definition of the concept of holder in the Anglo-American Legal Systems see pp.91-92 above, and for the attitude of the Anglo-American legal systems as to the effect of forged indorsements upon the bona fide third party acquirer see pp.82-85.

130. (1776) cited Chitty (11th Ed.) p.278.
For the facts of this case see pp.62-63 above.

131. cf. Byles on Bills of Exchange, (1963), 25th Edtn., pp.126-127.
Chalmers on Bills of Exchange, (1964), 13th Edtn., p.201.
For the narrow definition of holder see p.91.

132. Ibid.

133. Article 3-419 U.C.C. reads in part,
"1) An instrument is converted when
a) a drawee to whom it is delivered for acceptance refuses to return it on demand; or
b) any person to whom it is delivered for payment refuses on demand either to pay it or to return it; or
c) <u>it is paid on a forged indorsement</u>."

134. Examples of demand instruments analogous to cheques are banker's drafts and instruments drawn by a customer upon his bank in favour of a third party.
cf. Article 1 (2) of the 1957 Cheques Act.

135. Article 1 of the 1957 Cheques Act reads in part,
"1) Where a banker in good faith and in the ordinary course of business pays a cheque drawn on him which is not indorsed or is irregularly indorsed, he does not in doing so incur any liability by reason only of the absence of or irregularity in, indorsement and he is deemed to have paid it in due course."

136. cf. Kessler, Forged Indorsements. (1938), 47 Yale L. J., pp.868-871.
Charles v Blackwell (1877) 2 C.P.D. 151.
The protection afforded to paying bankers by virtue of section 60 B.E.A. and Section 1 1957 Cheques Act is not new. Section 19 of the 1853 Stamp Act provided a similar protection. It exonerated the bank upon whom a demand draft or order was drawn from the burden of establishing that the indorsement, according to which the acquirer recipient established his title to the said draft or order, was made by or on behalf of the intended payee or indorsee. The payment in reliance on the regularity of indorsements suffices to avail the payor banker a valid discharge as against the drawer and the original true owner.

Section 19 of the 1853 Stamp Act reads:
"19) Provided always, that any draft or order drawn upon a banker for a sum of money payable to order on demand, which shall when presented for apyment, purport to be indorsed by the person to whom the same shall be drawn payable, shall be a sufficient authority to such banker to pay the amount of such draft or order to the bearer thereof and it shall not be incumbent on such banker to prove that such indorsement or any subsequent indorsement was made by or under the direction or authority of the person to whom the said draft or order was or is made payable either by the drawer or any indorsor thereof."

137. Article 35 G.U.L. (Cheques) is the counterpart of Article 40 G.U.L. (Bills). It reads:
"The drawee who pays an endorsable cheque is bound to verify the regularity of the series of endorsements, but not the signatures of the endorsers."

Although the G.U.L. (Cheques) does not regulate expressly the effect of payment upon a forged indorsement on the drawee payor, Comment 97 of the report of the drafting committee made it possible to borrow from Article 40 G.U.L. (Bills) the rule that payment in good faith and without gross negligence may avail the drawee payor a valid discharge as between himself and the drawer or the party from whom the instrument was fraudulently dispossessed. Paragraph 5 of Comment 97 reads:

"Nevertheless, in the conferences opinion, it would be possible to apply on this subject the analogous provisions of the Uniform Law on Bills of Exchange (Article 40, third paragraph) in so far as the special nature of cheques permit of an interpretation by analogy in order to decide whether the drawee has validly paid the cheque from the point of view of the holder or of the successive holders."

138. cf. Kessler, Forged Indorsements. (1938) 47 Yale L. J., pp.868,869.
As early as 1787, the Parlement de Paris enacted a special rule the purpose of which is to afford bona fide drawee payors an adequate protection against the payment upon a forged indorsement. The said enactment availed the bona fide drawee payor a valid discharge as against the drawee. Dénisart 3 Collection des Décisions Nouvelles, p.597.

The said rule was imported into the 1807 Code de Commerce. Article 145 of the said Code incorporated the protection afforded to the bona fide drawee payor. It read in part:

> "145. Celui qui paie une lettre de change
> à son échéance et sans opposition
> est présumé valablement libéré."

139. Kessler, Forged Indorsements. (1938), 47 Yale L. J., pp.868-869.

140. For a brief outline of the abstract doctrine and its application in the context of negotiable instruments see p.85 above and accompanying notes.

141. cf. the rule of Kelly v Solari (1841) 9 M & W 54 cited above, pp.109, 110.

142. Ibid. pp. 111-123.

143. [1975] Q.B. 654. For the facts of the case and the decision of the court see pp.116-122.

144. [1979] 3 All ER. For the decision of the court see pp.122-123.

145. For the reading of section 60 B.E.A. and the scope of its application see pp.274-275 supra.

146. For the reading and application of Section 24 B.E.A. and its counterpart in the U.C.C. see pp.235-237 supra.

147. cf. Downs v Halling (1825) 4 B & C. 330.
Bobbett v Pinkett (1876) 1 Ex.D. 368.
Marquess of Bute v Barclays Bank Ltd. [1955] 1 Q.B. 202.
Midland Bank Ltd. v Eastcheap Dried Fruit Co. [1962] 1 Lloyds Rep. 359 (C.A.).

148. Article 4-207 U.C.C. incorporates similar warranties against the collecting agent and in favour of the drawees. Thus if an instrument vitiated by a forged indorsement was presented for payment through a collecting agent, such as

a bank and the drawee pays erroneously, the latter may recover the proceeds of the erroneously made payment from the collecting agent. Article 4-207 U.C.C. reads:
"1) Each customer or collecting bank who obtains payment or acceptance of an item and each prior customer and collecting bank warrants to the payor bank or other payor who in good faith pays or accepts the item that
a) he has a good title to the item or is authorised to obtain payment or acceptance on behalf of one who has a good title."

149. For the reading and application of Article 40 G.U.L. (Bills) and its counterpart in the G.U.L. (Cheques) see pp.275-277 and accompanying note.

150. For the reading and application of Article 16 G.U.L. (Bills) and its counterpart in the G.U.L. (Cheques) see pp.237-240 and accompanying notes.

151. See pp.206-207 supra.

152. For the purpose of this section assume that the instrument involved is a bill of exchange or a promissory note. Assume further that it is international. Assume finally that it contains in its title as well as its text a phrase which indicates that it is subject to the provisions of the UNCITRAL Convention on International Bills of Exchange and Promissory Notes. For the necessity to make such assumption and for the meaning of the term 'international' see n.74 above.

153. For the reading of Article 33 see p.2 above.

154. Article 5 reads:
"In this Convention .....
c) "Instrument" means a bill or a note."

155. Article 3 reads:
"1) A bill of exchange is a written instrument which ....
d) is signed by the drawer.
Paragraph 2 of the Article under consideration reads in part ...
2) A promissory note is a written instrument which ....
d) is signed by the maker."

156. Article 25 reads in part:
"1) If an endorsement is forged, the person whose endorsement is forged or a party who signed the instrument before the forgery, has the right to recover compensation for any damage that he may have suffered because of the forgery against:
a) the forger
b) the person to whom the instrument was directly transferred by the forger,
c) A party or the drawee who paid the instrument to the forger directly or through one or more endorsees for collection."

157. cf. The report of the Working Group on International Negotiable Instruments U.N. Document No. A/CN.9/249Ad1 1984.

158. For a more detailed account of the hypotheticals under consideration see pp.206-207 supra.

159. For the reading of Article 25 see p.246 supra.

160. For a detailed account of the hypotheticals under consideration see pp.206-207 supra.

161. For the purpose of this section assume that the cheque in question is international and it contains in its title as well as its text a phrase which indicates that the said cheque is subject to the provisions of UNCITRAL Draft Convention on International Cheques. For the necessity to make such assumptions see n.87 above.

162. Article 61 reads:
"1) A party is discharged of liability on the cheque when he pays the holder or a party subsequent to himself who has paid the cheque and is in possession thereof the amount due pursuant to Article 59 or 60.
2) A party is not discharged of liability if he pays a holder who is not a protected holder and knows at the time of payment that a third person has asserted a valid claim to the cheque or that the holder acquired the cheque by theft or forged the signature of the payee or an endorsee or participated in such theft or forgery."

163. Article 1 reads in part ...
"2) .... f) Is signed by the drawer."

164. Article 25 reads in part:
"1) If an endorsement is forged, any party has as against the forger and against the person towhom the cheque was directly transferred by the forger, the right to recover compensation for any damage that he may have suffered because of the forgery."

165. Article 6 reads in part:
"In this Convention ....
7) Party means any person who has signed a cheque as drawer, endorser or guarantor."

166. Unlike the Convention on International Bills of Exchange and International Promissory Notes the draft Convention on International Cheques does not regulate the liability arising off the instrument of the drawee who pays a cheque vitiated by a forged indorsement.
Article 25(2) provides ..
"2) Except to the extent provided in Arts 70 & 72 the liability of a party or of the drawee who pays or of an endorsee for collection who collects, a cheque on which there is a forged endorsement is not regulated by this Convention."

cf. the Commentary to Article 25 as to the nature of the liability regulated by the said Article. U.N. Document No. A/CN.9/214 (1981) P42.

From the foregoing it could be concluded that the valid discharge that could be established in favour of the drawee payor on the cheque does not provide a conclusive risk allocation rule. The person whose signature was forged and any other party whose interest would be impaired as a result of the forgery such as the drawer may, when the applicable national law so provides reallocate the resulting loss to the drawee. This could be approached by raising the latter's liability off the cheque in their favour, such as that arising from the latter's breach of the underlying contract. Accordingly, the discharge which is afforded in favour of the drawee payor by virtue of Article 16 (see below) will be of little practical comfort to him.

167. cf. Article 61. It reads in part ...
"1) A person is a holder if he is ..
a) In possession of a cheque drawn payable to bearer.
b) The payee in possession of the cheque.
c) In possession of a cheque which has been endorsed to him or on which the last endorsement is in blank and on which there appears an uninterrupted series of endorsements even if any of the endorsements was forged or was signed by an agent without authority."

168. For the reading of Article 25 see p.91 above.

169. For a more detailed account of the hypotheticals under consideration see pp.206-207 supra.