The risk of the forgery of signatures and the problem of the conflicting entitlements in the law of negotiable instruments: a comparative study

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

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INTRODUCTION

(i) A further instance of negotiable instrument fraud which may give rise to a situation of conflicting interests is the forgery of an essential indorsement for the transfer of the property right of a negotiable instrument. The forgery of such an indorsement diverts the normal currency of the instrument in question. It purports to attribute to the original true owner the intention to transfer the property of the instrument in favour of its thief or finder. Accordingly, it purports to attribute to the former the intention to establish in favour of the latter i.e. the thief or finder, the protected holder status i.e. the holder in due course or the holder in good faith. Through his prima facie protected holder status, the thief or finder perpetrates the last stage of his fraudulent practice. In his status as such, he cashes the instrument either with a bona fide third party or he cashes it with the drawee. In the former instance, the thief or finder purports to divert the property of the instrument to the bona fide third party acquirer. And in instances where he cashes it with the drawee, the thief or finder diverts the proceeds of the instrument to his favour.

(ii) The impact of the forgery of an indorsement materialises in order instruments only.[1] Indorsements

are indispensable for the purpose of negotiating such instruments.[2] Bearer instruments by comparison are negotiable by mere delivery.[3] An indorsement on a bearer instrument is valueless, as far as the negotiability of the instrument is concerned. The bearer instrument remains negotiable even if its delivery was not supported by an indorsement. If the bearer instrument was vitiated by a forged indorsement, the negotiability of the said instrument would not be impaired. It remains effective as if the forged indorsement was not written. Accordingly, the bona fide acquirer of such an instrument may possess a good title to the instrument or its proceeds. He may enforce it against any or all signatories such as the maker,drawer, special indorsor and the acceptor. In instances of payment he may retain the paid proceeds. Neither signatories may challenge his good title by setting up against him counter claims or defences, the existence of which he had no knowledge.[4]

(iii) Litigation over the forgery of an indorsement involves various parties. The number of the involved parties may vary according to the particular setting. In instances of dishonour, the involved parties are the prior obligor on a negotiable instrument such as the maker or drawer, the payee or indorsee in instances where the instrument was dispossessed from him and the bona fide third party acquirer. The party from whom the instrument was dispossessed i.e. the original true owner might, in some cases be the maker or drawer himself. This occurs

when the instrument was intercepted before it reaches the intended payee. In such an instance, the property of the instrument does not pass to the intended payee. It remains the property of the maker or drawer.

In instances of payment, the involved parties are the prior obligor, the payee or indorsee in instances where the instrument was dispossessed from him, the bona fide third party acquirer and the drawee payor. The thief or finder may, however, be a party to the negotiable instrument which was vitiated by the forgery of an indorsement. Nevertheless, in most instances, the enforcement of the instrument in question against such a party might not be available due either to his insolvency or non-availability.[5]

(iv) Since the forgery of an indorsement diverts the currency of the negotiable instrument, it gives rise to a situation of conflicting interests. It raises a conflict relating to the property right to the instrument, the property right to its proceeds, as well as the enforcement of the liability arising from it.

The interests to which the forgery of an indorsement gives rise in instances of dishonour are:

1) the prior obligor's interest to be accountable for a single payment,

2) the original true owner's interest to establish the property right to the instrument in his favour, and

3) the bona fide third party acquirer's interest to establish the property right to the instrument in his favour and ultimately his interest to enforce the incorporated contractual promise or undertaking exclusively to his favour.

The interests to which the forgery of an indorsement gives rise in instances of payment are:

1) the prior obligor's interest to have his credit with the drawee payor recredited for the face value of the vitiated instrument or have himself discharged from liability as between himself and his immediate transferor from whom the instrument was dispossessed e.g. the payee,

2) the interest of the original true owner to have the proceeds of the instrument paid to him or to have the liability arising from the underlying obligation revived,

3) the bona fide third party recipient's interest to have the good title to the paid proceeds established in his favour, and

4) the drawee payor's interest to have his act of payment upheld or have the right to recover the erroneously paid proceeds from the recipient, established in his favour.[6]

(v) Since litigation over the forgery of an indorsement involves various parties, each of whom possesses a conflicting interest or interests, the forgery of an indorsement represents a risk. The law, in such an

instance, should determine the most efficient manner of allocating the said risk. As has been mentioned earlier,[7] economic efficiency provides a valid basis for approaching an efficient risk allocation rule. Accordingly, and in order to achieve an efficient risk allocation rule, the risk arising from the forgery of an indorsement should be allocated to the party who is presumed to be in the best position to provide against its occurrence. The party who is in the best position to provide against the forgery of an indorsement, by reference to the cost/benefit analysis, is the party who is in the position to derive an enforceable utility from the cost and time incurrable in the course of providing the precautionary measures, or the party who is in he position to absorb such cost and time. As has been mentioned earlier,[8] the determination of the party who is in the best position to provide against the risk in question in the above mentioned manner, serves as a convenient theory for allocating the risk arising from negotiable instrument fraud. Its application is compatible with the considerations relevant to formulating the risk allocation rule in the law of negotiable instruments.

The Competing Parties' Ability to Provide Against the Forgery of an Indorsement.

The competing parties' ability to provide against the forgery of an indorsement depends on their proximity to

it. The parties more proximate to the forgery are presumed to be better situated to provide against it. The parties more remote from the forgery are presumed to be less able to provide against it.[9]

The Prior Obligor.

(i) The prior obligor on a negotiable instrument, such as the maker or drawer, is a remote party to the forgery. The forgery of an indorsement occurs after the instrument which it vitiates, leaves his possession and comes into the possession of the intended transferee. Once the instrument comes into the possession of the intended transferee, its prior obligor is presumed to forfeit his control upon it. The exercise of an effective control upon a particular property is the means whereby the possessor of the said property can provide against its misuse. Negotiable instruments are, by virtue of their special nature, a type of property. Their misuse can be prevented by the exercise of control upon them. Since the prior obligor, by securing the delivery of the negotiable instrument to its intended transferee, is presumed to forfeit his control upon it, he is presumed to be unable to provide against its misuse. Ultimately, he is presumed to be in no position to provide against the forgery of an indorsement.

(ii) It may be argued that the prior obligor on a negotiable instrument may, in some instances, be in the

position to provide against the forgery of a negotiable instrument, especially when the transferee notifies the former of the loss or theft of his instrument. In such an instance, the prior obligor can provide against the forgery by advising the drawee to stop the payment of the lost or stolen instrument. Such a measure, it is submitted, is not entirely effective to provide against the forgery or the occurrence of loss. In the first place, the lost or stolen instrument may come into the hands of the bona fide third party acquirer before the theft or loss of the instrument is made public. Accordingly, the lost or stolen instrument may establish a conflicting entitlement in favour of the bona fide third party acquirer. It may establish in favour of the said party, the property right to it and ultimately it may establish in his favour the right to enforce its incorporated credit against prior obligors, e.g. the maker or drawer.

In the second place, the provision against the forgery of an indorsement or the occurrence of loss in instances of the loss or theft of a negotiable instrument does not exclusively lie with the prior obligor. Rather it depends on the transferee's compliance with his duty to provide against the said risk. When and only when the said party notifies the maker or drawer of the theft or loss within a reasonable time, the latter's duty to provide against the risk of forgery may arise.

The Original True Owner.

(i) The original true owner of a negotiable instrument is, by comparison, an immediate party to the forgery. The forgery of an indorsement occurs whilst the instrument which it vitiates is in his control. Since the possession of the instrument is deemed to be with the original true owner the said party may be presumed to be in the position to exercise an effective control upon it. Accordingly, he is presumed to be in the position to provide against the forgery of an indorsement.

(ii) The original true owner can provide against the forgery of an indorsement by the exercise of care as to the safe custody of his negotiable instruments as well as the exercise of care as to their negotiation. The exercise of care in the safe custody and the negotiation of negotiable instruments is the means through which the original true owner can maintain an effective control on his instruments and ultimately provide against their misuse.

The exercise of care as to the safe custody of negotiable instruments involves the employment of measures the purpose of which is to prevent the instrument from coming into the hands of unintended third parties. Examples of such measures are the installation of sophisticated technology, the maintenance of a constant lookout on his instruments and the provision of a strict test in recruiting employees and supervising their jobs,

in instances where the safe custody of negotiable instruments is entrusted to them.

The exercise of care as to the negotiation of negotiable instruments, by comparison, involves the accurate identification of the party to whom the original true owner intends to negotiate his instrument, the election of the most reliable means of securing the delivery of the instrument to the intended transferee and the provision of a strict test of selecting and supervising employees or agents to whom the job of issuing negotiable instruments or the job of collecting their proceeds is entrusted. The provision of a strict test of selecting and supervising employees or agents requires the carrying out of a thorough examination of statements, accounts and invoices prepared by them. The failure to carry out such an examination could defraud the employer or principal in issuing instruments to fictitious persons i.e. to whom the employer or principal is not indebted.

The Bona Fide Third Party Acquirer.

(i) The bona fide third party acquirer is also an immediate party to the forgery. He establishes his title to the instrument which the forgery vitiates directly from the thief or finder i.e. the forger. Due to his proximity to the forger, the bona fide third party acquirer may be presumed to be in the position to provide against the forgery. By the exercise of care in his acquisition, the party in question can provide against the

said risk. The exercise of care in the acquisition of negotiable instruments involves the accurate identification of the possessor of the instrument in question i.e. the party from whom the bona fide third party intends to establish his title to it. For this purpose, the latter may need to shop for information concerning the identity of the possessor, as well as the validity of his title.

(ii) The bona fide third party acquirer alternatively can provide against the forgery by refraining from dealing with strangers i.e. with parties the character of whom he is not familiar with. If the dealing with strangers proved to be indispensable the bona fide third party to whom a negotiable instrument was offered for a valuable exchange should safeguard his interest. He should either suspend his acquisition of the offered instrument until its final payment, or he should demand from the party with whom he deals a more reliable payment instrument.

The Drawee Payor.

(i) The drawee payor could be either a remote or an immediate party to the forgery. His status as such depends on whether he cashes the vitiated instrument to the thief or finder i.e. the forger, or cashes it to a bona fide third party such as the collecting or an intermediary agent, or to a bona fide acquirer. In instances where the drawee payor cashes the instrument in question to the forger he is presumed to be an immediate

party to the forgery. His proximity to the forger illustrates his immediateness to the forgery. In instances where he cashes the instrument to a bona fide third party, the drawee payor is presumed to be remote from the forgery. The presence of an independent party between the forger and the drawee payor illustrates the remoteness of the latter from the forgery.

(ii) In all instances, the drawee payor's capability to provide against the loss resulting from the forgery of an indorsement is illustrated by the exercise of care in examining the identity of the acquirer i.e. the party to whose favour the instrument is intended to be cashed and by the exercise of care in examining the regularity of the presented instrument as well as the validity of the title of its possessor. To this end, the drawee payor would have to shop for information as to the true identity of the possessor, the validity of his title and the regularity of the presented instrument.

(iii) Unlike the instances of the forgery of a negotiable instrument, the drawee is unable, by the exclusive reference to the presented instrument to reveal the forgery of an indorsement. He does not keep on file a facsimile of the payee's or indorsee's signature or any equivalent identification. Accordingly, he is unable to compare the purported signature with the genuine signature of the said party. Consequently, the drawee of a negotiable instrument is in no position to provide against the occurrence of the forgery of an indorsement. For the

provision against the forgery of an indorsement to be feasible, the drawee would have to establish a relationship with the payee or indorsee. Through such a relationship, the drawee can introduce measures such as identification cards whereby the forgery of an indorsement would be impossible or more onerous.[10] Due to the fact that negotiable instruments are freely transferable in the stream of commerce, any member of the whole world may be the payee or indorsee of a negotiable instrument. It would be impracticable to require the drawee to establish a relationship with every member of the whole world.

(iv) It may be argued that the drawee can provide against the forgery of an indorsement or the occurrence of loss by dishonouring the presented instrument in instances where the circumstances surrounding its payment raise doubts as to its regularity, the true identity of its acquirer, or the validity of his title. In reply, it could be observed that such a measure is inconvenient. The drawee's decision to dishonour the presented instrument on the basis of the doubts arising from the circumstances surrounding the cashing of the instrument might prove to be erroneous. Accordingly, it might render the drawee liable for the damages resulting from his dishonour, to his customer. The resulting damage may, in instances where the customer is a merchant, be substantial. It may include damages caused to the customer's business.[11]

The Compatibility of the Competing Parties' Ability to Provide Against the Forgery of an Indorsement with Economic Efficiency.

The Prior Obligor.

Since, as has been established earlier, the prior obligor on a negotiable instrument such as the maker or drawer is in no position to provide against the forgery of an indorsement, in instances where the instrument leaves his possession and comes into the possession of the intended transferee, it would be superfluous to examine the compatibility of his ability to provide against the forgery of an indorsement with economic efficiency. Due to the transfer of the possession of the instrument to the intended transferee, the prior obligor is presumed to forfeit his control on the instrument. The power to exercise an effective control is the means through which the forgery of an indorsement and ultimately the occurrence of loss may be provided against. Since, due to the transfer of possession the prior obligor is deemed to forfeit his control upon the negotiable instrument, he is presumed to be incapable of providing against the forgery of an indorsement. Ultimately, it would be economically inefficient to allocate the loss resulting from the forgery to him.

The Original True Owner.

(i) The original true owner, by comparison, is in the

position to provide against the forgery of an indorsement. This could be maintained by the exercise of care in the safe custody of his instruments and by the exercise of care in their negotiation. The exercise of care in the safe custody or in the negotiation of negotiable instruments involves cost and time. The cost involved in the safe custody of negotiable instruments is illustrated by the installation of sophisticated technology and by the recruitment of an employee for the purpose of their safe keeping. The time involved in the safe custody of negotiable instruments is illustrated by the provision of a constant checking system on the existence of the negotiable instruments and by the exercise of strict supervision on the employee's job.

The cost involved in the negotiation of negotiable instruments by comparison, is illustrated by the shopping for information concerning the true identity of the party with whom the original true owner intends to deal, the selection of the most reliable means of communication and the recruitment of employees for the purpose of issuing negotiable instruments and collecting due payments. The cost involved in the shopping for information is illustrated in the communication expenses such as telex charges and fees payable to an independent agent as a consideration for his information services. The cost involved in the selection of the most reliable means of communication is illustrated in high postal charges, the purchase of insurance and the employment of a special messenger.

The time involved by the exercise of care in the negotiation of negotiable instruments is illustrated by the shopping for information concerning the true identity of the party to whom the proprietor of a negotiable instrument intends to transfer the instrument and by the provision of strict supervision on the job of the employees. The necessity to shop for information concerning the true identity of the party in question arises from the fact that such information might not be available from the surrounding circumstances. Thus, and in order for the proprietor of a negotiable instrument to satisfy his conviction as to the true identity of the party to whom he intends to negotiate the instrument, he may have to consult an independent agent or he may have to contact the employer or principal whom the party in question purports to represent. For the necessary information to be made available to the proprietor of a negotiable instrument, a period of time would need to elapse. The time involved in the shopping for information is illustrated in the period of time which the employed independent agent would need to collect the relevant information or the time which the employer or agent consumes to remit his reply to the proprietor.

(ii) Although the exercise of care in the safe custody and the negotiation of negotiable instruments involves cost and time, it does not result in an undue economic hardship to the original true owner. In the first place, the involved cost and time are directed to protect a

valuable property, namely negotiable instruments. Negotiable instruments, due to their special nature are deemed, in the hands of the original true owner, to be a valuable property. They derive their status as such from the incorporated valid signature. The instrument which incorporates a valid signature gains currency. It possesses the attributes of money. It incorporates an enforceable contractual promise or undertaking. It entitles its proprietor i.e. acquirer to demand the enforcement of the credit represented by the contractual promise or undertaking exclusively in his favour.[12] It establishes in favour of the said party a legal title to it as well as to its proceeds in instances of payment.

(iii) In the second place, the cost and time arising from the exercise of care in the safe custody and the negotiation of negotiable instruments, generate an enforceable value in favour of the original true owner of a negotiable instrument. The exercise of care in the general running of a business increases the reliability of the proprietor of the said business. The compliance with such a duty assures the merchants that their dealing with such a party would not be disturbed or disrupted. Accordingly, they would be assured that they would not be involved with him in disputes relating to the finality of foreclosed transactions or to the operativeness of outstanding entitlements. The parties who are interested to have the notion of finality established in their favour, are those who secure the delivery of the

negotiable instrument to the intended transferee. The parties who are interested to have their underlying entitlements upheld are the parties to whom the instrument is negotiated but fails to reach their possession.

Once the commercial community was secure in its reasonable expectation, it would be encouraged in issuing and accepting negotiable instruments. The value which the proprietor of a negotiable instrument would derive from such behaviour is that his commercial engagements would firstly increase and ultimately his business would be promoted and secondly he would obtain a credit. The credit derivable from dealing in negotiable instruments arises from the negotiation of such documents. The negotiation of negotiable instruments entitles the transferor i.e. the proprietor to obtain immediate value, such as services, commodities or absolute credit for a deferred value, i.e. the financial credit incorporated in the instrument. Negotiable instruments in practice are not liquidated into money immediately. There is an interval of time between their acquisition and their liquidation into money. The interval of time which separates the acquisition of negotiable instruments and their final payment is illustrated in the period of time involved in their deposit and collection. Although such an interval of time might be short, it represents a credit in favour of the transferor of such instruments. It entitles him to utilise the immediate value for which the instrument was exchanged before the incorporated credit in the instrument is transferred into absolute credit.

The Bona Fide Third Party Acquirer.

(i) The bona fide third party acquirer is also in the position to provide against the forgery of an indorsement or the occurrence of loss. The said risk may be provided against by the exercise of care in the acquisition of negotiable instruments. To this end, the third party to whom the instrument was offered for a valuable exchange, would need to shop for information concerning the regularity of the offered instrument, the identity of its possessor and the validity of his title.

The shopping for information as to the above mentioned particulars involves cost and time. The cost arising from the compliance with such a duty is illustrated by the expenses incurrable in the course of contacting the potential prior parties and by the fees payable to the employed independent agent, as a consideration for his information services. Through the establishment of contact with the potential prior parties such as the maker or drawer and through the employment of an independent agent, the bona fide third party may obtain the relevant information relating to the status of the offered instrument, the identity of its possessor and the validity of his title.

The time arising from the shopping for information, by comparison, is illustrated by the period of time within which the required information would be available to the bona fide third party. During the period of time within which the required information is gathered, the bona fide

third party would have to suspend his commercial engagement with the party from whom he intends to acquire the offered instrument. Accordingly, he would have to freeze the value i.e. the service, commodity, or the credit that he would be offering to the party in question as a consideration for the credit incorporated in the instrument. In such an instance, the bona fide third party might forego the opportunity to utilise the said value in a favourable manner. He might forego the opportunity to utilise the value in question in other transactions where an immediate enforceable value could be obtained in consideration for the value available with him.

(ii) In order for the assumption of cost and time to be economically valid, their involvement should generate an enforceable value or they should be absorbable in an efficient manner. That is to say that, the party to whom the costly and time consuming duty of care is allocated should be in a position to re-allocate the involved cost and time to other parties. The cost and time involved in shopping for information do not generate a practical enforceable value in favour of the bona fide third party to whom the instrument was offered for a valuable exchange. The only value derivable from the involvement of cost and time in the information shopping is that they reveal to the bona fide third party the true status of the offered instrument and the true status of its possessor.

Such value, it is submitted is not of a practical significance.

In instances where the revealed information indicates that the offered instrument is regular and the title of its possessor is valid, or in instances where the revealed information indicates that the offered instrument is irregular and the title of its possessor is invalid, the bona fide third party would be left to bear the cost evolving from the information shopping. In instances where he determines to acquire the offered instrument or in instances where he determines not to acquire the offered instrument, he would not normally be in a position to re-allocate the evolving cost to the possessor of the instrument i.e. the party from whom he intends or intended to acquire the instrument. The latter party would not normally accept to bear such cost. Should he be made to bear the cost evolving from the information shopping, he would be receiving a value less than the face value of the offered instrument or he would be assuming expenses without receiving an enforceable value in consideration. In either instance, the possessor of a negotiable instrument would deem the assumption of cost evolving from the shopping for information as a misallocation of wealth.

A further illustration of the fact that the allocation of the duty to shop for information to the bona fide third party is economically invalid, is that the said party in many instances is a consumer. Due to his status as such, he is not presumed to be in a position to absorb

the cost evolving from the information shopping. There would not be other parties against whom he may re-allocate the said cost. Ultimately, the said cost would have to be borne by him exclusively.

(iii) From the foregoing it could be concluded that since the duty of information shopping involves cost and the bona fide third party to whom the instrument was offered for a valuable exchange, does not derive a practical enforceable value from the assumption of the said cost and he is in no position to absorb it, the allocation to him of the duty to shop for information, is economically inefficient. The compliance with such a duty results in a misallocation of wealth. Thus, and in order to approach an economically efficient risk allocation rule, the bona fide third party should not be burdened with the duty to shop for information and ultimately the law should not allocate to him the risk arising from the forgery of an indorsement.

(iv) It may be argued that the bona fide third party acquirer can avoid the hardship resulting from the information shopping by refraining from acquiring negotiable instruments from strangers; or by demanding a more reliable payment instrument from the stranger with whom he intends to deal. Either course he chooses would frustrate the fraudulent intention of the forger. Ultimately, the rate of forgery and the occurrence of loss would be reduced. In reply, it could be observed that

the abstention from acquiring negotiable instruments from strangers or the demand of a more reliable payment instrument impairs the institution of negotiable instruments as a substitute for money. They, on the one hand, as it will be shown below,[13] restrict the free transferability of negotiable instruments whilst they, on the other hand, damage the reasonable expectation of the genuine acquirer of a regular instrument.

The Drawee Payor.

(i) The drawee payor is also in the position to provide against the forgery and ultimately against the occurrence of loss. The said risk can be provided against by the exercise of care in examining the regularity of the presented instrument, the identity of its possessor and the validity of his title. To this end, the drawee would have to shop for information concerning the above mentioned particulars.

For the relevant information to be made available to the drawee, the said party would have to contact the potential prior parties as to the regularity of the presented instrument,the identity of its possessor and the validity of his title. Such a measure is costly and time consuming. The cost involved in the information shopping is illustrated by the expenses incurrable in the course of establishing an efficient means of communication and by the recruitment of employees for the purpose of handling

such an investigation. The time involved in the information shopping, by comparison, is illustrated by the period of time within which the shopping for information would be completed.

(ii) The cost and time involved in the information shopping do not prima facie result in an undue economic hardship to the drawee. The drawee's compliance with such a duty assures the commercial community that its credits shall be dispensed in a manner compatible with its reasonable expectations. Accordingly, it would be encouraged to deposit its credits with the party who provides for such a security. Once the commercial community is encouraged to deposit its credits with such a party, the latter's business would necessarily expand. On the other hand, and due to the fact that the drawee is a party engaged in the business of banking, he is presumed to be in the position to absorb the cost involved in the information shopping. Through the rating of periodic and service charges, he may re-allocate the said cost among his customers. And finally, if the drawee deems the duty to shop for information unduly costly, and its observance could disturb his banking business, he remains, through the provision for insurance, in the position to provide against the loss resulting from the forgery of an indorsement. Due to his status as a party engaged in the banking business, the drawee is presumed to be in the best position to provide for insurance. And due to his status

as such, he is presumed to be in the position to absorb the cost of insurance.

(iii) To state the obvious, although the allocation of the duty to shop for information to the drawee is economically valid, it is incompatible with the special nature of negotiable instruments, as well as the objective of promoting the said institution. On the one hand, negotiable instruments are intended to function as a substitute for money. In order to fulfil their function as such, they should be capable of being liquidated into absolute credit i.e. money, immediately. If the drawee was to investigate the regularity of the presented instrument, the identity of its possessor and the validity of his title, the instrument in question would not be able to be liquidated into money on its day of maturity. The shopping for information concerning the above mentioned particulars involves time.

On the other hand, and in order to promote the institution of negotiable instruments, the commercial community engaging in the acquisition of such documents should be entitled to be timely informed of the fate of its instruments. Such an entitlement would enable the acquirer of a negotiable instrument to determine the convenient method of satisfying his commercial interests. It also enables him to settle his underlying financial entitlements with his prior transferor or transferors in a favourable manner.

The information shopping, as will be shown below,[14] frustrates the reasonable expectation of the genuine acquirer. It firstly, due to the time involved, deprives the genuine acquirer of the advantage of knowing the fate of his instrument timely and secondly, it may deprive him of a valuable security. Due to the above mentioned difficulties, the commercial community may be deterred from acquiring negotiable instruments. Ultimately, the objective of promoting the institution of such documents would fail.

From the foregoing, it could be concluded that the drawee of a negotiable instrument should not be burdened with the duty of shopping for information concerning the regularity of the presented instrument, the identity of its possessor and the validity of his title. If he fails to comply with such a duty, he should not be made to bear the evolving risk. In particular, in instances where the paid instrument was vitiated by a forged indorsement the loss arising from the erroneous payment should not be allocated to the drawee payor.

(iv) As far as the insurance argument is concerned, it could be observed that the party's capability to provide for insurance efficiently, should not be considered in a vacuum as a basis for determining the risk allocation rule. Its application as such could result in an inefficient risk allocation rule. It could allocate the resulting loss to a relatively innocent party, namely, the best insurer, whilst it could result in a windfall in

favour of the guilty party. From the foregoing it could be noted that the application of the insurance theory could give rise to moral hazard. By allocating the risk in question to the relatively innocent party, the negligent party could be encouraged to behave carelessly.[15]

For the insurance theory to provide a sufficient basis for allocating risk in an efficient manner, and in order to avoid moral hazard, the said theory should take into account in allocating the duty to provide for insurance, the party's capability to provide against the occurrence of the loss in question. That is to say that it should allocate the duty to provide for insurance to the party who is in the position to provide against the occurrence of loss. In instances where the loss results from the forgery of an indorsement, the theory under consideration should allocate the duty to provide for insurance to the party who is in the position to provide against the occurrence of the forgery or to the party who is in the position to provide against the occurrence of loss. Since, as has been established above,[16] the drawee is not in the position to provide against the forgery of an indorsement, nor is he in the position to provide against the occurrence of loss, it would be inefficient to allocate to him the duty of providing for insurance. It would be equally inefficient to allocate to him the loss resulting from the forgery of an indorsement, by reason that he is in the position to provide for insurance.

The Compatibility of the Parties' Ability to Provide Against the Forgery of an Indorsement with the Interests Relevant in Determining the Risk Allocation Rule in the Context of Negotiable Instruments.

(i) The most significant interest in determining the risk allocation rule in the context of negotiable instruments is the promotion of the institution of the said documents. The said interest arises from the necessity to devise a finance instrument capable of fulfilling the function of money. Due to the risk inherent in the transmission of money, the commercial community was in favour of a finance instrument of a dual nature. Firstly, it can be utilised as a substitute for money and secondly, its involvement as such avoids the risk inherent in money. As has been established earlier,[17] the institution of negotiable instruments is equipped to fulfil the above mentioned desire. Due to its large involvement as a finance device in commercial transactions and due to its proprietor's effective control upon it, the said institution is presumed to be the most convenient substitute for money.

In order for the institution of negotiable instrument to be promoted, the free transferability of such documents should be facilitated. The free transferability of negotiable instruments would be facilitated once the members of the commercial community are encouraged to engage in their negotiation and acquisition. To encourage the negotiation and acquisition of negotiable

instruments, the members of the commercial community engaging in such activities should be protected in their reasonable expectations. In particular, the parties engaged in the acquisition of negotiable instruments should be reasonably secured in their prima facie regular transactions. The parties engaged in the negotiation of such instruments, due to their capability to control the instrument in their possession, are presumed to be equipped to protect their interest. This could be achieved either by the exercise of care in the safe custody and negotiation of their instruments or by negativing or restricting the negotiability attribute of such documents.

(ii) The exercise of care in the safe custody and negotiation of negotiable instruments is not unduly onerous. The cost and time involved in the exercise of care generates an enforceable value in favour of the party engaging in the negotiation activity.[18] Should the said party i.e. the proprietor of such an instrument deem the exercise of care in the safe custody and negotiation of his instrument unduly onerous he may avoid the detriment arising from the involvement of cost and time, yet he may protect his interest, by negativing and restricting the negotiability attributes of the instrument in question.[19]

(iii) The party engaging in the acquisition of negotiable instruments is not, by comparison, similarly situated. The four corners of the offered instrument do not normally reveal the existence of an irregularity e.g. the forgery

of an indorsement. In order for the bona fide third party to whom the instrument in question was offered for a valuable exchange, to unveil its true status he would have to shop for information. The duty to shop for information as has been established above[20] involves cost and time. The involvement of cost and time in such an instance does not generate a practical enforceable value in favour of the bona fide third party. On the contrary, their involvement results in an economic detriment to him.

The other measures available to the bona fide third party, through which he may avoid the detriment arising from the information shopping yet he can provide against the forgery of an indorsement, namely the abstention from dealing with strangers or the demand of a more reliable payment instrument, are not entirely satisfactory. On the one hand, they restrict the acquisition of negotiable instruments to instances where the party offering the negotiable instrument and the party to whom the said instrument is offered are familiar to each other. In such an instance, the free transferability attribute would be impaired and ultimately, negotiable instruments would fail to function as a substitute for money.

On the other hand, the impact of the above mentioned measures is to create a detriment to the genuine acquirer of a regular instrument. In instances where the commercial community is deterred from dealing with strangers, the genuine acquirer of a regular instrument would be unable to utilise in an efficient manner, the credit incorporated in his instrument, in a foreign

jurisdiction. Due to his status as a stranger, he would not be able to cash his instrument in a timely manner. Accordingly, he would not be able to invest the incorporated credit to satisfy his commercial interest. He would have to defer the cashing of his instrument until he returns to the jurisdiction where his character is familiar. By the time he gets to the said jurisdiction, the maturity of the instrument may be time barred. It would then forfeit its practical value as a negotiable instrument. Its bona fide genuine acquirer would forfeit the advantage inherent in it. He may forfeit a valuable security on it and he would have to assume the burden of establishing and enforcing his claim against a potential liable party.[21]

Due to the above mentioned inconveniences, some members of the commercial community might be deterred from acquiring negotiable instruments. Once the members of the commercial community are deterred from acquiring negotiable instruments, the objective of promoting the institution of such documents would fail.

(iv) It has been argued that the allocation to the bona fide third party of the burden of safeguarding his interest by shopping for information concerning the status of the offered instrument, the identity of its possessor and the validity of his title, does not restrict the objective of promoting the institution of negotiable instruments. This could be inferred from the fact that the rate of acquiring negotiable instruments in the Anglo-

American legal systems is increasing despite the fact that the law in the said legal systems allocates the risk arising from the forgery of an indorsement to the bona fide third party acquirer.[22] The thesis underlying such a rule is that the Anglo-American legal systems deem the bona fide third party acquirer more at fault than the original true owner. The fault which the bona fide third party acquirer could be blamed for in causing the loss is illustrated by the acquisition of the vitiated instrument from the forger. In fact, the said legal systems attribute the causing of the loss to the bona fide third party acquirer because the said party failed to exercise care in his acquisition.

To state the obvious, the increase in the rate of negotiable instrument acquisition in the Anglo-American legal systems is not due to their manner of allocating the risk of the forgery of an indorsement, rather it is due to three factors. In the first place, the rate of forgery of indorsementa is minute. The parties engaged in the acquisition of negotiable instruments through indorsements deem the occurrence of forgery highly improbable. In the second place, the large majority of the circulated negotiable instruments in the legal system under consideration bear an absolute credit. This is illustrated by the drawee's acceptance or guaranty. It runs in favour of the initial holder i.e. payee, as well as the subsequent holder. It involves a promise to pay the bona fide holder the face value of the presented instrument. For the acquirer to qualify as the

protected holder, he need not concern himself with the genuineness of the incorporated signature, rather he only needs to examine the apparent regularity of it.[23] The promise incorporated in the negotiable instrument's absolute credit affords the bona fide acquirer a reasonable assurance that his instrument will be met. Such an assurance satisfies the reasonable expectation of the said party in that the acquired instrument shall be liquidated into money on its day of maturity.

In the third place, the large majority of the circulated negotiable instruments are not transferred more than once. The acquirers of such instruments are presumed to be the initial holders. Accordingly, their entitlements to the acquired instruments would not be the subject of a conflicting claim. That is to say that since the acquirer of a negotiable instrument is the initial holder, there would not be another potential competing party to whose favour the former would have to account for the acquired instrument or its proceeds. Due to the acquirer's status as the initial and only holder, together with the absolute credit incorporated in his instrument, the said party would be protected in his reasonable expectation. He would be enabled to satisfy the absolute credit exclusively in his favour.

The Entitlements Arising from the Security in the Transaction Rule.[24]

(i) In the context of negotiable instruments, the

security in the transaction protection involves three advantages. Firstly, it involves the separation between the property of the negotiable instrument from the validity or genuineness of the transaction or transactions incorporated in it. Once the property of the negotiable instrument is divorced from the validity or genuineness of the incorporated transaction or transactions, the resemblance between negotiable instruments and money becomes greater. The mere possession of the instrument would prima facie prove its property. The party to whom the instrument was offered for a valuable exchange would not need to investigate the title of its prima facie lawful possessor i.e. the party from whom he intends to establish his title to the offered instrument. He may base his acquisition of the negotiable instrument in reliance on its prima facie regularity only. In order to detect the existence of an irregularity in the offered instrument, the party in question would not have to enquire beyond the four corners of the said instrument and the circumstances surrounding his acquisition. Once the duty to detect the irregularity vitiating the offered instrument was confined to examining the four corners of the said instrument and the circumstances surrounding its acquisition, the third party to whom the instrument was offered for a valuable exchange would be released from the burden of allocating cost and time in an economically detrimental manner. His standard of care would be set in a manner compatible with his position to

provide against the forgery of an indorsement.

(ii) Secondly, the security in the transaction rule involves the establishment of the good title rule in favour of the bona fide third party acquirer. The good title rule is submitted to be the essence of the security in the transaction protection. Its establishment in favour of the bona fide third party acquirer entitles the said party to enforce the credit incorporated in the acquired instrument exclusively to his own interest. It entitles him to retain the proceeds of the instrument in instances of payment, whilst it entitles him to enforce its face value against prior liable parties in instances of non payment.

The establishment of the good title rule in favour of the bona fide third party acquirer is an application of the separation of the property of the instrument from the validity and genuineness of the incorporated transactions. The separation rule, as has been established above, deems the prima facie lawful possession of a negotiable instrument as an evidence of its property. From the foregoing, it necessarily follows that the separation rule establishes a prima facie ownership in favour of the prima facie lawful possessor of such an instrument. In such an instance, if the prima facie lawful possessor offers a bona fide third party a negotiable instrument for value, the latter would not need to investigate the property of the former. By virtue of the separation rule, the prima

facie lawful possessor is presumed to be the owner i.e. holder. Thus, if the bona fide third party determines to take the offered instrument for value, he is presumed to have acquired it from its holder. Accordingly, his acquisition as such is presumed to establish in his favour a good title to the instrument in question.

(iii) Finally, the security in the transaction rule involves the establishment in favour of the bona fide third party acquirer, of the right to be informed in good time of the fate of his instrument. Such an entitlement enables the said party to organise his financial affairs in an efficient manner. It enables him to determine the most convenient manner of settling his commercial engagements in prior transactions and the most convenient manner of financing subsequent commercial transactions. The bona fide third party acquirer's entitlement to be informed in good time of the fate of his instrument, also enables him to satisfy his interest against potential liable parties.

The parties to a negotiable instrument are not liable for an indeterminate time. Their liability on the negotiable instrument is short.[25] It crystallises when and only when the party in question was informed in good time of the non-payment of the instrument.[26] The time limit within which the said liability may be called into question, does not exceed two days following the day of maturity.[27] If the bona fide third party acquirer fails

to inform the party against whom he intends to enforce the instrument of the non-payment within the time limit, the latter may be discharged from liability.[28] Accordingly, the bona fide third party acquirer would forfeit a valuable security.

In order to preserve the bona fide third party acquirer's entitlement to be informed of the fate of his instrument in good time, the drawee of a negotiable instrument should not be burdened with the duty of shopping for information concerning the status of the presented instrument, the identity of its possessor and the validity of his title. Such a duty would involve time. The time involved in the shopping for information might overlap with the bona fide third party acquirer's entitlement to be informed timely of the fate of his instrument. The shopping for information might ultimately damage the interest of the genuine acquirer of a negotiable instrument.[29]

The Impact of the Entitlements Arising from the Security in the Transaction Rule on the Reasonable Expectations of the Original True Owner.

(i) The establishment of the above mentioned entitlements in favour of the party engaged in the acquisition of negotiable instruments, i.e. the bona fide third party acquirer, is not inconsistent with the reasonable expectation of the party engaged in the negotiation of such documents i.e. the original true

owner. Due to the special nature of negotiable instruments, the said party ought to foresee the probability that the failure to exercise care in their safe custody and negotiation could result in their misuse. Their possession may, due to lack of care, come into the hands of a fraudulent party. And since their four corners do not, on their own, unveil the existence of an irregularity, the fraudulent party may misrepresent to a bona fide third party their true status. Accordingly, he may induce the latter to cash the vitiated instrument.

The acquisition or payment of an irregular instrument represents a loss to the acquirer or payor in instances where the said bona fide third party is denied the above mentioned protection. The loss resulting from the acquisition or payment of an irregular instrument, such as that vitiated by a forged indorsement, is illustrated by the acquisition of the instrument from other than its true owner and by the payment of an instrument in favour of other than its lawful holder. Since the acquisition of an instrument or its payment was made from or in favour of other than the lawful holder, it would not confer an enforceable value in favour of the acquirer or payor. It would neither establish a good title in favour of the acquirer nor would it establish an operative discharge in favour of the payor.[30]

(ii) In order to avoid causing a loss to the bona fide third party, in order to avoid creating an economic detriment to the said party and in order to promote the

institution of negotiable instruments, the original true owner should exercise care in the running of his business. He should provide against the probability that his instrument would be misused and a bona fide third party would be misled as to its true status. For this purpose, he should exercise care in the safe custody of his negotiable instruments and he should exercise care in the negotiation of such documents.

(iii) Should the said party fail to comply with the above mentioned duty the law should, in instances where the failure to exercise care results in a loss, allocate to him the evolving risk. He should be denied the right to exercise a recourse against his prior obligor or obligors on either the instrument or the underlying obligation. He should be denied the right of challenging the bona fide third party acquirer's good title to either the instrument or its proceeds. Finally, he should be denied the right of challenging the bona fide drawee payor's act of payment and he should be denied the right of demanding from the drawee payor a fresh payment in his, i.e. the original true owner's favour.

The Compatibility of Allocating the Risk of the Forgery of an Indorsement to the Original True Owner with the Promotion of Negotiable Instruments.

(i) The allocation of the duty to exercise care, or the allocation of the loss resulting from the forgery of an

indorsement to the original true owner does not restrict the objective of promoting the institution of negotiable instruments. On the one hand, the compliance with the duty to exercise care generates an enforceable value in favour of the original true owner. It increases the reliability of the said party in the market. It encourages the commercial community to advance credit in his favour and ultimately it promotes his business.[31] On the other hand, the allocation of the loss resulting from the forgery of an indorsement to the original true owner is not unreasonable in instances where the occurrence of the loss in question arises from the said party's failure to exercise care. Due to the special nature of negotiable instruments as documents possessing the attributes of money, their proprietor, i.e. owner, ought to foresee that the failure to exercise care in their safe custody and acquisition could facilitate their misuse and ultimately it could result in a loss to a bona fide third party. If the original true owner of such an instrument determines not to exercise care in the safe custody and negotiation of his instrument with the knowledge that the failure to comply with the said duty could result in a loss to a bona fide third party, he would be presumed to have consented to assume the resulting loss. He would be presumed to deem the resulting loss less detrimental to him than the burden involved in the exercise of care. Accordingly, it would be reasonable to allocate to the

said party the loss which he prima facie consented to assume.

Finally, and due to his status as a party in control of the negotiable instrument, the original true owner is presumed to be in the position to avoid the hardship resulting from the exercise of care or from the allocation of the loss to him. This he can maintain by negativing or restricting the negotiability attribute of his instrument. In such an instance, he would be divesting the instrument of its special nature as a substitute for money. Once the instrument was divested of the characteristic of money, the considerations underlying its promotion as such would be irrelevant. The considerations underlying the formulation of its risk allocation rule would likewise be irrelevant.[32] Accordingly, the parties to whose favour the protection arising from the application of the negotiability concept would have been established had the negotiability attribute been preserved, would not qualify for the said protection in instances where the negotiability attribute was negatived or restricted. In such an instance the standard of care allocable to the said parties would be restored to the limit which the general rule of law requires, namely, to that of the reasonable man or to that of the rational man. The failure to comply with the said standard of care would place the party in question in the shoes of the negligent party. Accordingly, the law would allocate to him the loss resulting from his negligence.

The Compatibility of the Parties' Ability to Provide Against the Forgery of an Indorsement with Other Interests

(i) The other interests relevant for determining the risk allocation rule, in the context of negotiable instruments are, the interest of the public at large and the notion of fairness and justice.[33] The interest of the public would be protected once the perpetration of fraud, such as the forgery of an indorsement and the occurrence of loss are avoided. As has been shown earlier,[34] each of the involved competing parties, namely, the original true owner, the bona fide third party acquirer and the drawee payor, in theory is in the position to provide against the forgery of an indorsement and/or against the occurrence of loss. Each can provide against the said risk by the exercise of care. The original true owner can provide against the forgery of an indorsement and the occurrence of loss by the exercise of care in the safe custody and the negotiation of negotiable instruments. The bona fide third party acquirer can provide against the said risk by the exercise of care in the acquisition of such instruments, and the drawee can provide against the loss resulting from the forgery of an indorsement by the exercise of care in his act of payment.

(ii) Nevertheless, the allocation of the duty to exercise care to either of the above mentioned parties does not always result in an equitable risk allocation rule. In particular, the allocation to the bona fide

third party acquirer of the duty to exercise care in the acquisition of negotiable instruments, results in an economic detriment to him. The compliance with such a duty involves cost and time. The said cost and time arise from the information shopping concerning the status of the presented instrument, the identity of its possessor and the validity of his title. The bona fide third party acquirer does not derive a practical enforceable value from the information shopping. And due to his status as such, he is not normally in a position to absorb the evolving cost and time. The said cost and time represents to him a misallocation of wealth.[35]

(iii) As far as the drawee payor is concerned, although the allocation of the duty to exercise care in his act of payment does not create an economic detriment to him, its observance is firstly incompatible with the special nature of negotiable instruments and, secondly, it results in an undue hardship to the genuine acquirer. It could cause the latter to forego a valuable security on the instrument, or it could cause him to disturb his commercial arrangements. It, ultimately, and due to the above mentioned inconveniences, could deter the commercial community from acquiring negotiable instruments. Once the commercial community was deterred from acquiring negotiable instruments, the free transferability of such documents would be restricted. Accordingly, the objective of promoting the institution of negotiable instruments would fail.[36]

(iv) The allocation of the duty to exercise care to the original true owner is not, by comparison, inconsistent with the notion of fairness and justice. Although the compliance with such a duty involves cost and time, the said cost and time generate an enforceable value in favour of the said party. Their investment increases the reliability of the original true owner in the market, it encourages the commercial community to advance credits in his favour and finally, it results in promoting his business.[37] Since the original true owner is in the position to derive an enforceable value from the exercise of care, it would be fair and reasonable to allocate such a duty to him. If he fails to exercise care, it would be fair and just to allocate the resulting loss to him. The blame for causing the loss in such an instance should be allocated in its entirety to the said party.

The Party to Whom the Risk of the Forgery of an Indorsement Should be Allocated.

(i) The party to whom the risk of the forgery of an indorsement should be allocated is the party who is, firstly, better situated to provide against the said risk and secondly, the party to whom had the risk been allocated, it would have satisfied more efficiently the considerations underlying the risk allocation rule in the context of negotiable instruments. Since, as has been established above,[38] the original true owner of a negotiable instrument, in instances of payment as well as

dishonour is, firstly, better situated to provide against the forgery of an indorsement and secondly the allocation of risk to him satisfies more efficiently the objective of promoting the institution of negotiable instruments, and it serves to protect the reasonable expectations of the commercial community, the interest of the public to have the crime of forgery avoided, and the notion of fairness and justice,[39] the loss resulting from the said risk should be allocated to the party in question.

(ii) In either instance, the original true owner, i.e the party from whom the negotiable instrument was stolen, should be divested of the holder status. He should be denied the right of claiming the surrender of the instrument from its bona fide acquirer and he should be denied the right of claiming from the latter the surrender of the proceeds of the said instrument. If the original true owner was afforded the right of claiming the instrument or its proceeds from the bona fide acquirer, he would be allocating the risk of the forgery of an indorsement to the latter. Such an application as could be noted, is inefficient. It indicates that the bona fide third party acquirer bears the blame for causing the loss. It attributes the occurrence of loss to the acquirer's failure to exercise care.

To state the obvious, the blame for causing the loss cannot be attributed to the bona fide third party acquirer. As has been established above,[40] the said party is in no position to provide against the loss in

question efficiently. The allocation of the duty to exercise care in the acquisition results in an economic detriment to him. The allocation of the said duty to the bona fide third party acquirer moreover is inconsistent with the considerations underlying the determination of the risk allocation rule in the context of negotiable instruments. On the one hand, it could restrict the objective of promoting the institution of negotiable instruments. On the other hand, its application violates the notion of fairness and justice in the sense that it throws the resulting loss on the party least able to provide against it, whilst it relieves the most able party of the said loss.

(iii) By divesting the original true owner of the holder status, the said party should be denied the right of exercising a recourse on the instrument or the underlying transaction against a prior obligor, such as the maker or drawer of a negotiable instrument. The original true owner should also be denied the right of claiming the payment of the instrument from the drawee and he should be denied the right of challenging the validity of the former's act of payment in instances where it is made in favour of a bona fide third party acquirer. If the said party was allowed to exercise a right of recourse against his prior obligor or he was allowed to assert the above mentioned entitlements against the drawee, he would be compelling the other competing party to make double

payments, one in favour of the bona fide acquirer and the other in his favour, i.e. the original true owner. In fact, the original true owner in such an instance would be allocating the risk of the forgery of an indorsement to the other competing party, namely, the prior obligor or the drawee payor. This is tantamount to suggesting that the said competing parties bear the blame for causing the loss.

To state the obvious, the suggestion that the prior obligor or the drawee payor bears the blame for causing the loss resulting from the forgery of an indorsement, is erroneous. As has been established above,[41] the prior obligor, such as the maker or drawer is in no position to provide against the forgery of an indorsement or the occurrence of loss. This is due to the fact that, in instances where the prior obligor secures the delivery of the instrument to its intended transferee, he is deemed to forfeit his control on the instrument. As far as the drawee payor is concerned, although he is presumed to be in a position to provide against the occurrence of loss, it is submitted that, due to the special nature of negotiable instruments, and for the purpose of promoting the institution of such documents, the allocation of the duty to exercise care to the drawee, through which the said party could provide against the occurrence of loss, is not practicable. Accordingly, the drawee, in practice, is not deemed to be in a position to provide against the loss in question.

The Party to Whose Favour the Risk of the Forgery of an Indorsement Should be Established.

(i) The party to whose favour the risk arising from the forgery of an indorsement should be established is:

1) the party who is unable to provide against the said risk, or,

2) the party to whom, had the risk in question been allocated, it would have damaged the considerations underlying the determination of the risk allocation rule in the context of negotiable instruments.

The parties who could fall within either of the above mentioned categories and ultimately could claim in their favour the establishment of the risk of the forgery of an indorsement, are the prior obligor such as the maker or drawer of a negotiable instrument, the bona fide third party acquirer and the drawee payor. As has been established earlier,[42] the prior obligor, due to his forfeiture of the power to exercise an effective control on the instrument which the forgery of an indorsement subsequently vitiates, is presumed to be unable to provide against the occurrence of the said risk. Although, in theory, the bona fide third party acquirer and the drawee payor are presumed to be in a position to provide against the forgery of an indorsement and/or the occurrence of loss, it is submitted that the allocation of the said risk

to them would either result in an inefficient risk allocation rule, or it would restrict the objective of promoting the institution of negotiable instruments.

(ii) An inefficient risk allocation rule would result if the risk of the forgery of an indorsement was allocated to the bona fide third party acquirer. In such an instance, the risk allocation rule deems the acquirer's failure to exercise care in his acquisition as the cause of the forgery of an indorsement. As could be noted, the rule in question allocates the duty to provide against the forgery of an indorsement to the bona fide third party acquirer. To state the obvious, for the allocation of the duty to provide against a particular risk to be efficient, it should be allocated to the party who is in a position to derive an enforceable value from the evolving cost and time or to the party who is in a position to absorb such cost and time. To allocate the duty in question otherwise, the risk allocation rule could result in a misallocation of wealth.

In the context of negotiable instrument fraud the bona fide third party acquirer is not presumed to be in a position to derive a practical enforceable value from the cost and time involved in the information shopping i.e the care through which the said party can provide against the forgery of an indorsement. Moreover, due to his status as such, the bona fide third party acquirer is not presumed to be in a position to absorb the said cost and

time.[43] In other words, the exercise of care as illustrated by the information shopping, results in a misallocation of wealth against the party in question. Thus, it would be inefficient to allocate to the said party, the duty to exercise care in his acquisition. Ultimately it would be inefficient to allocate to him the risk of the forgery of an indorsement, by reason that he failed to observe the said care.

(iii) The objective of promoting the institution of negotiable instruments would be restricted, by comparison, if the risk of the forgery of an indorsement was allocated to the drawee payor. For the drawee to avoid the allocation of the risk to him, he would have to investigate every presented instrument. To this end, he would have to shop for information concerning the status of the instrument in question, the identity of its possessor and the validity of his title. Such a duty involves time. The time involved in the information shopping may overlap with the maturity of the instrument. Accordingly, it could prevent the said instrument from being liquidated into money immediately, or it could discharge a potential liable party.[44] The information shopping, in such an instance, damages the interest of the genuine acquirer of a negotiable instrument. It, firstly, causes him to forego the opportunity to satisfy his commercial interest in an efficient manner and, secondly, it causes him to forego a valuable security. Due to the above mentioned inconveniences, the information

shopping could deter the commercial community from acquiring negotiable instruments. Once the commercial community was deterred from acquiring negotiable instruments, the free transferability of negotiable instruments would be restricted and ultimately the objective of promoting the institution of negotiable instruments would fail.

(iv) The establishment of the risk of the forgery of an indorsement in favour of the prior obligor, the bona fide third party acquirer and the drawee payor, involves the establishment of particular entitlements in favour of the above mentioned parties. It, on the one hand, entitles the obligor, such as the maker or drawer, to have himself discharged on the instrument, as well as the underlying obligation. On the other hand, it entitles the bona fide third party acquirer to have the good title rule established exclusively in his favour. Accordingly, it entitles him to have the incorporated credit enforced in his favour against prior liable parties and in instances of payment, it entitles him to retain the proceeds of the acquired instrument. Finally, the establishment of the risk of the forgery of an indorsement in favour of the above mentioned competing parties, entitles the drawee payor to be discharged from his obligation with his customer, i.e. the maker or drawer of a negotiable instrument. Accordingly, it entitles the former to have his act of payment validated.

The Scope of the Rule of Establishing the Risk of the Forgery of an Indorsement in Favour of the Prior Obligor, the Bona Fide Acquirer and the Drawee Payor.

(i) The establishment of the foregoing entitlements should not be absolute. There are instances in which the protected competing parties should be denied the said entitlements. The instances in which the competing party should be denied the entitlements arising from the allocation of the risk of the forgery of an indorsement to the original true owner, are:

1) those in which the competing party in question was alerted or ought to have been alerted to the theft or loss of the negotiable instrument according to which the forgery of an indorsement was materialised, and,
2) those instances in which the competing party's behaviour has caused or contributed to the occurrence of loss.

(ii) The competing party would be alerted to the theft or loss of an instrument when the said information was brought home to him. The loss or theft of his instrument would be brought home to the competing party when the original true owner informs the said party directly of its occurrence, or when the original true owner makes the said information available to the competing party in question. Knowledge of the theft or loss of an instrument would be made available to the competing party when the original true owner secures the publication of such information in

the official gazette of the jurisdiction in which he resides.[45]

The Duty of Care Allocable to the Competing Party to Whom the Information Relating to the Theft or Loss of a Negotiable Instrument was made Available.

(i) In instances where the information relating to the theft or loss of a negotiable instrument was brought home to the competing party, the said party should behave in a manner so as to avoid the occurrence of loss. The behaviour necessary to avoid the occurrence of loss in such instances varies according to the status of the competing party to whom the theft or loss of the instrument was made available. If the said competing party was a prior obligor, such as the maker or drawer of a negotiable instrument, the behaviour necessary to avoid the occurrence of loss would be to pass the information in question to the party who is in the position to provide against the occurrence of loss.

(ii) In instances where the competing party to whom information relating to the theft or loss of the negotiable instrument was initially made available was the issuer of the instrument, the behaviour necessary to render the said information available to another potential party such as the drawee, would be the issuance of a stop payment order. Through such practice, the maker or drawer of the negotiable instrument would be directing his debtor, i.e. the drawee to dishonour the presented mandate

i.e. instrument. In such an instance, the maker or drawer would be providing against the erroneous payment of a negotiable instrument. Accordingly, the said party, by the issuance of the stop payment order would be providing against the occurrence of loss.

(iii) In instances where the competing party to whom the theft or loss of the negotiable instrument was initially made known was a prior indorsor, the behaviour necessary to avoid the occurrence of loss would be to facilitate the issuance of the stop payment order. To this end, the prior indorsor would have to communicate the theft or loss of the instrument in question to the issuer of the mandate i.e. the maker or drawer of the said instrument. The right to issue a stop payment order is not established in favour of other than the maker or drawer of the negotiable instrument. The stop payment order is a direction addressed to another. For the addressee to be bound by such a direction, he should be under a duty to comply with it. In order for the party to be under a duty to comply with another's direction, he should be related with him. The drawee of a negotiable instrument does not engage with other than his customer i.e. the maker or drawer of the negotiable instrument. Since the drawee does not engage with the indorsor of a negotiable instrument, he is not deemed to be related with him. Accordingly, he is not legally bound to comply with the latter's mandates such as the stop payment order.

(iv) In instances where the information relating to the theft or loss of the negotiable instrument was brought home to the bona fide third party acquirer, the behaviour necessary to avoid the occurrence of loss would be the abstention from acquiring the offered instrument. In such an instance, the third party's non-acquisition would frustrate the fraudulent intention of the forger. Accordingly, the latter would be disabled from exchanging the intercepted instrument for value. That is to say that the forger, in instances where his fraudulent practice was made public, would not be able to liquidate the credit incorporated in the stolen or lost instrument. The instrument, in its status as such, would operate in his possession as a worthless piece of paper.

(v) Finally, in instances where the occurrence of the theft or loss of the negotiable instrument was brought home to the drawee, the behaviour necessary to avoid the occurrence of loss would be to refuse payment on the presented instrument. In such an instance, the non-payment of the presented instrument has a substantially similar impact to that arising from the non-acquisition of the offered instrument. It could frustrate the fraudulent intention of the forger in that it deprives him of the opportunity to divert the incorporated credit to his favour. Once the forger was deprived of the opportunity of enforcing the incorporated credit in his favour, the risk of loss occurrence would be avoided.

The Compatibility of Allocating to the Competing Party the Duty of Exercising Due Care with Economic Efficiency.

The allocation to the prior obligor, the bona fide third party to whom the instrument was offered for a valuable exchange and the drawee, of the duty to behave in the above mentioned manner, does not result in an economic detriment to the competing party in question. The compliance with the said duty does not involve undue cost and time. In order to discharge his duty, the prior obligor would not need to do more than to inform in good time, the potential party i.e. the party who is in the position to provide against the occurrence of loss, of the theft or loss of the negotiable instrument. The bona fide third party and the drawee, by comparison, would not need, in order to discharge their respective duties, to do more than consult the record from which the information in question could be collected. The record from which the said information could be collected is normally readily available to the party in question. This is more apparent in instances where the party to whom the duty to investigate the irregularity of the negotiable instrument is allocated, was the drawee. The record from which the said information could be collected is compiled by him and is constantly in his custody and under his supervision.

The Risk Arising from the Failure to Exercise Due Care.

(i) If the competing party in question fails to comply with the above mentioned duty and his non-compliance

results in the occurrence of loss, the resulting loss should be allocated to the said party. He should be denied the entitlement arising from the allocation of the risk of the forgery of an indorsement to the original true owner. In instances where the negligent competing party was the prior obligor, he should be denied the right of being liable for a single payment. His failure to render the information relating to the theft or loss of the negotiable instrument public in a timely manner, and his failure to issue or facilitate the issuance of the stop payment order should, firstly, deny him the right of having himself discharged on the instrument as well as the underlying obligation. Secondly, it should deny him the right of challenging the bona fide third party acquirer's good title to the instrument or its proceeds and finally, it should deny him the right of challenging the validity of the drawee's act of payment.

The prior obligor's failure to inform the potential party of the theft or loss of the negotiable instrument is presumed to be the cause of loss occurrence. On the one hand, it is presumed to cause the true owner to forego the opportunity to prevent the stolen or lost instrument from coming into the possession of a bona fide third party or from being bona fide paid by the drawee. On the other hand, the prior obligor's failure to comply with the said duty is presumed to mislead the bona fide third party acquirer and the drawee payor as to the true status of the offered or presented instrument. Due to his failure as such, the prior obligor is presumed to mislead the bona

fide third party acquirer in his acquisition and to have misled the drawee payor in his payment.

Since the prior obligor's failure to inform the potential party of the theft or loss of the negotiable instrument is presumed to be the cause of the loss occurrence, the party against whom the said loss is directed should be entitled to recoup the loss in question from the negligent party e.g. the prior obligor. The original true owner, for example, should have his entitlement arising from the underlying transaction revived. The bona fide third party should be entitled to have the acquired instrument enforced against the negligent prior obligor or to have a good title to the paid proceeds established in his favour. And finally, the drawee payor should be entitled to have his act of payment validated.

(ii) In instances where the negligent competing party was the bona fide third party acquirer, he should be denied the good title protection, that is to say that the said party should be denied the protected holder status. Accordingly, he should be denied the right of enforcing the incorporated credit against a prior liable party, and in instances of payment, he should be denied the right to retain the erroneously paid proceeds. He should either account for the erroneous payment to the original true owner, or he should account for the same to the drawee payor.

The bona fide third party's failure to consult, prior

to his acquisition, the official gazette from which the information relating to the theft or loss of a negotiable instrument could be collected is presumed to cause the occurrence of the loss.[46] Due to the bona fide third party's failure to comply with the above duty, the said party is presumed to frustrate the original true owner's intention to protect his property. The latter party's intention to protect his property is manifested by his publication of the loss and theft of his instrument in a record, the contents of which are readily available to every member of the public. Due to the third party's failure to comply with the duty under consideration, he is presumed to frustrate the desire to prevent the erroneous payment of the stolen or lost instrument. The desire to prevent the erroneous payment of the said instrument is manifested by the publication of its theft or loss. Finally, due to the said party's failure to comply with the above mentioned duty, he is presumed to cause the drawee payor to erroneously pay the lost or stolen instrument. The bona fide third party, by acquiring a negotiable instrument purporting to bear a regular chain of indorsements, is presumed to represent to the latter his lawful holder status. In reliance on such a representation, the drawee is presumed to have accepted to cash the lost or stolen instrument in favour of the negligent acquirer.

Since the third party's failure to comply with the required duty is presumed to be the cause of loss occurrence, the said loss should not be allocated to the

other competing parties. The maker or drawer of the lost or stolen instrument should not be held liable on it to the negligent acquirer. The original true owner should have the protected holder status restored to him. He should be entitled to claim from the negligent acquirer the surrender of the instrument in question or its proceeds in instances of payment. And finally the drawee payor should be entitled to claim the return of the erroneously paid proceeds from the said party insofar as the return of the paid proceeds does not cause the acquirer a detrimental alteration in his position. If the drawee's entitlement to claim the return of the erroneously paid proceeds was to cause a detrimental alteration in the acquirer's position, the loss resulting from the erroneous payment should be divided between the competing parties in proportion to their degree of negligence.

(iii) In instances where the negligent competing party was the drawee, he should be denied the right of having his act of payment validated. Accordingly, he should be denied the right of charging to his customer the erroneous payment of the lost or stolen instrument. He should be denied the right of not making a fresh payment in favour of the original true owner and he should be denied the right of claiming in full the return of the erroneously paid proceeds from the bona fide third party acquirer recipient.

The drawee's failure to consult, prior to his

payment, his own record from which the information relating to the theft or loss of the negotiable instrument could be collected is presumed to be the cause of the loss occurrence. Due to his failure to comply with the said duty, the drawee is presumed to frustrate the original true owner's intention to protect his property. Due to the failure to comply with the required duty, the party in question is presumed to frustrate his customer's intention to prevent the occurrence of the erroneous payment of the stolen or lost instrument. And due to the failure to comply with the duty to consult his own record, the drawee is presumed to cause the bona fide recipient a detrimental alteration in position. By honouring the presented stolen or lost instrument, the drawee purports to represent to the recipient that the instrument in question is regular. In reliance on such a prima facie representation the recipient is presumed to base his financial status as to prior obligors as well as other related transactions.

Since the drawee's failure to comply with the required duty is presumed to be the cause of loss occurrence, the said loss should be allocated to him. The competing parties whose interests are affected by the drawee's negligent behaviour should be afforded a reasonable protection. The maker or drawer of the stolen or lost instrument for an example should be entitled to have his account re-credited as if the erroneous payment had not occurred. The original true owner should be entitled to have a fresh payment established in his

favour, and the bona fide third party recipient should be entitled to retain a portion of the erroneously paid proceeds to the extent to which the drawee's negligence could be blamed for contributing to the former's detrimental alteration in position.

The Reasonableness of the Rule of Allocating the Risk of the Forgery of an Indorsement to the Careless Competing Party.

The allocation to the negligent competing party of the loss resulting from the theft or loss of a negotiable instrument and the subsequent forgery of its essential indorsement is not unreasonable. By informing the competing party in question of the theft or loss of the negotiable instrument or by rendering such information available to the said party, the original true owner is presumed to have provided against the occurrence of loss. By such behaviour, the said party is presumed to have remedied the situation which his failure to exercise care in the safe custody and negotiation of his instrument has created. Accordingly, the original true owner, by informing the other competing party of the theft or loss of his instrument is presumed to have discharged himself of any blame for causing the loss. In such an instance, the competing party to whom the information relating to the theft or loss of the negotiable instrument was made available, is presumed to possess the last clear chance for providing against the occurrence of loss. In order

for him to discharge the said duty, he should behave in a manner described above. If he fails to comply with the said behaviour, the blame for causing the loss should be allocated to him. In such an instance, it would be reasonable to deem the negligent competing party liable for causing the loss. Accordingly, it would be reasonable to allocate to the said party the loss resulting from his negligent behaviour.

The Rule of Contributory Negligence and Its Impact on the Problem of Risk Allocation

(i) In the context of contributory negligence, i.e. comparative negligence, the determination that a particular behaviour is a contributing factor for causing a particular loss necessarily presumes the involvement of a counter-behaviour as a contributing factor for causing the said loss. That is to say that in the context of contributory negligence there should always be more than one careless party, each of whom bears the blame for causing the loss in question.

(ii) In instances where the resulting loss arises from the conversion of a tangible property, the parties to whom the blame for the occurrence of loss in question could be attributed are, the proprietor of the converted property, i.e. the party from whom or by whom the property in question was stolen or lost, and the acquirer of the said property, i.e. the party to whose favour the thief or finder transfers the converted property. The blame

attributable to the proprietor for causing the loss is illustrated by his failure to exercise care in the safe custody of his property. The blame attributable to the acquirer by comparison is illustrated by his failure to exercise care in his acquisition. The prior proprietor, i.e. the party from whom the property was initially acquired, cannot be blamed for causing the loss. Due to the delivery of the property in question, to the intended transferee, the prior proprietor is presumed to forfeit his control upon the said property and ultimately he is presumed to be unable to provide against its misuse.

(iii) In instances where the loss in question arises from the interception of a negotiable instrument, the forgery of its proprietor's indorsement and its negotiation in favour of a bona fide third party, the proprietor of such a document, i.e. its original true owner, bears the blame for causing the loss as long as he does not inform in a timely manner the potential party such as his prior transferor i.e. obligor, of the theft or loss of his instrument. In such an instance the latter party due to his unawareness of the theft or loss of the instrument is presumed to be unable to provide against the occurrence of loss. The blame attributable to the original true owner for causing the loss is firstly illustrated by his failure to exercise care in the safe custody and or the negotiation of his instrument and secondly by his failure to remedy the above situation by rendering the information relating to the theft or loss of

his instrument, available to a potential party such as the bona fide third party. The failure to comply with either of the foregoing duties is presumed to mislead the bona fide third party as to the true status of the offered or presented instrument. Ultimately it is presumed to mislead the said party in his acquisition or payment of the said instrument.

The other party to whom the blame for causing the loss in instances of the theft or loss of a negotiable instrument could be attributed, is the convertor of such a document. In the context of negotiable instruments the convertor of such document involves the acquirer and the drawee payor. The acquirer of a stolen or lost instrument, is deemed to be its convertor, because he establishes his title to it from or through other than its original true owner. The acquirer of such a document establishes his title to it from or through its thief or finder i.e. the forger. In instances of payment the acquirer of a stolen or lost instrument is deemed to convert its proceeds. Due to the establishment of the property right to the instrument from or through other than its original true owner, the acquirer is presumed to have received the proceeds which belong in practice to the said party.

The drawee in instances of payment by comparison is deemed to be the convertor of the stolen or lost instrument as well as its proceeds. One the one hand, by making payment on the negotiable instrument, the drawee payor retains the paid instrument as evidence of payment

and in order to avoid its re-presentment and ultimately its payment. On the other hand by making payment the drawee debits his customer's account with the face value of the paid instrument. His act of debiting the customer's account with the paid instrument indicates that the drawee has appropriated the proceeds of the presented instrument in favour of the party to whom they in practice belong, i.e. the proprietor of the said instrument. In instances where the drawee pays someone other than the proprietor, i.e. original true owner, he is presumed to acquire the instrument from other than its proprietor and he is presumed to appropriate its proceeds in favour of other than the party to whom they belonged.

The Determination of the Duty of Care Allocable to the Convertor of a Negotiable Instrument the Breach of Which may involve the Application of the Rule of Contributory Negligence.

(i) The convertor of a stolen or lost instrument is deemed to bear the blame for causing or contributing to the occurrence of loss, if the careless behaviour which gave rise to the loss in question was the result of the convertor's failure to exercise "manageable care".[47] In order for the duty to exercise care to be manageable to the convertor, it should firstly be economically efficient and secondly its observance should not damage the considerations underlying the determination of the risk allocation rule in the context of negotiable instruments.

The compliance with the duty to exercise care would be economically efficient if,

1) it generates an enforceable value in favour of the party to whom it is intended to be allocated, or,

2) the cost and time evolving from it are absorbable by such a party.

The considerations underlying the determination of the risk allocation rule in the context of negotiable instruments would be damaged if,

1) the objective of promoting the institution of negotiable instruments was restricted, or,

2) the notion of fairness and justice was violated.

From the foregoing it appears that the only instance whereby the convertor of a stolen or lost instrument could be blamed for causing or contributing to the occurrence of loss, in instances where the original true owner does not render the information relating to the theft or loss of his instrument available to the potential party, is that when the former behaves with gross negligence in his acquisition or payment. The convertor of a stolen or lost instrument is presumed to be guilty of gross negligence if he fails to safeguard his interest in suspicious circumstances. The appropriate behaviour through which the convertor could safeguard his interest in such circumstances is non-acquisition or information shopping in instances where the convertor was the bona

fide third party to whom the stolen or lost instrument was offered for a valuable exchange. In instances where the convertor was the drawee, the appropriate behaviour through which the said party could safeguard his interest, is non-payment of the presented instrument, or information shopping, concerning the status of the said instrument, the identity of its possessor and the validity of his title.

(ii) The circumstances which compel the convertor to safeguard his interest, vary, according to whether the convertor was the bona fide third party, or the drawee. In instances where the convertor was the bona fide third party, he would be under a duty to safeguard his interest, if the four corners of the offered instrument or the surrounding circumstances raise suspicion as to the regularity of the instrument or the validity of its possessor's title. An example of the instance whereby the four corners of the offered instrument raise suspicion as to its regularity, is the instrument which bears an irregular chain of indorsements, such as that which specifies on the face of it that it is payable to William Smith, whilst it purports to be indorsed in the name of William Smythe. In such an instance the third party to whom the said instrument was offered for a valuable exchange should, prior to his acquisition, investigate the regularity of the instrument and the validity of its possessor's title. Should he deem the cost and time required for his investigation more onerous than the value

derivable from such behaviour, the bona fide third party is presumed to be in a position to avoid the said hardship. This he can maintain by refraining from acquiring the offered instrument.

An example of the instance whereby the circumstances surrounding the acquisition of a stolen or lost instrument could raise suspicion as to its regularity or the validity of the title of its possessor, is that which purports to indicate that the character of the possessor who intends to exchange his instrument for value does not suggest that he is the ostensible endorsee. Such an instance could occur when the offered instrument purports to be issued for a large sum and indorsed in favour of a person of an English name such as Walter Tyler, whilst the character of the person offering it for value who claims to be Walter Tyler purports to suggest that he is a poor class African citizen. The fact that the offered instrument purports to be issued for a large sum and payable to an English person whilst the character of its possessor suggests that he is African and shabby, raises suspicion that the said person is not the indorsee, namely Walter Tyler. Accordingly, it indicates that his title is invalid. In such an instance, the third party to whom such an instrument is offered for a valuable exchange should safeguard his interest. He should either shop for information as to the true identity of the possessor or he should refrain from its acquisition. The third party to whom such an instrument was offered for a valuable exchange, should either investigate its regularity and if

he deems such an investigation to be unduly onerous, he should refrain from its acquisition.

(iii) In instances where the convertor was the drawee he would be under a duty to safeguard his interest, if the four corners of the presented instrument raise suspicion as to its regularity. The four corners of the presented instrument would raise suspicion as to its regularity if the said instrument bore an irregular chain of indorsements. In such an instance the drawee should investigate the regularity of the presented instrument, the identity of its possessor and the validity of his title. Should he deem the compliance with such a duty unduly onerous he may refuse the payment of the presented instrument. Such behaviour enables him to provide against the occurrence of loss without the need of assuming undue cost and time.

The non-payment of an irregular instrument does not subject the drawee to liability. As between himself and his customer, the drawee is under no duty to honour the latter's mandates, as long as they do not comply with the required form. It is submitted that, for a document to qualify as a negotiable instrument, it must be regular on the face of it. That is to say that it must among other things bear indorsements in conformity with the purported indorsees. As between the drawee and the proprietor of a negotiable instrument, the former is not liable per se, on the instrument, to its proprietor. The drawee does not normally engage with the said party. Accordingly he is

under no duty to honour the presented instrument. Thus if the drawee dishonours the presented instrument, the proprietor of such a document may not, in the absence of a special arrangement, claim damages from the drawee.[48]

(iv) Finally the drawee should not be burdened with the duty to safeguard his interest in instances where it is only the circumstances surrounding the payment of the presented instrument which raise suspicion as to its regularity or the validity of the title of its possessor.

Unlike the bona fide third party to whom the instrument was offered for a valuable exchange the drawee in such an instance does not have a practical choice. In instances where the four corners of the presented instrument do not reveal the existence of an irregularity, the drawee cannot safely refuse its payment. The suspicion which the drawee possesses as to the regularity of the presented instrument or the validity of its possessor's title, might be erroneous. As far as the above illustration is concerned,[49] the shabby African possessor may be the named indorsee of the large instrument, i.e. Walter Tyler. His Afraican appearance could be due to his resemblance to his African mother whom his father married whilst he was on a military mission in that Continent. Thus if the drawee decided in reliance on the surrounding suspicious circumstances, to dishonour the presented instrument, he may render himself liable to his customer, i.e. the maker or drawer of the dishonoured instrument. And in instances where the said party was a

merchant, the damages for which the drawee could be liable, may be substantial. It may include those caused to the customer's business.[50]

(v) In fact the only practical choice with which the drawee is left is to pay the presented instrument. The argument that the drawee possesses the choice of information shopping as a technique through which he can reveal the regularity of the presented instrument, the identity of its possessor, and the validity of his title, and ultimately can provide against the occurrence of loss, is not entirely satisfactory. As has been shown earlier,[51] information-shopping damages the interest of the genuine acquirer. It on the one hand, prevents the negotiable instrument from being liquidated into money on its day of maturity. Accordingly, it deprives the genuine acquirer of the advantage of satisfying his credit in an economically efficient manner. On the other hand, and due to the involvement of time, the information shopping could overlap with the maturity of the acquired instrument. Accordingly, it could discharge a potential liable party. The genuine acquirer would in the last analysis forego the opportunity to enforce his instrument against a valuable security. Due to the above inconveniences the commercial community might be deterred from acquiring negotiable instruments. Once the commercial community was deterred from acquiring negotiable instruments, the objective of promoting the said institution would fail.

The Reasonableness of the Rule of Allocating the Duty to Exercise Due Care to the Convertor of a Negotiable Instrument.

(i) The allocation to the convertor of the duty to safeguard his interest in instances where the offered or presented instrument or the circumstances surrounding its acquisition or payment, raise suspicion as to its regularity or the validity of its possessor's title, is not unreasonable. The offered or presented document in such an instance would either fail to qualify as a proper negotiable instrument or the necessities of the market would require the observance of some care. The fact that the market requires the observance of some care is obvious in that the objective of the said institution is to maximise value. An efficient means of value maximisation is to avoid loss occurrence. Loss occurrence would be avoided once the parties, proximate to the accident which could give rise to the occurrence of loss, exercise some care in their behaviour.

(ii) A potential proximate party to the forgery of an indorsement is the third party to whom the stolen or lost instrument was offered for a valuable exchange. The forgery of an indorsement and ultimately the occurrence of loss would be significantly avoided once the third party exercises some care in his acquisition in instances where the circumstances surrounding the offered instrument raise suspicion as to its regularity. Moreover should the compliance with such a duty prove to be unduly onerous,

the market offers the third party a practical choice whereby he could avoid the occurrence of loss as well as the hardship arising from the exercise of some care. The said choice is illustrated by the non-acquisition of the offered instrument.

Summary

(i) From the foregoing, the proposed risk allocation rule could be summarised as follows:
In instances where the risk in question arises from the forgery of an essential indorsement, it should be allocated to the party from whom the instrument which the forgery vitiates was stolen or lost, i.e. the original true owner. The evolving loss should accordingly be sustained by him. The application of the said rule should be maintained in instances where the vitiated instrument was paid or dishonoured. The original true owner, in either instance, should be denied the right of exercising a right of recourse against his innocent prior obligor. He should also be denied the right of challenging the bona fide third party acquirer's good title to the vitiated instrument or its proceeds. And finally, he should be denied the right of challenging the innocent drawee payor's act of payment. Accordingly, he should be denied the right of demanding a fresh payment to his favour.

In such instances, it is submitted that the original true owner is better situated to provide against the

forgery of an indorsement. This is due to the fact that the forgery occurs whilst the instrument which it vitiates was under his control. And by the exercise of an effective control, the original true owner is presumed to be in the position to provide against the said risk. This can be maintained by the exercise of due care in the safe custody and negotiation of negotiable instruments.[52] Although the compliance with such a duty involves cost and time, it is not incompatible with economic efficiency. The involved cost and time are, firstly, directed to protect a valuable property and secondly, they generate an enforceable value in favour of the original true owner.[53]

The remaining competing parties, namely, the prior obligor such as the maker or drawer, the bona fide third party acquirer and the drawee payor are not, by comparison, in the position to provide against the forgery of an indorsement. This is due either to their remoteness from the fraudulent practice which renders them virtually unable to provide against its occurrence or it is due to their inability to provide against it in an economically efficient manner.[54]

(ii) The allocation of the risk of the forgery of an indorsement to the original true owner satisfies more efficiently the considerations underlying the determination of the risk allocation rule in the context of negotiable instruments. It, firstly, promotes the function of negotiable instruments as a substitute for money. This it approaches by protecting the reasonable

expectations of the community engaging in the business of acquiring and paying such documents. It assures the members of the said community that the negotiable instrument transaction to which they engage is secured, as long as the circumstances surrounding it do not indicate the existence of an irregularity. Ultimately, it assures the party who determines to take the offered instrument up for value and in good faith, that a good title to the said instrument will be established in his favour, whilst it assures the drawee who bona fide determines to meet the presented instrument, of an operative act of payment.[55]

Secondly, the allocation of the risk of the forgery of an indorsement to the original true owner satisfies the interest of the public to have the commission of the said crime avoided. This it approaches by deterring the said party from not exercising due care. It warns him of the detrimental consequences of not complying with the said duty. It induces him to exercise care in the safe custody and negotiation of his instruments. Once the original true owner was under a duty to exercise care in his business, he would frustrate the fraudulent intention of the fraudulent person. By the exercise of due care, he would prevent the instrument from coming into the possession of a fraudulent person. Ultimately, and by such behaviour, he would be rendering it impossible for the latter to perpetrate his fraud.[56]

Thirdly, the allocation of the risk of the forgery of an indorsement to the original true owner conforms with the notion of fairness and justice. It allocates the

loss resulting from the said risk to the party who would endure the least hardship from the exercise of the care necessary to provide against its occurrence. It operates in favour of the party who would endure the most hardship from the exercise of the said care. In other words, the allocation of the risk of the forgery of an indorsement to the original true owner, comes to allocating the duty to exercise due care to the party who is in the best position to absorb it.[57]

Finally, the allocation of the risk of the forgery of an indorsement to the original true owner conforms with the notion of reasonableness. This is due to the fact that the risk in question arises from the failure to exercise an effective control upon a document, the main function of which is to serve as a substitute for money and the main attribute of which is its free transferability in the stream of commerce. Since the original true owner of a negotiable instrument is presumed to be the party in control of a document possessing the above mentioned nature, he ought reasonably to foresee the probability that his failure to exercise an effective control could facilitate the coming of the said document into the possession of a fraudulent person and ultimately he ought to foresee that his behaviour as such could mislead a bona fide third party in his acquisition or payment. Accordingly, and due to the fact that the failure to exercise an effective control upon a negotiable instrument may result in a loss to a bona fide third party, it would be reasonable to allocate to the original

true owner the duty to provide every precautionary measure so as to avoid the fraudulent misuse of his property.[58]

If the said party fails to comply with such a duty, it would be reasonable to allocate to him the resulting loss.

(iii) The allocation of the risk of the forgery of an indorsement to either of the remaining competing parties, by comparison, damages the considerations underlying the risk allocation rule in the context of negotiable instruments as well as the notion of reasonableness. On the one hand, it prevents the negotiable instrument in question from being liquidated into absolute credit i.e. money, on its day of maturity. Due to the said inconvenience, the allocation of the risk of the forgery of an indorsement to either the prior obligor, the bona fide third party acquirer, or the drawee payor would deprive the party in question of the opportunity of enforcing the value incorporated in his instrument, or the value obtained in consideration for its exchange in an economically efficient manner. It compels him to freeze the value in question for a period of time. Accordingly, it compels the said party to suspend his commercial engagements, the finance of which is dependent on the said value. As could be noted from the foregoing, the allocation of the risk of the forgery of an indorsement to either of the competing parties would disturb the financial business of the said party. In such an instance, the commercial community engaging in the business of negotiating, acquiring and paying negotiable

instruments would be deterred from dealing with such documents. Ultimately, the objective of promoting the institution of such documents as a substitute for money would fail.[59]

On the other hand, the allocation of the risk of the forgery of an indorsement to either of the remaining competing parties results in allocating the evolving risk to a wholly or relatively innocent party. The prior obligor, the bona fide third party acquirer and the drawee payor are presumed to be innocent because they are in no position at all to provide against the said risk or because they are in no position to provide against it in an economically efficient manner. The allocation of the risk of the forgery of an indorsement to either of them in such an instance would be unreasonable. It comes to the conclusion that the said party bears the blame for not providing against its occurrence by the exercise of due care in situations where the compliance with such care is beyond his reach.[60]

(iv) The rule of allocating the risk of the forgery of an indorsement to the original true owner should not be absolute. The said party should be entitled to re-allocate the resulting loss in its entirety, or a portion of it, to the other competing party whose behaviour is presumed to be the dominating or contributing factor for causing the loss. In instances where the loss results from the forgery of an indorsement, the competing party's behaviour would be presumed to be the dominating factor

for its occurrence when the original true owner timely informs the said party of the theft or loss of his instrument. In such an instance, the former is presumed to have discharged his duty to provide against the occurrence of loss. This is due to the fact that his act of informing the potential competing party of the theft or loss of his instrument is presumed to have alerted the latter to the risk surrounding the instrument in question and its proceeds. Ultimately, it is presumed to have vested the said party with the last clear chance to provide against the occurrence of loss.

In such an instance, the potential competing party would be under a duty to exercise the care necessary to provide against the said loss. The care necessary to provide against the occurrence of loss does not, in the instances under consideration, involve the assumption of an undue hardship. Its compliance does not require more than the passing of the information relating to the theft or loss of the negotiable instrument to a potential competing party or the abstention from cashing the said document in favour of its offeror or presentor.[61]

The competing party to a negotiable instrument and to whose favour the risk of the forgery of an indorsement is initially established, is presumed to be guilty of contributing to the occurrence of loss when he fails to exercise manageable care.[62] To this end the said party in theory must be in the position to provide against the loss in question. In particular, the competing parties who could be contributing to the occurrence of loss are

the bona fide third party acquirer and the drawee payor. The prior obligor such as the maker or drawer, due to his remoteness from the forgery and due to his forfeiture of an effective control on the instrument, is not presumed to be in the position to provide against the occurrence of loss. Ultimately, and in the absence of his knowledge of the theft or loss of the negotiable instrument, the prior obligor can not be a contributing party to the occurrence of loss.

The bona fide third party acquirer and the drawee payor would be guilty of not exercising manageable care when they fail to abstain from cashing the offered or presented negotiable instrument in favour of its possessor, in instances where the four corners of the said document and/or the circumstances surrounding its cashing raise suspicion as to its regularity or the validity of its possessor's title. The imposition of such a duty upon the competing parties in question is neither inefficient nor is it incompatible with the considerations underlying the risk allocation rule in the context of negotiable instruments.[63] In the first place, the compliance with such a duty does not result in an undue hardship to either the bona fide third party acquirer or the drawee payor. It does not involve more than the abstention from the cashing of the negotiable instrument in favour of its possessor. In the second place, the considerations underlying the determination of the risk allocation rule in the context of negotiable instruments, in particular, that relating to the promotion of the

institution of such documents, do not become relevant unless the instrument to which they are intended to be established was regular on the face of it and the circumstances surrounding its acquisition or payment did not raise any suspicion as to its regularity.[64] In such instances only, the negotiable instrument becomes comparable to money and ultimately, it qualifies for the characteristics of the latter, the most notable of which is its negotiability characteristic.

In instances where the four corners of the prima facie negotiable instrument or the circumstances surrounding its acquisition raise suspicion as to its regularity, the said document, due to the foregoing fact, would not function as a negotiable instrument in the proper sense and ultimately it would not qualify as a substitute for money. Due to the suspicious circumstances surrounding its regularity, the document in question would fail to resemble the instrument which it intends to substitute i.e. money.

In instances where the document in question fails to qualify as a negotiable instrument in the proper sense, the necessity to promote its function would be irrelevant. Accordingly, it would not be necessary to regulate its practice by importing laws different from those applicable to the common law. In particular, it would not be necessary to formulate its risk allocation rule in a manner dissimilar to the general risk allocation rule.

Since it is accepted as a general rule of law that every person should safeguard his interest by the exercise

of reasonable care, and in instances where he behaves inconsistently with the required care, he ought to bear the resulting loss, the same rule should be applied to the acquisition or payment of a document, the four corners of which or the circumstances surrounding its acquisition or payment raise suspicion as to its regularity. The party who accepts to exchange such a document for value and the party who accepts to pay its face value without investigating its true status, the identity of its possessor and the validity of his title, should bear the resulting loss. They should be denied the right of establishing a good title to it and they should be denied the right of establishing an operative discharge on it. Their failure to investigate the above mentioned particulars suggests that they were careless in safeguarding their interests. Accordingly it would be reasonable to allocate the resulting loss to them.

CHAPTER SEVEN

BACK NOTES - (1.-64.)

1. Order instruments are those documents the last or only signature on which stipulates that the instrument in which it is incorporated shall be payable to a specific person or to his order. cf. Section 8(3) B.E.A. An example of such a document is the bill of exchange in which its drawer stipulates at the time of issuing that it shall be payable to John Alex, or to John Alex or order, or the cheque which is initially drawn to bearer but the last indorsement on which stipulates that it is payable to John Alex or to John Alex or order.

In the Anglo-American legal systems, bearer instruments may, by a special indorsement, be converted into order instruments, cf. Article 34 B.E.A. In the Continental Geneva legal systems, by comparison, cheques initially issued to bearer may not be converted into order instruments. The said cheque remains payable to bearer even if the last indorsement was a special indorsement, cf. Article 20 G.U.L.(Cheques).

2. cf. Section 31(3) B.E.A. This sub-section reads as follows ... "A bill payable to order is negotiated by the indorsement of the holder completed by delivery." cf. Article 3-202(1) U.C.C. and Article 16(1) G.U.L. (Bills). The former subsection is worded substantially similar to subsection 31(3) B.E.A. As far as Article 16 G.U.L.(Bills) is concerned, the necessity of the presence of an indorsement could be inferred from the fact that the said sub-section requires the presence of a regular chain of "indorsements" in order to establish the lawful holder status.

3. Bearer instruments are those documents the only or last signature on which stipulates that the instrument in which it is incorporated shall be payable to bearer or those documents the last signature on which does not stipulate to whose favour the instrument in which it is incorporated shall be payable. It leaves the name of the beneficiary unspecified. This is technically known as a blank indorsement. For the definition of bearer instruments and the impact of a blank indorsement cf. Sections 8(3) and 34(1) B.E.A. and Article 12 G.U.L.(Bills). An example of a bearer instrument is the cheque in which its drawer, at the time of its issuance, stipulates that it is payable to bearer. Or the bill of exchange, the last indorsement on which stipulates that it is payable to bearer or the last indorsement on which does not specify to whose favour it shall be payable.

In the Anglo-American, as well as the Continental Geneva legal systems, instruments initially issued in favour of a specific person or his order may be converted into a bearer instrument. This could be maintained by indorsing the said instrument to bearer or in blank, cf. Section 34(4) B.E.A., Article 3-204(3) U.C.C. and Article 14 G.U.L.(Bills).

4. cf. the decisions of the courts in:

Miller v Race (1758) 1 Burr 452,
Grant v Vaughan (1764) 3 Burr 1516,
Peacock v Rhodes (1781) 2 Doug. 633, and
Collins v Martin (1797) 2 Esp 520.

cf. also Sections 2, 21, 29, 31 and 36 B.E.A.
Articles 1-201(20), 3-115 official comment, 3-202, 3-204, 3-302, 3-305, 3-407 U.C.C.
Articles 16 G.U.L.(Bills), Articles 19 and 21 G.U.L. (Cheques)

Since the subject matter of this thesis is concerned with the manner of allocating risk in instances where it arises from the forgery of signatures and since the forgery of an indorsement of a bearer negotiable instrument does not strictly speaking give rise to a risk allocation problem, it would be outside the scope of this thesis to examine in detail the risk arising from the theft or loss of a bearer instrument, the rational manner of allocating the said risk and the compatibility of the Anglo-American and the Continental Geneva legal systems with the rational rule.

5. For a detailed account concerning this argument see pp.213-214 supra.

6. For a detailed account concerning the interests of the competing parties in instances of the forgery of an essential indorsement cf. pp.215-223 supra.

7. cf. p.112 et seq.

8. cf. pp.134-169 supra.

9 For a more detailed examination of the fact that parties proximate to the forgery are in a better position to prevent it than the parties remote to it, see the immediately following discussion in the text.

10. For a more detailed account as to how the introduction of an identification scheme would provide against the forgery of signatures see pp.328-330 supra.

11. cf. Wilson v United Counties Bank Ltd. [1920] AC 102, 112.
Paget's Law of Banking, Ninth Edition, p.240.
Byles, Bills of Exchange 25th Edition, pp.269-270.

12. cf. Sections 29, 54, 55 B.E.A.
Articles 3-302, 3-413, 3-414 U.C.C.
and Articles 9, 14, 16 and 47 G.U.L. (Bills).

13. See pp.617-620 infra.

14. cf. pp.622-624 infra.

15. For a more detailed account of this argument and for a typical illustration of its application see pp.162-165 supra.

16. See pp.598-599.

17. For a more detailed account concerning the argument that negotiable instruments are equipped to operate as a convenient substitute for money and ultimately satisfy the desires of the commercial community cf. pp.100-107 supra.

18. cf. pp.601-605.

19. The negotiability attribute of negotiable instruments i.e. bills of exchange, promissory notes and cheques would be negatived when such documents purport at the time of issuance to be "not negotiable". In the Anglo-American and the Continental Geneva legal systems such documents would be deemed not negotiable when they contain the words "not negotiable", when they are made payable to a named person only, when they do not contain the words "or order" or when they are drawn not to order, cf. Section 8(1) and 81 B.E.A., Article 3-104 U.C.C., Article 11 G.U.L.(Bills) and Article 14 G.U.L.(Cheques).

The negotiability attribute of negotiable instruments would be restricted when, by comparison their property right is not inteded to be transferred conclusively in favour of the transferee. In the Anglo-American and the Continental Geneva legal systems, the negotiability attribute of negotiable instruments would be restricted when such documents are indorsed "for collection" or in trust, cf. Sections 35 B.E.A., Article 3-120, 3-205 U.C.C., Article 18 G.U.L.(Bills) and Article 23 G.U.L.(Cheques).

The negotiability attribute of negotiable instruments could also be restricted when the liability of the signatory in question has been excluded by an express stipulation on the instrument. A typical example of such a stipulation is the stipulation without recourse. The immediate effect of such a stipulation is that it denies to the bona fide third party acquirer the right of enforcing the face value of his instrument against the signatory excluding his liability. It denies him such an advantage even if he satisfies the protected holder status i.e. the holder in due course or the good faith lawful holder.

The Anglo-American legal systems establish the right of excluding liability in favour of the drawer of a negotiable instrument as well as to its indorsor, cf. Section 16 B.E.A. and Article 3-413, 3-414 U.C.C. The Continental Geneva legal systems establish such a right in favour of the indorsor only, cf. Article 15 G.U.L.(Bills) and Article 18 G.U.L.(Cheques). By comparison they deny such a right in favour of the drawer should the said party stipulate the exclusion of his liabiliy to guarantee the payment on the instrument in question, his stipulation as such would be deemed to be not written, cf. Article 9 G.U.L.(Bills) and Article 12 G.U.L.(Cheques).

The Continental Geneva legal systems are of the view that if the drawer of a negotiable instrument was entitled to exclude his liability on it, he in practice would be excluding the only potential liability. This is especially the case when the instrument in question is not intended to be circulated in the stream of commerce, or when the indorsement incorporated on it purports to exclude the liability of the particular indorsor. In such an instance, the drawer would be setting in the stream of commerce a worthless piece of paper. His act as such would deter the members of the commercial community to whom such an instrument is offered, from acquiring it. Ultimately, the free circulation of negotiable instruments could be impaired whereas the objective of promoting the function of the institution of such documents as a finance device would fail.

In the Anglo-American as well as the Continental Geneva legal systems, the effect of negativing and the above-mentioned first form of restricting the negotiability attribute of negotiable instruments is that it divests the bona fide third party acquirer and the drawee payor of the advantages inherent in the acquisition and payment of such documents. In particular they divest the party in question of the advantage of perfect title and the advantage of a valid discharge, respectively in instances where the interest of the said party to have the advantage in question established in his favour arises in a situation of conflicting claims, the occurrence of which has been facilitated by his failure to exercise reasonable care. In fact the negativing and restricting the negotiability attribute of negotiable instruments operates to raise the standard of care which ought to be exercised by the bona fide third party acquirer and the drawee payor. They allocate to them the duty to exercise the care which is that of the reasonable man. They would have to satisfy their conviction that the person offering the instrument in question and the person presenting it for payment is its original true owner i.e. the person to whom it is intended to be payable. If they fail to comply with such a duty and the offered or presented instrument proves to be stolen or lost, they would be denied the right of claiming in their favour the advantage of good title or the advantage of a valid discharge. They would

be placed in the shoes of the person from whom they acquired the instrument or to whom they paid it. That is to say that the bona fide third party acquirer and the drawee payor would be subject to the defences and claims which could be set up against the person to whose favour the instrument in question was cashed. If the cashed instrument proved to be stolen or lost its original true owner may, in instances where its negotiability attribute has been restricted or negatived, set up against the bona fide third party acquirer the invalidity of his title and he may set up against the drawee payor the invalidity of his act of payment. Ultimately, he may recover the proceeds of the instrument from its acquirer or he may demand a fresh payment in his favour from the drawee payor.
cf. Sections 35, 36, 81 B.E.A., and Articles 3-205, 3-805 U.C.C., Articles 11 and 18 G.U.L.(Bills) and Articles 14 and 23 G.U.L.(Cheques).
cf. also Hibernian Bank, Ltd. v Gysin and Hanson [1939] 1 KB 483.
Ladup Ltd. v Shaikh Nadeem [1982] 3 WLR 172.

20. See pp.606-610 supra.

21. To illustrate how the non-acquisition of negotiable instruments from strangers would create an undue economic detriment to the genuine acquirer of a negotiable instrument see the example mentioned on pp.354-355 supra.

22. cf. W. Britton, Defences Claims of Ownership and Equities, (1955), 7 Hastings L. J. 1.
W. Vis, Forged Indorsements, (1979), 27 Am. J. Comp. L. 547.

23. The contractual promise involved in the banker's guarantee is normally incorporated in an independent card commonly known as the banker's cheque guarantee card. The party intending to claim the enforceability of the said guarantee in his favour, must demand from the party from whom he intends to acquire a negotiable instrument, the presentation of the banker's guarantee card and he must require him to write on the back of the said document the relevant identification number. A typical example of the contractual promise involved in the banker's guarantee card is that incorporated in Barclays Bank Visa Card. The relevant clause of Barclays Bank Visa Card guarantee legend reads as follows,

> "Payment of any personal cheque not exceeding £50 issued within the United Kingdom of Great Britain and N. Ireland (including the Channel Islands and the Isle of Man) during the validity period shown hereon in settlement of any one transaction is guaranteed provided the cheque is taken from a Barclays Group cheque book issued in the U.K., the signature agrees with the specimen hereon and is written in the presence of the payee who must

record the Barclaycard number on the reverse of the cheque."

The extension of the contractual promise involved in the negotiable instrument's guarantee or acceptance in favour of a party who establishes his title to the instrument in question through an invalid but a regular signature is a clear recognition of the fact that such an extension is essential for the purpose of promoting the function of such documents as a substitute for money. Without it the commercial community in particular and the public in general would be deterred from acquiring negotiable instruments from strangers. Ultimately the objective of facilitating the free transferability of such documents would be severely restricted.

24. For a recap of the significance of the security in transactions rule in promoting the institution of negotiable instruments, see pp.610-611 supra.

25. In the Continental Geneva legal systems the liability of primary parties on a negotiable instrument, such as the acceptor, is limited to 3 years only, whilst the liability of secondary parties such as the drawer and indorsers is limited to 1 year. The time limit of the liability of the party in question, in all instances runs from the maturity date of the negotiable instrument. cf. Article 70 G.U.L.(Bills). Compare the foregoing time limitations to that applicable to ordinary civil and commercial transactions. In the Romanistic and the Germanic legal families the time limitation for a civil transaction is thirty years whilst the time limitation for commercial transactions ranges from 2 to 10 years, cf. Article 195 German Civil Code and
Cohn, Manual of German Law 2nd Edition Section 176, and Lawson Anton Brown, Amos Walton's Introduction to French Law Third Edition, p.356.

26. See - Section 45 B.E.A.; Article 53 G.U.L.(Bills).

27. cf. Articles 38 and 44 G.U.L.(Bills).
In the Anglo-American legal systems, for the holder of a negotiable instrument to preserve his right of recourse against a secondarily liable party, he must notify the latter ofthe non-payment of his instrument within one day following the day of maturity.
cf. Section 49 (12) B.E.A.

28. cf. Section 45 B.E.A. and Article 53 G.U.L.(Bills).

29. See pp.617-620 and 622 et seq.

30. The allocation of the loss resulting from the acquisition of a negotiable instrument from other than its lawful holder, i.e. proprietor, or that resulting from its payment in favour of the said party to the acquirer or payor, in the absence of compelling considerations, is an application of the general rule of law. The generally

accepted rule of law is in favour of conferring upon the transferee of a chose in action, the entitlements inherent in his transferor's title. This is a well established principle in the law of property. It derives its basis from the maxim, "Nemo dat quod non habet." Thus, in instances where the title of the prior transferor was defective for any reason, the title of the immediate transferee would bear the said defect. If the title of the prior transferor was invalid because of the lack of delivery, such as the case in the text, the title of the immediate transferee, acquirer would be invalid for the same reason. Due to the said defect, the transferee acquirer would not be able to utilise the unlawfully transferred chose in action e.g. negotiable instrument, to his favour. He would have to restore it to its lawful proprietor or he would have to account to him for its proceeds.

It is also accepted as a general rule of law that debtors, due to their status as such and by reference to their contractual relationship with their creditors, are under a duty to discharge their underlying obligations in a manner compatible with the latter's authorised mandates only. In instances where they behave inconsistently with such a mandate, they are not entitled to debit their creditor's account with the erroneously paid amount. Debtors would be behaving inconsistently with their creditor's mandates when the former pay the issued mandate in favour of other than the intended transferee. The payment of the issued mandate in favour of other than the intended transferee is presumed to be inconsistent with the creditor's mandate because it violates the latter's order. The creditor at the time of issuing his mandate orders his debtor to pay its incorporated credit in favour of the intended transferee, or to whose order the latter renders the said credit payable.

31. See pp.603-605 supra.

32. For a detailed account concerning the impact of negativing and restricting the negotiability attribute of negotiable instruments see p.616 supra.

33. cf. pp.107-111 supra.

34. See pp.594-601.

35. See pp.607-610 supra.

36. cf. pp.612-613 and 622-624 supra.

37. cf. pp.603-605 supra.

38. cf. pp.614-628.

39. For a more detailed account as to how the allocation of the risk of the forgery of an indorsement to the original true owner would satisfy in an efficient manner

the considerations underlying the determination of the risk allocation rule in the context of negotiable instruments see pp.614-628.

40. See pp.607-610

41. See pp.594-596 and 598-600.

42. Ibid.

43. See pp.607-610 supra.

44. See pp.622-624 supra.

45. The publication of the theft or loss of a negotiable instrument in an official gazette is an existing practice. It exists in some of the jurisdictions which apply the Geneva Conventions on the Uniform Laws relating to Bills of Exchange Promissory Notes and Cheques. For a more detailed account of such a practice, see p.699 infra.

46. The rule of allocating the loss resulting from the theft or loss of a negotiable instrument to the bona fide third party acquirer, by reason of the said party's failure to consult the official gazette of the jurisdiction in which he resides, could be found in the jurisdictions in which the practice of publishing such information in such a record is established.
cf. note immediately above.

47. For the definition of the concept of manageable care and its distinction from the concept of reasonable care see n.210 Ch.6.

48. An example of the special arrangement whereby the drawee of a negotiable instrument may be held liable to the proprietor of such a document is the certification practice. In the North American legal system the act of certification is tantamount to the act of acceptance, cf. Article 3-411 U.C.C. Its incorporation in the negotiable instrument creates a contractual relationship between the certifier, i.e. the drawee and the holder of the negotiable instrument i.e. its proprietor. It imposes upon the former a contractual duty to pay the credit incorporated in the instrument on its day of maturity, cf. Article 3-413 U.C.C. If the drawee fails to honour his contractual duty, the party to whose favour it is established, i.e. the holder, may on the basis of the contractual relationship, enforce the instrument against the latter. And in instances where his act of recourse against the said party incurs to him additional expenses, the holder may recoup the said expenses from him.

In the English and the Continental Geneva legal systems, the act of certification is not deemed an acceptance. Accordingly, the drawee certifier is not under a contractual duty in favour of the holder of the

certified negotiable instrument, to pay its incorporated credit.
cf. Keene v Beard (1860) 8 CBNS 372
and Article 6. Annex II Geneva Convention on Uniform Law Relating to Cheques 1931.

The act of certification in the legal systems under consideration is deemed a mere statement of the availability of funds in the customer's account,
cf. Gaden v Newfoundland Savings Bank (1899) AC 281,
Imperial Bank of Canada v Bank of Hamilton [1903] AC 49.

Nevertheless, if the drawee certifier's statement was proved to be erroneous and the customer's account at the time of certification was insufficient to meet the instrument in question, the holder of such a document may recoup the resulting loss, i.e. the face value of his instrument from the drawee.
cf. Warwick v Rogers (1843) 5 Man & G 340.
His cause of action against the latter would be tortious in nature. It would be based on the doctrine of misrepresentation.

From the foregoing, it could be concluded that although the act of certification does not impose upon the drawee a contractual duty to honour the credit incorporated in the negotiable instrument on its day of maturity, it imposes upon the said party a duty to exercise care in making his statement. If he fails to comply with such a duty and his failure as such causes a loss to the holder of the negotiable instrument, he would be liable for the resulting loss.

49. cf. pp.655-656

50. See authorities cited in n.11.

51. cf. pp.622-624.

52. See pp.601-603 supra.

53. See pp.603-605 supra.

54. See pp.594-596, 598-600, 601, 607-610 and 612-613 supra.

55. See pp.614-620 supra.

56. See pp.624-626 supra.

57. See pp.628-631.
For a more detailed account as to the definition of the notion of fairness and justice and its relationship to the concept of hardship as well as its significance as a consideration for determining the risk allocation rule in the context of negotiable instruments, see pp.111, 175.

58. See pp.624-626 supra.

59. See pp.634-638 supra.

60. See pp.634-638 supra.

61. See pp.639-643 supra.

62. For the meaning of manageable care and its distinction from other standards of care see n.210 Ch.6.

63. See pp.651-660 supra.

64. See pp.659-660 supra.

CHAPTER EIGHT

THE COMPATIBILITY OF THE ATTITUDE OF THE ANGLO-AMERICAN AND THE CONTINENTAL GENEVA LEGAL SYSTEMS IN ALLOCATING THE RISK OF THE FORGERY OF AN INDORSEMENT WITH THE PROPOSED RISK ALLOCATION RULE.

INTRODUCTION

The central issue of this chapter is to examine the compatibility of the attitude of the legal systems under consideration in allocating the risk of the forgery of an indorsement with the rational risk allocation rule as proposed in the immediately previous chapter. Throughout the following discussion, a brief account of the above mentioned rule will be made when appropriate, whilst a cross-reference to the previous chapter will be made for a more detailed account of the said rule.

The General Attitude of the Anglo-American and the Continental Geneva Legal Systems in Determining the Risk Allocation Rule in Instances of the Forgery of an Indorsement.

The general attitude of the Anglo-American legal systems on the one hand and the general attitude of the Continental Geneva legal systems on the other hand, in determining the risk allocation rule in instances of the forgery of an indorsement are not uniform. The legal systems' respective attitudes are based on their determination of the impact of a forged indorsement on the

negotiable instrument and their impact on its remote parties. The legal systems which attribute to forged indorsements a wide adverse impact on the negotiability of the instrument, allocate the risk arising from the involvement of such signatures to the party subsequent to the forgery. The legal systems which attribute a limited adverse impact on negotiability to forged indorsements, by comparison, allocate the risk arising from the involvement of such signatures to the original true owner i.e. the party prior to the forgery.

The North American Legal System

I. The North American legal system allocates the risk arising from the forgery of an indorsement to the bona fide third party acquirer. In instances where the negotiable instrument, i.e. the subject matter of acquisition, was stolen or lost, the legal system under consideration equates the title of its acquirer with that established in favour of his prior transferor or transferors.[1] Since the acquirer in such an instance is presumed to establish his title to the instrument in question from or through its thief or finder, his title would be similar to that of the latter. And since the title of the said party by law is null and void due to the lack of negotiation the title of the acquirer, notwithstanding his bona fides would likewise be null and void.

From the foregoing, it could be noted that once the

bona fide third party acquirer's title to the negotiable instrument which has been vitiated by a forged indorsement is rendered null and void, the said party fails to qualify as the holder of such a document and by necessary inference he fails to qualify as its protected holder i.e. the holder in due course.[2] Due to his status as such, he may neither enforce the incorporated credit against parties prior to the forgery, nor may he demand its enforcement from the drawee, nor may he retain its proceeds in instances of payment. In such an instance, he would either have to account to the original true owner for the paid proceeds or he would have to revert the same to the drawee payor.[3]

The U.C.C. approaches the above rule by determining that forged indorsements are wholly inoperative.[4] By such a determination, the U.C.C. purports to suggest that forged indorsements are of no enforceable value. They are not capable of transferring the rights incorporated in the negotiable instrument which they vitiate. In particular, they are not capable of transferring the property right of such a document. In their status as such, they interrupt the chain of indorsements and accordingly they do not effect an enforceable transfer of the property right of the document in which they appear, in favour of a third party.[5] Thus, whoever establishes his title to a negotiable instrument from or through a forged indorsement would not acquire a good title to it. Notwithstanding his bona fides, the said party would not be able to enforce its incorporated rights against prior

liable parties nor may he retain its proceeds in instances of payment.

II. In instances where the drawee pays the negotiable instrument which has been vitiated by a forged indorsement, in favour of its thief or finder, the North American legal system allocates the resulting loss to the former.[6] This is due to the fact that the payment of a vitiated instrument in favour of the fraudulent party deprives the drawee payor of the opportunity to recoup the erroneously paid proceeds from its payee recipient. The latter, in the instance under consideration, is the thief or finder i.e. a fraudulent party. The recovery of the erroneously paid proceeds from such a party is normally unavailing due either to his insolvency or non-availability.

By allocating the loss arising from the payment of a vitiated negotiable instrument to the drawee payor, the North American legal system entitles the maker or drawer of such a document and its original true owner, i.e. the party from whom it was stolen or lost, to challenge the former's act of payment. It entitles the maker or drawer to have his account with the said party recredited as if payment had not been made. By comparison, it entitles the original true owner to demand from him a fresh payment in his favour.[7]

Like the instances in which the risk of the forgery of an indorsement is allocated to the bona fide third party acquirer, the U.C.C. approaches the rule of

allocating the said risk to the drawee payor, in instances where the payment is made in favour of the thief or finder, by denying the operativeness of forged indorsements.[8] By such a rule, the U.C.C. purports to suggest that forged indorsements are of no legal effect. In particular, they do not function as an order to the drawee to pay in accordance with its tenor. Accordingly, they are incapable of affording a valid discharge in favour of the said party. Thus, if the drawee erroneously makes payment of a negotiable instrument in accordance with the tenor of a forged indorsement, he may not avail himself of a valid discharge as against his customer, i.e. the maker or drawer or as against the original true owner. He would have to recredit his customer's account with the erroneously debited amount, or he would have to make a fresh payment in favour of the original true owner.[9]

III. By allocating the risk of the forgery of an indorsement to the drawee payor and by allocating it to the bona fide third party acquirer in instances where the vitiated negotiable instrument is negotiated or/and paid to the latter, the North American legal system appears to presume that the party subsequent to the forgery, due to his direct contact with the thief or finder i.e. the forger, is better situated to provide against the said risk. This he can do by refraining from dealing with parties the character of whom he is not familiar with, or by investigating the status of the offered or presented

instrument, the identity of its possessor and the validity of his title.[10] By choosing not to follow either of the above courses he should bear the resulting loss. His failure to do just that would attribute to him the blame for causing the said loss.

The English Legal System

I. The English legal system allocates the risk arising from the forgery of an indorsement in instances of dishonour to the bona fide third party acquirer. Like the North American legal system in instances where the negotiable instrument was stolen or lost, the legal system under consideration equates the title of the acquirer of such a document with that of his prior transferor or transferors. Since the acquirer is presumed to establish his title to the instrument in question from or through its thief or finder, his title to the said document would be similar to that of the latter. And since the title of the thief or finder is presumed to be null and void for the lack of negotiation, the title of the subsequent acquirer, notwithstanding his bona fides would likewise be null and void.[11]

Once the title of the bona fide third party acquirer to the negotiable instrument which has been vitiated by a forged instrument is rendered null and void, the said party may not qualify as its lawful holder and ultimately, he would not qualify as the protected holder i.e. the holder in due course.[12] Due to his status as such, he

would not be able to establish in his favour the rights incorporated in the acquired instrument. In particular, he would not be able to enforce the incorporated credit against parties prior to the forgery.[13]

The English legal system approaches the above application by denying to the forged indorsements their operativeness.[14] By such a rule, the English legal system, like that of North America, purports to suggest that forged indorsements are of no enforceable value. They are not capable of transferring the rights incorporated in the negotiable instrument which they vitiate. In particular, they are not capable of transferring the property right of such a document. In their status as such they interrupt the chain of negotiation and ultimately they do not establish a good title in favour of a subsequent party.[15]

II. In instances of payment, the English legal system allocates the risk arising from the forgery of an indorsement to the drawee payor in so far as:

1) he is not a banker,[16] and

2) his right of recourse against the payee recipient for the recovery of the proceeds of his payment would result in a detrimental change in position for the latter.[17]

The drawee payor's right of recourse would result in a departmental change in position to the payee recipient if it would cause the latter party to forego the opportunity of giving a timely notice of non-payment to his immediate transferor. In such an instance, the failure to give

timely notice of non-payment to the immediate transferor could cost the immediate transferee i.e. the payee recipient, dearly. It could deprive him of the opportunity to satisfy the credit incorporated in the acquired instrument against a valuable security.[18]

Thus, in order for the payee recipient to set up the defence of the detrimental change in position with full force, he should establish his title to the negotiable instrument through a valid indorsement.[19] That is to say that the said party should establish his title to the document in question through the act of another who purports to be its proprietor i.e. lawful holder. In such an instance only, there would be a party liable on the negotiable instrument to the payee recipient and ultimately, in such an instance only the latter party would experience the detrimental change in position had the right of recovery been exercised against him.

By disentitling the drawee payor of the right of recovering the proceeds of the erroneous payment from the payee recipient, the English legal system does not immunise the latter party from being accountable for the proceeds of the erroneous payment absolutely. Rather its effect is restricted as between the said party and the drawee payor. The English legal system holds the payee recipient always accountable for the paid proceeds to the original true owner[20] i.e. the party from whom the negotiable instrument was stolen or lost. The payee recipient's accountability for the paid proceeds becomes of practical value where the recourse against the drawee

payor was unavailing.

The recourse against the drawee payor would be unavailing when:

1) the said party was insolvent, and

2) when the law establishes in his favour a valuable protection.

An example of the latter instance is that when the drawee pays a negotiable instrument in a banking capacity. In the English legal system, bankers are not under a duty to examine the genuineness of indorsements of the presented instrument. Their duty of care in the payment of such instruments is discharged by examining the regularity of their signatures only.[21] Thus, if the drawee banker pays a demand negotiable instrument after examining the regularity of the chain of indorsements, he would be discharged as against his customer i.e. the maker or drawer of the paid document and its original true owner. Notwithstanding the existence of a forged indorsement, the maker or drawer may not demand from the drawee banker the recrediting of his account nor may the original true owner demand a fresh payment in his favour from the said party.[22]

From the foregoing, it could be concluded that the English legal system allocates the risk arising from the forgery of an indorsement in instances of payment, to the payee recipient in instances where the recourse against the drawee payor is unavailing. It holds the payee recipient accountable for the proceeds of the erroneous payment. It entitles the original true owner to recover

in conversion or restitution the face value of his stolen or lost instrument from the payee recipient.

The English legal system approaches the above rule by determining that forged indorsements are wholly inoperative.[23] By such a determination, the English legal system purports to suggest that forged indorsements are of no enforceable value. They, on the one hand, are incapable of transferring the rights incorporated in the negotiable instrument which they vitiate. On the other hand, they are incapable of functioning as an order directing the drawee to pay according to their tenor. Due to their status as such, they are incapable of transferring the property right of such a document and they are incapable of establishing a valid discharge in favour of the drawee payor. Thus, if a person takes up a negotiable instrument vitiated by a forged indorsement, or receives payment on it, or makes payment of it he may not avail himself of an enforceable value. He may not demand its enforcement against a prior liable party. He may not claim a good title to its proceeds and he may not avail himself of a valid discharge.[24]

As to the rule relating to the persons in the banking business, namely that such parties are validly discharged from their obligation to pay, notwithstanding the genuineness of the chain of indorsements, the English legal system approaches such a rule by way of derogation of the above mentioned general rule. It restricts the duty of bankers to examine the regularity of the signatures on the presented instrument. It deems the

compliance with such a duty sufficient to discharge bankers from their obligation to pay.[25]

The considerations underlying the English legal system's rule as to bankers are dictated by the necessity of banking business and the promotion of the institution of negotiable instruments as a substitute for money.[26] For the banking business to be enhanced, the duty of bankers should not be extended to examine every minute particular, such as that involved in the examination of the genuineness of indorsements. Due to the involvement of time in the carrying out of such a duty, the business of banking would be handicapped. It is equally submitted that for the institution of negotiable instruments to function as a substitute for money, it should be capable of being liquidated into absolute credit, i.e. money, on its day of maturity. To this end, the party to whom such a document is offered for a valuable exchange and the party to whom it is presented for payment should not be burdened with the duty to examine the genuineness of the signatures. Such a duty involves time. Ultimately, it prevents the said document from being liquidated into money on its day of maturity.

III. By allocating the risk of the forgery of an indorsement to the bona fide third party acquirer and by allocating it to the drawee payor in instances where the latter's right of recourse against the payee recipient proves to be detrimental to the latter, the English legal system appears to presume that the party subsequent to the

forgery, due to his direct contact with the forger, is better situated to provide against the said risk.[27] This he can maintain by either refraining from dealing with strangers, the character of whom he is not familiar with, or by investigating the status of the offered or presented instrument, the identity of its possessor and the validity of his title. By such behaviour, the party subsequent to the forgery can frustrate the fraudulent intention of the forger. In instances where the said party fails to comply with the above mentioned duty, his behaviour as such would be presumed to be the cause of the resulting loss. Due to the said fact, the loss in question should be allocated to him.

The Continental Geneva Legal Systems

I. The Continental Geneva legal systems allocate the risk arising from the forgery of an indorsement to the original true owner i.e. the party from whom the vitiated negotiable instrument was stolen or lost. In instances where the said document comes into the possession of a bona fide third party, they deny to the original true owner the right of demanding from the former the surrender of the instrument in question or its proceeds.[28] They establish in favour of the said party a property right to the stolen or lost instrument, independent of that of his prior transferor or transferors. They establish in his favour a good title to the said document. They establish in favour of the bona fide third party acquirer the lawful

holder status, notwithstanding the invalidity of his prior transferor's title.[29]

By establishing the lawful holder status in favour of the bona fide third party acquirer, the Continental Geneva legal systems avail the said party of the right of enforcing the credit incorporated in the acquired instrument exclusively to his favour. They enable him to demand its payment from the drawee. In instances of the latter's failure, they enable the bona fide third party acquirer to enforce it against any or all prior liable parties such as the maker or drawer of the negotiable instrument and its indorsor.[30] They disentitle the party against whom the instrument is intended to be enforced to impeach the bona fide third party acquirer's property right to the said instrument by settling up the theft or loss defence.[31]

By establishing the lawful holder status in favour of the bona fide third party acquirer, and ultimately by establishing in his favour an exclusive property right to the negotiable instrument and the credit incorporated in it, the Continental Geneva legal systems deny to the original true owner the right of exercising a right of recourse against his prior obligor. They also deny him the right of demanding a fresh payment in his favour from the drawee in instances where the latter pays the document in question in favour of its bona fide third party acquirer. They establish in favour of the prior obligor or obligors as well as the drawee payor a valid discharge

of their underlying as well as their negotiable instrument obligations.[32]

II. In instances where the thief or finder of a stolen or lost negotiable instrument retains its possession and by fraudulently negotiating it to his favour in the name of its original true owner obtains its proceeds from the bona fide drawee, the Continental Geneva legal systems again allocate the resulting loss to the original true owner. They deny him the right of challenging the drawee/payor's act of payment. They deny him the right of demanding a fresh payment in his favour from the said party. Accordingly, they establish a valid discharge in favour of the drawee payor, as long as he acts in good faith, free from gross negligence and in reliance on a regular chain of signatures.[33] The regularity of the chain of signatures requirement is presumed to be satisfied when the said signatures purport to be made in the name of the signatory in question.

By establishing a valid discharge in favour of the bona fide drawee payor, the Continental Geneva legal systems establish an equally valid discharge in favour of the prior obligor such as the maker or drawer of the negotiable instrument. The establishment of a valid discharge in favour of the drawee payor necessarily suggests that the said party's act of payment of the presented instrument was proper and ultimately it suggests that such an act is sufficient to discharge the negotiable instrument. As could be recalled, the discharge of the

negotiable instrument discharges retroactively the underlying obligations giving rise to it.[34] That is to say, the discharge of the negotiable instrument restores the status ante of the parties engaged on it, such as the original true owner as if no obligation had ever been created between them. Accordingly, it forfeits the said parties' causes of action against their prior obligors on the negotiable instrument, as well as the underlying obligation.

The Continental Geneva legal systems approach the foregoing risk allocation rule by limiting the impact of forged indorsements to denying such a signature its binding attribute. That is to say that the legal systems under consideration restrict the application of the impact of forged signatures as between the party whose signature was forged and the party who intends to enforce the acquired negotiable instrument against him. They deny to the latter party the right to enforce the instrument in question against the party whose signature was forged.[35] Unlike the Anglo-American legal systems, they do not hold that forged signatures are inoperative. On the contrary, they are in favour of the rule that the genuineness of signatures is not a requirement for establishing a good title to the negotiable instrument and it is not a requirement for establishing a valid discharge upon it.[36] By such a rule the legal systems under consideration suggest that forged signatures such as indorsements do not interrupt the currency i.e. negotiability of negotiable instruments. Such documents may function in their full

negotiability capacity, notwithstanding the presence of forged signatures. Accordingly, they may confer an enforceable value in favour of bona fide third parties. In particular, they may establish a good title in favour of the party to whom they are offered for a valuable exchange and they may establish a valid discharge in favour of the party to whom they are presented for payment.

III. By allocating the risk of the forgery of an indorsement to the original true owner, the Continental Geneva legal systems appear to presume that the said party, due to the fact that the forgery occurred whilst the instrument in question was in his possession and under his control, is better situated to provide against the risk in question.[37] This he can maintain by the exercise of care in the safe custody and the negotiation of his instrument. By such behaviour, the said party can frustrate the fraudulent intention of the fraudulent party in the sense that he renders it impossible or more onerous for the latter to misuse such documents and ultimately by such behaviour the original true owner prevents the fraudulent party from perpetrating his fraud. In instances where the said party fails to provide for such care, his behaviour as such would be presumed to be the cause of the resulting loss. In such an instance, the said loss would be allocated to him.

IV. The Continental Geneva legal systems do not apply the above mentioned rule rigidly. There are instances in

which the said legal systems reformulate the risk allocation rule in question. In instances where the competing parties to whose favour the rule is allocated, namely the bona fide third party acquirer and the drawee payor were informed in time of the theft or loss of the negotiable instrument, the acquisition or the payment of which gives rise to the situation of conflicting entitlements, the Continental Geneva legal systems reallocate the resulting loss to the third party acquirer and the drawee payor respectively. They divest the competing party in question of the protection afforded to him by virtue of the general risk allocation rule. They deny to the bona fide third party acquirer the perfect title protection and ultimately they deny him the protected lawful holder status. By comparison, they deny to the drawee payor the right to be validly discharged of his obligation. Accordingly, they allocate to him the duty to recredit his customer's account with the erroneously debited amount or to make a fresh payment in favour of the original true owner i.e. the person from whom the instrument in question was stolen or lost.

The rule that the bona fide third party acquirer and the drawee payor bear the loss resulting from their acquisition and payment in instances where they were informed of the theft or loss of the offered or presented instrument could be inferred from the proviso incorporated in Articles 16 and 40 G.U.L.(Bills). By virtue of the said articles, for the bona fide third party acquirer and the drawee payor respectively to claim in their favour the

protection afforded to them, they must behave free from bad faith and gross negligence.[38] When the bona fide third party to whom the stolen or lost instrument is offered for a valuable exchange or the drawee to whom it is presented for payment was informed of its theft or loss, his subsequent acquisition or payment is presumed to fall within the above mentioned behaviour. If the acquisition or payment of the offered or presented stolen or lost instrument was made with actual knowledge of the theft or loss of the document in question, it is presumed to be made in bad faith. The act of acquisition and payment in such an instance attributes to the bona fide third party acquirer and the drawee payor, the intention to injure the original true owner i.e. the person from whom the instrument was stolen or lost.

If the act of acquisition or payment was made due to an oversight of the fact that the offered or presented instrument was stolen or lost, or if it was made without examining the records from which such information could be obtained, it is presumed to be made with gross negligence. The bona fide third party acquirer and the drawee payor in such an instance are presumed to have failed to behave as the reasonable man, the conduct of whom would have unveiled the irregularity surrounding the offered or presented instrument at no undue cost and time.[39] Such behaviour is illustrated in the examination of the records from which the information relating to the status of the offered or presented instrument could be collected.

As to what constitutes a sufficient act to inform the

third party to whom the negotiable instrument was offered for a valuable exchange or to whom it was presented for payment, of its theft and loss, and ultimately to allocate to the said party the duty to exercise the care necessary to provide against the occurrence of loss, depends on the status of the potential competing party involved. In instances where the said party was the person to whom the negotiable instrument was offered for a valuable exchange, the Continental Geneva legal systems are in agreement that the act sufficient to inform the above mentioned party of the theft or loss of the document in question is the publication of its theft or loss in the official gazette of the jurisdiction in which such an event occurs.[40] The publication of the theft or loss of a negotiable instrument in an official gazette renders such information readily available to every member of the community. Accordingly, it enables the party to whom the stolen or lost instrument was offered for a valuable exchange to exercise the care which would provide against the occurrence of loss.

In instances where the involved potential competing party was the drawee, the Continental Geneva legal systems are in disagreement as to what constitutes a sufficient act to inform the said party of the theft or loss of the negotiable instrument and ultimately they are in disagreement as to what constitutes a sufficient act the impact of which is to allocate to the drawee the duty to exercise due care to provide against the occurrence of loss. Some legal systems are of the view that the mere

issuance of a stop payment order is not sufficient to compel the drawee to dishonour the presented instrument in instances where the ultimate holder, i.e. the party demanding payment from the drawee, can prove that he satisfies the protected holder status as described in Article 16 G.U.L.(Bills) and Articles 19 and 21 G.U.L.(Cheques).[41] In such an instance, the drawee may pay the document in question in favour of the former. His act as such affords him a valid discharge as against his customer or the original true owner. Neither may the drawee's customer demand the former to recredit his account nor may the original true owner demand him to make a fresh payment in his favour. If the customer or the original true owner wished to impose upon the drawee the duty to dishonour the presented stolen or lost instrument, he would have to secure a court order to that effect. This is commonly known as amortization.[42] The legal effect of the court's order is to annul the stolen or lost instrument. Once the stolen or lost instrument was annulled it forfeits its mandatory nature. Accordingly, it does not operate as a payment order to the drawee. If the said party negligently or erroneously pays it, he is deemed to have behaved without a mandate. Ultimately, he may not charge the paid amount to his customer's account.

Other Continental Geneva legal systems by comparison are of the view that the mere issuance of a stop payment order is sufficient to compel the drawee to dishonour the presented instrument. If he fails to comply with such an order he would be liable to his customer. He would have

to recredit the erroneously debited amount to his account. Such a rule applies even in instances where the drawee was convinced that the ultimate holder satisfied the protected holder status.[43] The determination of such a question is a matter of law and fact. It must be decided by the judiciary. The drawee, it is submitted, does not possess a judicial capacity. If however the ultimate holder wished to enforce the credit incorporated in the negotiable instrument in his favour, he would have to secure a court order to that effect. In such an instance, the court order would be binding on the drawee. It requires him to release the frozen cover in favour of the ultimate holder.[44]

V. Another instance in which the Continental Geneva legal systems reallocate the loss arising from the acquisition or payment of a stolen or lost negotiable instrument to the bona fide third party acquirer and the drawee payor is that where, in the absence of the knowledge that the offered or presented instrument was stolen or lost, the party in question behaves with gross negligence in his acquisition or payment. In such an instance, the legal systems under consideration divest the bona fide third party acquirer and the drawee payor of the protection afforded to them by virtue of the general risk allocation rule. They deny to the former the good title protection whilst they deny to the drawee payor the right to be validly discharged.

The foregoing rule could also be inferred from the

proviso incorporated in Articles 16 and 40 G.U.L.(Bills). By virtue of the said articles, for the bona fide third party acquirer and the drawee payor respectively to claim in their favour the protection afforded to them they should behave in a manner free from gross negligence.[45] The test for determining whether or not the act of acquisition or payment was grossly negligent is that of the reasonable man. The bona fide third party to whom a stolen or lost instrument is offered for a valuable exchange and the drawee to whom such an instrument is presented for payment are deemed to be grossly negligent in their acquisition and payment respectively when they fail to behave as a reasonable man, the conduct of whom could unveil the irregularity surrounding the status of the document in question.[46]

The circumstances which compel the bona fide third party and the drawee to comply with the standard of care of the reasonable man are not uniform. They are wider in instances where the behaviour of the bona fide third party acquirer is intended to be examined than in those instances where the behaviour of the drawee payor is intended to be examined. In the former instances, the bona fide third party acquirer is deemed to behave with gross negligence when the circumstances surrounding his acquisition raise suspicion as to the regularity of the offered instrument.[47] The bona fide third party acquirer's gross negligence is illustrated in his failure to shop for information as to the regularity of the instrument in question or to refrain from its acquisition.

In instances where the behaviour of the drawee in making payment is intended to be examined, the circumstance which renders this act of payment grossly negligent is illustrated in the failure to identify the presenter when such identification would reveal to the drawee the irregularity surrounding the presented instrument.[48] The fact that the circumstances surrounding the payment of the stolen or lost negotiable instrument raise suspicion as to the regularity of the title of its possess, does not require the drawee to shop for information or to refuse the payment of the presented instrument in favour of the latter.[49] Thus, if the drawee in such circumstances pays the stolen or lost instrument in favour of its possessor, he may establish in his favour a valid discharge. Accordingly, neither his customer nor the original true owner may demand from the drawee payor a recredit of the erroneously debited amount or a fresh payment of the face value of the stolen or lost document.

Unlike the instance in which the bona fide third party acquirer and the drawee payor were informed of the theft or loss of the instrument in question, the majority of the legal systems under consideration do not allocate the resulting loss in full to the grossly negligent acquirer or payor. They apportion the said loss between the party in question and the original true owner, i.e. the person from whom the instrument in conflict was stolen or lost. This is due to the fact that the majority of the Continental Civil legal systems do not deem the

party's gross negligence a complete bar to the strict liability, unless the strictly liable party could show that the fault of the former party is inevitable, unforeseeable, extraneous or unrelated to his i.e. the strictly liable party's conduct. In any other situation, the gross negligence of the injured party does not do more than reduce the extent of liability of the strictly liable party.[50]

It is submitted that the gross negligence of the acquirer or payor is neither inevitable, unforeseeable, extraneous nor is it related to the original true owner's conduct. On the other hand, the original true owner is in the position to avoid placing the third party or the drawee in a situation where he could behave with gross negligence. This could be achieved by exercising a high standard of care so as to prevent his instrument coming into the hands of a fraudulent person in the first place.[51] On the other hand, the grossly negligent behaviour of the third party or the drawee is not totally unforeseeable. The original true owner could, with regard to the huge volume of the circulated negotiable instruments anticipate that the third party and the drawee who engages in the business of acquiring, guaranteeing, accepting and paying such documents could behave with gross negligence. Finally, the grossly negligent behaviour of the third party and the drawee in their acquisition and payment of a vitiated instrument is closely related to the original true owner's own conduct. Such activities would not have occurred had the latter

exercised a high standard of care in the safe custody and negotiation of his documents. From the foregoing, it could be concluded that the majority of the Continental Geneva legal systems would not be prepared to afford the original true owner a complete exoneration from liability by reason that the third party acquirer or the drawee payor was grossly negligent. They are more inclined to reduce his liability to the extent which the grossly negligent party could be blamed for causing it.

The Compatibility of the Anglo-American and the Continental Geneva Legal Systems' General Attitude in Allocating the Risk of the Forgery of Indorsements with the Proposed Risk Allocation Rule

I. By allocating the risk of the forgery of indorsements to either the bona fide third party acquirer or the drawee payor, the Anglo-American legal systems' general attitude in allocating such a risk is submitted to be incompatible with the proposed risk allocation rule. Its application results in allocation of the risk in question to the party who is least capable of providing against its occurrence in an economically efficient manner and conflicts with the special nature of negotiable instruments as a substitute for money.[52] It restricts the liquidation of such documents into money on their day of maturity. Such an application could operate against the genuine acquirer of a genuine negotiable instrument in the sense that it could prevent him from utilising the value incorporated in his document in an enforceable manner and it could forego to

him the right of satisfying the incorporated value from a valuable security.[53] In the last analysis, the introduction of the rule of allocating the risk of the forgery of an endorsement to either the bona fide third party acquirer or the drawee payor could impair the negotiability attribute of negotiable instruments. Accordingly, the objective of promoting the function of the institution of such documents would fail.[54]

II. By comparison, the Continental Geneva legal systems' general attitude in allocating the risk of the forgery of indorsements to the original true owner i.e. the party from whom he vitiated negotiable instrument was stolen or lost is submitted to be more compatible with the proposed risk allocation rule. Its application takes into account the party's capability to provide against the occurrence of the risk in question in an economically efficient manner, in determining the party to whom the blame for causing the said risk should be attributed. Accordingly, it allocates the duty to exercise due care to the party who would suffer the least hardship from its occurrence, whilst it relieves the party who would suffer the most hardship from the duty to exercise such care.[55]

The compatibility of the general attitude of the Continental Geneva legal systems in allocating the risk arising from the forgery of indorsements with the proposed risk allocation rule is that the majority of the said legal systems to not reallocate the loss resulting from such a risk in whole to the grossly negligent acquirer or

payor. That is to say that they do not exonerate the original true owner totally from liability, by reason that the former party was grossly negligent. They only reduce the liability of the original true owner to the extent which the grossly negligent party has contributed.[56]

Such an approach is both reasonable and efficient. It does not throw the blame for causing the loss on the grossly negligent acquirer or payor. It deems the original true owner, due to his failure to exercise a high standard of care, to bear part of the blame for causing the loss. By apportioning the blame for causing the loss resulting from the forgery of an indorsement between the grossly negligent acquirer/payor and the original true owner, the Continental Geneva legal systems appear to take into account the parties' capability to provide against the loss in question in allocating its risk allocation rule. It does not allocate the risk wholly to one party when the said party does not bear on his own the full blame for causing it. It holds the other competing party liable for the loss to which his fault has contributed.

The apportionment of liability rule operates to provide against moral hazard. It creates an incentive to the competing parties to exercise care in their conduct. It also induces them to increase their standard of care so as to avoid establishing liability against them; the increase in the standard of care necessarily avoids or minimises loss occurrence. Once loss occurrence is

avoided or minimised, wealth would be allocated in an economically efficient sense.

III. However, the Continental Geneva legal systems' general attitude in allocating the risk of forged signatures does not fall squarely within the ambit of the proposed risk allocation rule. In instances where the said legal systems reallocate the risk in question to the bona fide third party acquirer and to the drawee payor, they do not all purport to allocate it in an efficient manner. The legal systems which require more than the issuance of a stop payment order, namely the securing of a court order to that effect so as to, firstly, provide the drawee with the necessary information that the presented instrument is stolen or lost, secondly to compel the said party to refuse the payment of the instrument in question and thirdly to hold him liable for the loss resulting from his failure to dishonour it, are submitted to be incompatible with loss prevention.[57] It causes the original true owner, i.e. the person from whom the negotiable instrument was stolen or lost, to forego the opportunity of providing against the payment of the said document in favour of a dishonest person, in a timely manner.

Furthermore, the amortisation procedure as demonstrated by the securing of a court order for the purpose of stopping the payment of the stolen or lost negotiable instrument, is incompatible with the advantages inherent in the negotiability attribute of such documents.

This is due to the fact that the amortisation procedure allocates to the bona fide third party acquirer the burden or enforcing his entitlements. In order to have the court's order lifted, he would have to litigate the case. Accordingly, he would have to persuade the court of trial of his satisfaction of the lawful holder status.[58].

The rule of allocating to the bona fide third party acquirer the duty of litigating his case is onerous. Firstly, it involves cost and secondly it causes the bona fide third party to forego the opportunity to enforce the face value of his instrument on its day of maturity. Due to the involvement of cost, the bona fide third party acquirer might not decide to litigate the case, especially in instances where the face value intended to be enforced is trivial. In such an instance, he would have to bear the loss resulting from the forged indorsement whilst the original true owner would gain a windfall from his failure to exercise the care necessary to provide against the occurrence of such a risk. Due to the fact that litigation prevents the negotiable instrument from being enforced on its day of maturity, the bona fide third party acquirer might have to suspend his commercial engagements, the finance of which is dependent on the value incorporated in the acquired instrument. In such an instance, he would not be able to satisfy his interests in an economically efficient manner. From the foregoing, it could be concluded that the burden of litigation arising from the amortisation procedure, due to its involvement of

cost and time is incompatible with the objective of promoting the function of the institution of negotiable instruments as a substitute for money. It deters the bona fide third party acquirer i.e. the party to whom it is allocated, from acquiring negotiable documents.

A more compatible result would be approached when the bona fide third party acquirer was entitled to lift the stop payment order by securing in his favour a court order to that effect.[59] In such an instance the said party would be relieved of the burden of establishing his entitlement to the face value of the acquired instrument. He would only have to show that at the time when the instrument was offered to him for a valuable exchange it did not, nor did the circumstances surrounding it, raise any suspicion as to its regularity.

By enabling the bona fide third party acquirer to lift the stop payment order by securing a court order to that effect, he would be placed in the shoes of the defendant. Accordingly, the burden of establishing his dissatisfaction of the protected lawful holder status would be allocated to the original true owner. Such a rule would relieve the bona fide third party acquirer of the burden of assuming cost and time. It would encourage the commercial community to engage in the acquisition of negotiable instruments. Finally, it would promote the function of the institution of such documents as a substitute for money.

Exceptions to the General Attitude of the Anglo-American Legal Systems in Allocating the Risk of the Forgery of Indorsements

The Anglo-American legal systems make exceptions to their general attitude in allocating the risk of forged indorsements. There are instances whereby the legal systems under consideration shift from allocating the risk of forged indorsements to the bona fide third party acquirer and the drawee payor respectively. In such instances, they reallocate the risk in question to the original true owner. Notwithstanding the fact that the acquired or paid negotiable instrument is vitiated by a forged indorsement, the Anglo-American legal systems, in the instances under consideration, establish liability on the instrument against the signatory in question in favour of the bona fide third party acquirer and the drawee payor. They entitle the former to enforce the face value of the acquired instrument against its signatory, whilst they entitle the drawee payor to charge to his customer the value paid in respect of the presented instrument. They deny to the party against whom the vitiated instrument is intended to be enforced and they deny to the party against whom the payment of the instrument is intended to operate, the right of challenging the bona fide third party acquirer's entitlement to enforce the payment of the vitiated instrument and they deny to him the right of challenging the drawee payor's act of payment, by setting up the defence of the forgery of an indorsement. In the instances under consideration the

Anglo-American legal systems do not deem the forged indorsement to interrupt the chain of negotiation. They deem it to be effective for the purpose of transferring the property right of the instrument which it vitiates. Accordingly, they deem such a signature to be capable of establishing a good title in favour of a bona fide third party and they deem it to be capable of establishing a valid discharge in favour of the drawee who pays the instrument which it vitiates in favour of who purports to establish his title through it.

The Rule of the Fictitious Payee

In the Anglo-American legal systems, the concept of fictitious payee is interpreted in a broad sense. It denotes the insertion of the name of a person as a payee without intending him to have a valid interest in the instrument on which his name appears as its payee. It is insignificant for the situation of fictitious payee to exist, for the person whose name is inserted in the instrument as its payee to be imaginary or non-existing. The situation in question may be interpreted as a fictitious payee situation, even if the person whose name is used as payee proves to be existing, as long as the person making the instrument payable to the said payee does not intend that the latter should have a valid interest on it.[60]

An example of the situation where a negotiable instrument is deemed to be made payable to a fictitious

payee, notwithstanding the fact that the payee is an existing person could be illustrated by the facts of The Bank of England v Vagliano Brothers.[61] In this case, Vagliano was a merchant residing in London. He had in his employ a clerk. The latter wrote up a bill of exchange and forged the of the correspondent of his employer in Odessa. He made the bill payable to one of the customers of the business of his employer i.e. Vagliano; the clerk presented the bill as such to Vagliano for acceptance. Finally, the clerk indorsed the bill in the name of the payee in favour of a fictitious person. He presented the bill to the Bank of England, with whom it was domiciled, for payment. He purported to be the named indorsee and ultimately, he misled the bank into paying the bill to his favour.

In the foregoing case, the bill was issued in favour of a known and existing customer of the acceptor. However, the insertion of his name was not intended to establish a valid interest in his favour. There was no debt accruing to him from the acceptor. The fact that the bill was issued to a known person did not stop the House of Lords from finding that the case involved a situation of fictitious payee. Lord Herschell, speaking for the majority in the House of Lords, held that the words fictitious payee, were not confined to the situation of non-existing persons. It extends to cover those situations where the named payee is existing but is not intended to have an interest in the instrument on which his name is used. His Lordship said,

> "Whenever the name inserted as that of the payee is so inserted by way of pretence merely, without any intention that payment shall only be made in conformity therewith, the payee is a fictitious person within the meaning of the statute, whether the name be that of an existing person, or of one who has no existence."[62]

The Scope of Applying the Rule of Fictitious Payee in the Anglo-American Legal Systems

I. The Anglo-American legal systems do not adhere to a uniform rule in determining the application of the situation of fictitious payee. They are in disagreement as to what is the decisive factor in determining whether or not such a situation exists. The English legal system deems the intention of the nominal maker/drawer as the decisive factor. It deems the situation of fictitious payee to exist when and only when the nominal maker/drawer intends that the named payee, to whom it purports to be made payable, should not have a valid interest on the instrument, provided that the person to whose favour the instrument purports to be payable is in fact related with the maker or drawer. If, however, the named payee was imaginary or if he was in fact unrelated with the maker or drawer, the decisive factor determining whether or not a situation of fictitious payee exists would be the intention of the active maker or drawer i.e. the person who prepares the negotiable instrument, supplies the name of the fictitious payee and is entrusted with the job of settling the account of the nominal maker/drawer.[63]

The rule that the intention of the nominal maker or

drawer is the decisive factor in determining that whether or not the situation of fictitious payee exists, is incorporated in the decision of the court in Vinden v Hughes[64]. In this case Vinden was a merchant. He had in his employ a clerk who was entrusted with the job of writing up cheques in favour of his employer's customers. In the course of his job, the clerk wrote up several cheques, making them payable to the business's customers. In order to conceal his fraudulent intention, the clerk forged invoices. He indicated in them that debts were accruing to the payees. He next filed the cheques together with the forged invoices to Vinden for signature. The latter, in the honest belief that debts were accruing to the business's customers, signed the cheques and handed them to the clerk for dispatch. Finally the clerk cashed the cheques with Hughes and misappropriated their proceeds.

Obviously, the cheques in the foregoing case were not intended by the clerk i.e. the active drawer, to establish a valid property right in favour of the customers of the business. Their names were inserted as a mere pretence only. Nevertheless, the nominal drawer i.e. Vinden, honestly believed that debts were accruing to the payees. Accordingly, at the time of signing the cheques he intended that the said documents should be remitted to the named payees. That is to say that he intended that the named payees should have a valid interest in the issued cheques.

In this case the court considered the relevant

factor, whether or not the fictitious payee situation occurs to be the intention of the drawer/maker i.e. Vinden. Since he had the intention to confer benefit upon the payees whose names appear on the cheques, they are real payees and not fictitious. Thus for a signature to be effective in transferring the cheque in question, it must be by the hand of the named payee, otherwise it is a forgery and renders the instrument so forged inoperative in the hands of a subsequent taker.

The Court distinguished the case of Bank of England v Vagliano[65] on the grounds that, in that case, there was no true drawer and the forger who purported to act as the drawer, did not intend that the named payee, although he was a customer of the acceptor, should have an interest on the bill of exchange in question. Warrington J. said in effect that, since the names of the payee had not been inserted as a mere pretence, the payees were not fictitious persons and the plaintiffs therefore were entitled to the judgement.[66]

II. In the North American legal system, prior to the U.C.C. the Negotiable Instruments Law (NIL) which was modelled on the B.E.A. had a similar provision to Section 7(3) B.E.A..[67] The courts were caught in the dilemma whether the relevant factor in determining the situation of fictitious payee is the intention of the nominal drawer, or that of the person who dominates the scene i.e. the person who prepares the instrument in question, supplies the name of the payee and delivers the instrument

to the named payee. Some of the courts went along with the former opinion,[68] whilst others followed the latter.[69] Finally the U.C.C. settled the dispute in favour of the second opinion. It declared in Article 3-405 that,

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

The law in the United States stands thus, the signature of a fictitious payee is effective even if it is made by the hand of the supplier of the said name i.e. the agent or employee of the drawer.

The Nature of Instruments Made Payable to Fictitious Payees

I. In the English legal system, instruments made payable to fictitious payees are deemed to be bearer instruments. This is expressly mentioned in Section 7 B.E.A., which reads, in this respect:

> "7(3) Where the payee is a fictitious or non-existing person the bill may be treated as payable to bearer."

II. In the North American legal system, the law regulating the rules relating to commercial paper i.e. negotiable instruments, does not define the nature of instruments payable to fictitious payees. However the official comment to the rule regulating the situation of fictitious payee provides that instruments made payable to

such a person are order instruments. It militates against the view which defines such documents as bearer instruments. The Official Comment to Article 3-405 U.C.C. in this context reads,

> ".... The instrument is not made payable to bearer and indorsements are still necessary to negotiation. The section however recognises as effective indorsement of the types of paper covered no matter by whom made."

The Effect of the Signature in the Name of the Fictitious Payee

I. The determination of the effect of signature in the name of the fictitious payee is related with defining the nature of the instrument which is made payable to a fictitious payee. This is due to the fact that the nature of the instrument determines the necessity of the genuineness of the signature for the purpose of procuring an operative transfer of its property right in favour of a third person.

Since, in the English legal system, instruments made payable to fictitious payees are deemed by law to be bearer instruments, they would be negotiable by mere delivery. The signature i.e. the indorsement of the beneficiary is irrelevant for the purpose of transferring the property right of the bearer instrument. Thus, if the indorsement of the beneficiary was forged, it would not impair the transferability of the property right of such a document. By the same token, if the signature

i.e. the indorsement of the fictitious payee was forged, the negotiability attribute of the instrument which purports to be payable to such a person would not be impaired. Due to its bearer nature, the property right of such a document would be transferable by mere delivery.

Since bearer instruments are negotiable by mere delivery, they create a prima facie presumption of ownership in favour of their possessor. They purport to establish the holder status in favour of their possessor.[70] Accordingly, they purport to establish in favour of the said party, the right to effect a valid transfer of their property right in favour of third persons. They also purport to establish in favour of the possessor the right to demand their payment from the drawee.

Finally, since every possessor of a bearer instrument is its purported holder, its acquisition from him and its payment in his favour establishes a good title in favour of the acquirer and a valid discharge in favour of the payor,[71] the bona fide third party may enforce the face value of the bearer instrument against its signatory, such as the maker and in instances of payment he may return its proceeds. The drawee payor by comparison may charge to his customer the face value of the paid instrument and he may refuse to make a fresh payment in favour of the original true owner. Neither the drawer of a bearer instrument nor its original true owner may, in instances of acquiring or paying such a document, refuse the payment

of the instrument in favour of its bona fide third party acquirer. They may not demand the surrender of the paid proceeds from the latter, they may not demand the recredit of the customer's account with the drawee and they may not demand from the latter a fresh payment in favour of the original true owner.[72] In other words, the drawer and the original true owner of an instrument made payable to a fictitious payee may not challenge the bona fide third party acquirer's good title to the bearer instrument, nor may they challenge the drawee payor's act of payment by setting up the defence of the forgery of the indorsement of the fictitious payee.

From the foregoing, it can be concluded that the English legal system allocates the risk arising from the theft or loss of a bearer instrument to the original true owner, it entitles the bona fide third party acquirer to enforce the acquired instrument against any liable party and it enables him to retain its proceeds in instances of payment. By comparison, it entitles the drawee payor to charge to his customer the face value of the paid instrument and it entitles him to refuse the making of a fresh payment in favour of the original true owner.

Since instruments made payable to fictitious payees are by law bearer documents, the risk arising from their acquisition and payment is allocated to their proprietor i.e. the person who engages on them. He is denied the right of challenging the bona fide third party's and the drawee's act of acquisition and payment, notwithstanding

the fact that the title of the person to whom the instrument is paid was void, the legal system under consideration establishes in favour of the bona fide third party acquirer a good title and it establishes in favour of the drawee payor a valid discharge.

II. In the North American legal system, although instruments made payable to fictitious payees are presumed to be order documents, the law provides that the indorsement in the name of the fictitious payee is effective. This is expressly mentioned in Article 3-405 U.C.C. Article 3-405 reads in this respect:

> "1) An indorsement by any person in the name of the named payee is effective if ....
>
> b) a person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument or
>
> c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest."

The effectiveness of the indorsement in the name of the fictitious payee suggests that the indorsement under that name transfers the property right of such a document in favour of a bona fide third party. It also suggests that the indorsement in the name of the fictitious payee is capable of establishing a valid discharge in favour of the drawee in instances where he makes payment in reliance on it. In fact, the indorsement in the name of the fictitious payee is interpreted as if it is made in the name of the intended payee. It necessarily follows that

the person who establishes his title to the instrument through the indorsement in the name of the fictitious payee may claim in his favour the advantage of good title, whilst the drawee who pays an instrument in reliance on the indorsement in the name of the fictitious payee may claim in his favour the advantage of a valid discharge. In such instances, the original true owner i.e. the person who signs an instrument made payable in favour of a fictitious payee may not challenge the bona fide third party's and the drawee's act of acquisition or payment by setting up the defence that the instrument in question was not signed by the hand of the intended payee. Accordingly, he may not defeat the acquirer's right of recourse against him and the drawee's act of charging to his customer, the face value of the paid instrument by setting up the defence that the indorsement in the name of the fictitious payee is inoperative.

From the foregoing, it could be concluded that, like the English legal system, the North American legal system allocates the risk arising from the acquisition and/or payment of an instrument made payable to a fictitious payee, to the original true owner. It establishes liability on the instrument against the said party. It denies him the right of challenging the bona fide third party acquirer's right of recourse against him whilst it denies him the right of challenging the drawee payor's act of payment.

The Compatibility of the Risk Allocation Rule of the Anglo-American Legal Systems in Allocating the Risk Arising From the Issuance of Negotiable Instruments in Favour of Fictitious Payees with the Proposed Risk Allocation Rule

I. The allocation of the risk arising from the issuance of negotiable instruments in favour of fictitious payees to the original true owner is submitted to be compatible with the proposed risk allocation rule. The proprietor of instruments which purport to be issued in favour of fictitious payees is the best situated person to provide against the occurrence of the said risk. It can be provided against by his exercise of a high standard of care in the safe custody and negotiation of his documents. In instances where the proprietor entrusts his employees with the safe keeping and negotiation of such documents, he can provide against the issuance of instruments in favour of fictitious payees, by exercising a high standard of care in selecting his employees and by exercising a high standard of care in supervising their work.[73]

The allocation to the proprietor of instruments of the duty to exercise:

1) the safe custody and negotiation of such documents,

2) the selection of employees to whom he entrusts the job of safe keeping and negotiation and,

3) the supervision of the work of the said employees,

is not unduly onerous, nor is the establishment of his liability for the loss resulting from his failure to exercise such care, unreasonable. It is submitted that

the exercise of a higher standard of care is profitable to his business. It results in promoting it and ultimately it enables him to spread the arising cost among his customers.[74] Due to his status as the proprietor of a business, the original true owner to whom the duty to exercise care is intended to be allocated and against whom the risk arising from his failure to comply with his duty of care is intended to be established, is submitted to be in the position to appreciate the rate and the gravity of the loss arising from his employee's fraudulent practice. Accordingly, he is presumed to be in the position to determine the necessity to provide for insurance and its extent. Thus if he deems the duty to exercise a high standard of care too onerous, he may provide for insurance. The cost involved in the provision for insurance could, however, be recovered by spreading it among his employees and customers. This could be approached through wage and service rating.

The allocation of the duty to exercise a high standard of care to the proprietor of instruments is less onerous than its allocation to the bona fide third party acquirer or the drawee payor. Its allocation to the bona fide third party acquirer requires him to invest cost and time in an economically detrimental manner or it requires him to refrain from acquiring negotiable instruments from persons, the character of whom he is not familiar with. The former alternative is economically detrimental to the bona fide third party acquirer. Due to his status as such, he is not in the position to derive a practical

enforceable value from the investment of cost and time, nor is he in many cases in the position to absorb them.[75] The second alternative is detrimental to the institution of negotiable instruments. It restricts the free transferability of such documents. Ultimately, it impairs the objective of promoting the function of the institution of negotiable instruments as a substitute for money.

The allocation of the duty to exercise a high standard of care to the drawee payor does not, by comparison result in an undue hardship to him. Nevertheless, the allocation of such a duty to him results in a detriment to the institution of negotiable instruments. Due to the involvement of time, the exercise of a high standard of care prevents the negotiable instrument from being liquidated into money on its day of maturity. It presents the said document from fulfilling its intended function i.e. as a finance device.

A further difficulty confronting the allocation of the duty to exercise a high standard of care, to the drawee payor, is that such a rule operates against the genuine acquirer of a genuine negotiable instrument. Due to the involvement of time, it prevents him from satisfying his entitlements in an economically efficient manner and it could cause him to forego the opportunity to satisfy his entitlements from a valuable security.[76] Such difficulties could deter the commercial community from engaging in the acquisition of negotiable instruments. Ultimately it could impair the objective of

promoting such an institution.

Finally, the allocation to the drawee payor of the duty to provide for insurance is inefficient. Although its provision avoids the inconveniences inherent in the exercise of a high standard of care and although the cost arising from its provision could be absorbed by spreading it among the beneficiaries of the banking business, its allocation to the drawee results in the initial allocation of the risk arising from the issuance of an instrument in favour of a fictitious payee to a relatively innocent party, whilst it results in a windfall in favour of the negligent party, namely, the original true owner. The latter is presumed to be negligent in the instances under consideration because the issuance of an instrument in favour of a fictitious payee is facilitated by his failure to exercise care in the selection and supervision of employees with whom he entrust the job of safe keeping and negotiation of his instruments.[77]

By initially allocating the loss resulting from the issuance of an instrument which is made payable to a fictitious payee, in favour of the negligent original true owner, such party might escape liability for the resulting loss. This would be the case especially when the resulting loss is trivial and when the person to whom the loss is initially allocated is not related to the original true owner. Due to the cost involved in suing the latter party, the person to whom the loss resulting from the issuance of an instrument in favour of a fictitious payee

is allocated, such as the drawee payor, might not consider court settlement practical; the loss in question would be allocated conclusively to him.

It is submitted that the allocation of the loss resulting from the issuance of instruments to a fictitious payee in favour of the proprietor of such documents could encourage the said party to behave recklessly. His behaviour as such would increase the rate of loss occurrence. Accordingly, it would result in a misallocation of wealth. The loss that would be invested to satisfy urgent needs would have to be invested to repair the damage that could have been avoided by the exercise of manageable care.[78]

II. A related subject matter to determining the compatibility of the risk allocation rule, in instances of issuing negotiable instruments in favour of fictitious payees, with the proposed risk allocation rule is the determination of the scope of the risk allocation rule underlying the situation in question. In instances where the scope of the rule is restricted, the manner of allocating the resulting loss would be removed from the proposed risk allocation rule. The risk arising from the situation which is not governed by the rule in question, would be governed by the general rule which formulates the risk allocation rule applicable to the forgery of signatures. Since the general risk allocation rule in the Anglo-American legal systems is incompatible with the proposed risk allocation rule,[79] the risk arising from the

issuance of a negotiable instrument in favour of a fictitious payee would be allocated in an economically inefficient manner. In instances where the rule underlying the allocation of the risk arising from the issuance of negotiable instruments in favour of a fictitious payee is enlarged, the resulting loss would be allocated in a manner more compatible with the proposed risk allocation rule. Its application would restrict the scope of the general risk allocation rule. Ultimately, it would narrow the situations where the resulting loss would be allocated in an economically inefficient manner.

The English legal system illustrates the restricted scope of the rule underlying the allocation of the risk arising from the issuance of a negotiable instrument in favour of a fictitious payee. This is due to the fact that it determines the existence of a situation of fictitious payee by reference to the intention of the nominal maker or drawer.[80] In instances where the said person intends, at the time of issuing his document, to confer an interest on the instrument in favour of the named payee, there would not be a situation of a fictitious payee. This would be the case even if the active drawer i.e. the supplier of the name of the payee did not intend the latter to possess an interest on the instrument. In such an instance, the instrument would have to be indorsed by the named payee. If the supplier of the name of the payee misappropriates the instrument by indorsing it with the name of the latter, his act as such would be a forgery. The resulting loss would be

allocated to the bona fide third party acquirer or the drawee payor.[81]

The allocation of the risk arising from the indorsement in the name of the named payee to the bona fide third party acquirer and the drawee payor is inefficient. The bona fide third party acquirer and the drawee payor are not, in the instances under consideration, in the position to provide against the occurrence of loss in an efficient manner. The care, the compliance with which could provide against the occurrence of loss, would either result in an economic detriment to the party to whom it is intended to be allocated, or it would result in a detriment to the institution of negotiable instruments.[82] The person who is in the position to provide against the occurrence of loss, in the instances under consideration, is presumed to be the original true owner, i.e. the proprietor, who issues his instrument in favour of a fictitious payee. This could be achieved by the exercise of care in the selection and supervision of his employees to whom he entrusts the job of safekeeping and negotiating negotiable instruments. The allocation of such a duty to the proprietor of negotiable instruments is not unduly onerous. The exercise of such care is, firstly, profitable to his business and secondly, the cost arising from the exercise of care could be absorbed by him.[83] Since the English legal system allocates the risk arising from the indorsement in the name of the fictitious payee to the bona fide third party acquirer, or to the drawee payor, it

is presumed to allocate it to a relatively innocent party. By comparison, it is presumed to allocate the arising risk in favour of the guilty party. Ultimately, the risk allocation rule which it enforces is presumed to give rise to moral hazard.

The North American legal system illustrates the enlarged scope of the rule underlying the allocation of the risk arising from the issuance of negotiable instruments in favour of a fictitious payee. It determines the existence of a situation of fictitious payee by reference to the intention of the active maker/drawer i.e. the person who supplies the name of the payee.[84] In instances where the said party inserts the name of the payee by way of pretence only, the legal system under consideration establishes the existence of a situation of fictitious payee. This would be the case even if the nominal maker or drawer intended, at the time of issuing his instrument, that the entitlement incorporated in it should run in favour of the named payee. From the foregoing, it could be concluded that the North American legal system enlarges the instances whereby the indorsement in the name of the named payee may be effective. It enlarges the situation whereby the risk would be allocated in favour of the bona fide third party acquirer and the drawee payor. It enlarges the situation whereby the signatory of a negotiable instrument would be held liable on the negotiable instrument. Ultimately it enlarges the situations whereby the risk arising from the indorsement in the name of the named payee, by the hand of

other than the latter, would be allocated to the original true owner. Such an attitude is more compatible with the proposed risk allocation rule. It allocates the risk arising from the forgery of a signature to the party in the position to provide against its occurrence, namely, the original true owner.[85] It narrows the situations whereby the risk would be allocated to a relatively innocent party i.e. the bona fide third party acquirer and the drawee payor.

The Rule of Impersonated Payee

The situation of impersonation occurs in the context of negotiable instruments when one person defrauds another as to his true character. In his character as such he misleads the latter person in engaging with him in a business relationship. Accordingly, he induces the latter to issue in his favour a negotiable instrument as a means of settling the underlying commercial obligation.

The fraudulent acquisition of a negotiable instrument by way of impersonation takes two forms. Either the fraudulent person represents himself to the defrauded person to be the principal party with whom the commercial transaction is intended to be concluded, or he represents himself to be the authorised agent of another on whose behalf he intends to conclude the transaction in question. In the former instance, the defrauded person issues a negotiable instrument exclusively in favour of the fraudulent person. He intends the latter to have an

interest in the issued instrument. In instances where the fraudulent person represents himself as the authorised agent of another, the defrauded person issues the negotiable instrument in favour of the principal. But he delivers it to the purported agent in order to secure its remittance to the former. In such an instance, the maker or drawer does not intend to establish in favour of the purported agent, a valid interest in the issued negotiable instrument. Rather, he intends to establish such an interest in favour of the latter or to whose favour the latter so orders. In order to illustrate the first form of impersonation, assume that Willy Williams, a fraudulent person represents himself to John Alex to be Jimmy Johnbow, a well known stockbroker. Willy Williams, in his fraudulent character, induces John Alex who happens to be a share purchaser, to buy shares of a named company, on the basis that the shares of the said company will rise dramatically because of the increasing demand. John Alex fancies the deal and entrusts Willy Williams to purchase the said shares. By way of enabling him to purchase the required shares, John Alex issues a cheque in favour of Willy Williams in his impersonated character.

The above illustration indicates that the maker of the negotiable instrument i.e. the cheque, intended to deal with the fraudulent person himself, albeit he honestly believed that he was the person whom he represented to be, i.e. Jimmy Johnbow, the well known stockbroker. The maker i.e. John Alex, did not intend to deliver the cheque to Willy Williams as the agent of Jimmy

Johnbow. Rather he intended that he should have a valid interest on the cheque. That is to say that John Alex intended to issue the cheque in favour of Willy Williams.

The Application of the Rule of Impersonated Payee in the Anglo-American Legal Systems

I. The North American legal system regulates in express terms the situation of impersonated payee. Article 3-405 U.C.C. regulates such a situation. In this respect it reads:

> "1) An indorsement by an person in the name of a named payee is effective if
> a) an impostor by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee ...."

The foregoing provision does not appear to contemplate the situation where the fraudulent person represents himself to be the agent of another. It appears to regulate the situation where the fraudulent person represents himself to be the principal with whom the commercial transaction is intended to be concluded. Thus if the fraudulent person represents himself to be the authorised agent of another, there would not, strictly speaking, be a situation of impersonated payee.[86] The risk arising from such an instance would not be regulated by the rule incorporated in Article 3-405 U.C.C. The person who is interested to reallocate the resulting risk to the original true owner would have to rely on other provisions in the law, the application of which would

result in allocating the risk in question to the original true owner. Otherwise the general rule relating to the allocation of the forgery of indorsements would apply. That is to say that the loss resulting from the forgery of an indorsement would have to be allocated to the bona fide third party acquirer, or to the drawee payor.

An example of the instance in which the fraudulent person represents himself to be the authorised agent of another arises when Willy Williams represents himself 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 fancies the bargain and 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.

In the foregoing illustration, John Alex did not intend to engage with Willy Williams. Rather his intention was directed to engage with Williams Household Electrics. His only relationship with Willy Williams is with that of the agent of another. Accordingly, at the time of issuing the cheque, John Alex did not intend to establish in favour of Willy Williams a valid interest on it. His delivery of the cheque to him was for the purpose of securing its remittance to the intended payee,

namely Williams Household Electrics.

According to the North American legal system, Willy Williams in such an instance could not indorse the cheque in the name of Williams Household Electrics. His act as such constitutes a forgery. It is incapable of transferring the property right of the cheque in favour of a bona fide third party, nor is it capable of authorising the drawee to pay the said document in reliance on it. Thus if Willy Williams indorses the cheque in the name of Williams Household Electrics and cashes it with a bona fide third party acquirer or with the drawee, the arising loss would be allocated to the cashier. In such an instance, the latter may not enforce the value incorporated in the acquired instrument against any prior signatory, be he the person who caused the instrument to be delivered to the impostor, nor may he charge the face value of his payment to the maker or drawer of the said document.

The theory underlying the North American legal system's distinction in allocating the applicable risk allocation rule to the instance where the fraudulent person represents himself to be the principal, with whom the commercial transaction is intended to be concluded and the instance where he represents himself to be the authorised agent of another, is the intention of the maker or drawer of the negotiable instrument.[87] The legal system under consideration deems the intention of the maker or drawer of a negotiable instrument as the relevant factor, in determining whether or not the rule

characterising the situation of impersonated payee applies. In instances where the maker or drawer intends to confer an interest on the negotiable instrument in favour of the fraudulent person, albeit that he impersonates another person, it enforces the rule characterising the situation of impersonated payee. In instances where the fraudulent person does not intend to confer an interest on the negotiable instrument in favour of the fraudulent person, such as the case when the said party represents himself to be the authorised agent of another, it enforces the rule which characterises its attitude in allocating the risk arising from the forgery of indorsements. It deems the signature in the name of the person to whose favour the fraudulent person induces the maker or drawer to issue the negotiable instrument, a forgery. Accordingly, it deems such an indorsement inoperative for the purpose of establishing a good title in favour of a third party and it deems it inoperative for the purpose of establishing a valid discharge in favour of the drawee payor.[88] In the last analysis, it results in allocating the loss arising from the indorsement in the name of the intended payee, to the bona fide third party acquirer and to the drawee payor.

II. By comparison, the English legal system does not provide a special rule for the situation of impersonated payee. It applies to it the rule characterising the attitude in allocating the risk of the forgery of indorsements. It deems the indorsement in the name of

the impersonated payee a forgery. It deems such an indorsement inoperative for establishing a good title in favour of a bona fide third party and it deems it inoperative for the purpose of establishing a valid discharge in favour of the drawee payor. In other words, the English legal system allocates the risk arising from the issuance of an instrument in favour of an impersonated payee to the bona fide third party acquirer and to the drawee payor. It denies to the former the right of enforcing the value incorporated in the acquired instrument against any prior signatory, be he the person who caused the issuance of the instrument in favour of an impersonated payee, whereas it denies to the drawee payor the right to charge to his customer the face value of the paid document.

The rule incorporated in section 7(3) B.E.A.[89] apparently does not apply to the situation of impersonated payee. By virtue of the decision in Vindem v Hughes,[90] the decisive factor which determines whether or not a situation of fictitious payee exists, is the intention of the nominal maker drawer. When and only when the said party does not intend the named payee to have an interest in the negotiable instrument, to whose favour it purports to be made payable, such a document may be characterised as a bearer instrument.

Since, in situations of impersonated payee the maker or drawer of a negotiable instruments intends to confer the entitlements incorporated in his document in favour of the impersonated payee and not to the impostor himself,

the latter may not indorse the instrument in the name of the impersonated payee without his authorisation. His act as such constitutes a forgery. Accordingly, it is incapable of transferring the property right of the instrument in question in favour of a third party, nor is it capable of operating as an authority to the drawee to pay the face value of the presented instrument.

Apparently the theory underlying the English legal system's rule of allocating the risk of delivering or issuing negotiable instruments to an impostor, is the intention theory. It considers the intention of the nominal maker or drawer of the negotiable instrument the relevant factor which determines whether or not the property right of the said document is intended to be transferred in favour of the impostor.[91] It appears to interpret the intention of the said party in a subjective manner. That is to say that the English legal system appears to suggest that the proprietor, at the time of issuing his instrument does not intend to engage with the impostor in person. Rather he intends to engage with the person whom the impostor represents to be. Thus, by delivering or issuing the instrument in favour of the impostor, he does not intend to confer an interest on the instrument in favour of the latter. Accordingly, he may not appropriate the entitlement incorporated in the acquired negotiable instrument to his own interest by indorsing it to a third party, or by cashing it with the drawee. His behaviour as such would be a forgery and

accordingly, it would be divested of any practical value.[92]

The Nature of Instruments Issued or Delivered to an Impostor

In the English, as well as the North American legal systems, instruments issued or delivered to impostors are deemed order documents. This could be inferred from the fact that the legal systems under consideration confine the bearer nature of instruments to those documents which expressly provide that they are payable to bearer, or those documents the last endorsement on which, is an indorsement in blank. For an example, section 8(3) B.E.A. reads in this context:

> "....3) a bill payable to bearer which is expressed to be so payable or on which the only or last indorsement is an indorsement in blank."[93]

Obviously, instruments issued or delivered to impostors are not covered by the above mentioned section. They neither expressly say that they are payable to bearer, nor the indorsement according to which the impostor establishes his possession is an indorsement in blank. On the contrary, such an instrument expressly provides that it is payable to a named payee, namely to the person whom the impostor represents himself to be, or the person whom the impostor represents to be his authorised agent.

Section 7(3) B.E.A.[94] which extends the bearer nature

to instruments payable to fictitious payees, does not apply to instruments made payable to impostors. By virtue of the decision in Vinden v Hughes,[95] for a situation of fictitious payee to exist, the nominal maker or drawer of a negotiable instrument at the time of issuance, should not intend to confer an interest on the instrument in question in favour of the named payee. The issuance of his instrument in favour of the latter should be made by way of pretence only. As has been mentioned earlier, the maker or drawer at the time of issuing his instrument, or delivering it to an impostor does not intend to insert the name of the intended payee by way of pretence. Rather, he intends that the said party should establish a valid interest on the instrument. Accordingly, instruments issued or delivered to impostors cannot be characterised as instances giving rise to a situation of fictitious payee.

The Effect of the Signature in the Name of the Impersonated Payee

I. The determination of the effect of signatures in the name of the impersonated payee is closely related with determining the nature of the instrument made payable to such a party. The determination of the nature of such an instrument would determine the necessity that the said document be signed by the hand of the impersonated payee. Since, in the Anglo-American legal systems, instruments issued or delivered to an impostor are presumed to be

order documents, they would have to be signed i.e. indorsed by the hand of the impersonated payee.[96] If the indorsement in the name of the impersonated payee was made by the hand of the impostor, it is presumed to be a forgery. This is due to the fact that such a signature falsifies the instrument in the sense that it renders such a document to tell a lie about itself. It suggests that it is signed by the impersonated payee whereas in fact it is signed by the impostor.[97] Since the indorsement in the name of the impersonated payee is a forgery, it is deemed by law inoperative for the purpose of transferring the property right of the instrument which it vitiates and it is deemed to be inoperative for the purpose of directing the drawee to pay in accordance with it.[98] From the foregoing, it could be concluded that the indorsement in the name of the impersonated payee is incapable of establishing a good title in favour of the acquirer, nor is it capable of establishing a valid discharge in favour of the drawee payor. It results in allocating the evolving loss to either of the above mentioned parties.

II. However, the North American legal system derogates from the above mentioned rule in instances where the maker or drawer issues his instrument in favour of the impostor, albeit that he issues the said document in the honest belief that the said party is the person whom he represents himself to be. In such an instance, the legal system under consideration deems such a signature in the

name of the impersonated payee effective, even when it is made by the impostor. This is expressly mentioned in Article 3-405 U.C.C. It reads in part:

> "1) An indorsement by any person in the name of a named payee is effective if
>
> a) an impostor by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee."

The effectiveness of the indorsement in the name of the impersonated payee indicates that such a signature operates, for the purpose of transferring the property right of the negotiable instrument in which it appears, in favour of a third party. It also indicates that it is operative for the purpose of authorising the drawee to pay the face value of the presented instrument in favour of its indorsee. Ultimately, it enables the bona fide third party acquirer who establishes his title to the negotiable instrument from or through such a signature, to enforce in his favour the incorporated value against any or all liable parties, whilst it enables the drawee payor to charge to his customer, i.e. the maker or drawer of the negotiable instrument, the paid face value. In other words, the indorsement in the name of the impersonated payee results in allocating the loss evolving from the issuance of a negotiable instrument in favour of an impostor, to the original true owner, i.e. the person who was misled into issuing the instrument in question in favour of such a person.

The Compatibility of the Rule of the Anglo-American Legal Systems, in Allocating the Risk Arising From the Delivery and Issuance of Negotiable Instruments to an Impostor, with the Proposed Risk Allocation Rule.

I. Due to the fact that the English legal system allocates the risk arising from the delivery and issuance of a negotiable instrument in favour of an impostor, to the person who acquires it from such a party, or the drawee who pays it in favour of the latter, the said legal system is presumed to enforce a risk allocation rule incompatible with the proposed risk allocation rule. It results in allocating the risk in question in favour of the guilty party, whilst it allocates the blame for causing it to a party who is incapable of providing against it in an efficient manner.

The bona fide third party acquirer and the drawee payor are presumed to be incapable to provide, in an efficient manner, against the risk arising from the delivery and issuance of negotiable instruments in favour of an impostor, because compliance with the care which could provide against the occurrence of such a risk would either result in an undue detriment to the party to whom it is intended to be allocated, or it results in a detriment to the institution of negotiable instrument. To comply with the standard of care which could provide against the occurrence of the risk under consideration, would result in an economic detriment when it is allocated to the bona fide third party acquirer. The exercise of

such care requires the bona fide third party acquirer to invest cost and time. The need to invest cost and time arises from information shopping i.e. the only method through which the bona fide third party acquirer can reveal the true status of the offered instrument and the title of its possessor.

It is submitted that the bona fide third party acquirer is not in the position to derive an enforceable value from information shopping. It causes him to invest cost and time without generating to him a practical value in consideration. Moreover, the bona fide third party acquirer is not, in many instances, in the position to absorb the involved cost and time. There might not be other persons among whom he can spread the incurrable cost. In other words, the allocation to the bona fide third party acquirer of the duty of information shopping, results in a misallocation of wealth to him.[99]

The care, the compliance with which could provide against the risk arising from the delivery and issuance of a negotiable instrument in favour of an impostor, would result in a detriment to the institution of negotiable instruments when it is allocated to the drawee. Its allocation to the said party requires him to shop for information as to the true status of the presented instrument, the circumstances surrounding its issuance and the true status of its possessor. Information shopping is the only practical method through which the drawee can provide against the risk arising from the delivery and issuance of a negotiable instrument to an impostor. The

dishonouring of a presented instrument is not, by comparison, recommended. It could render the drawee liable to his customer for substantial damages which it could cause to the latter's business.[100]

Information shopping involves time. The involvement of time prevents the presented negotiable instrument from being liquidated into money on its day of maturity. Accordingly, it prevents the document in question from fulfilling its intended function, namely as a finance device. Furthermore, the involvement of time in the information shopping operates against the genuine acquirer of a genuine instrument. It prevents him from satisfying his entitlement in an economically efficient manner and it could cause him to forego the opportunity to satisfy the entitlement in question against a valuable security.[101] Due to the above inconveniences, the commercial community would be deterred from acquiring negotiable instruments. Ultimately the free circulation of such documents would be restricted, whereas the objective of promoting the institution of negotiable instruments as a substitute for money would fail.

The person who is presumed to be guilty of causing the risk of the delivery and the issuance of a negotiable instrument in favour of an impostor to arise, is the original true owner, i.e. the person who delivers or issues the negotiable instrument to an impostor. This is due to the fact that his failure adequately to identify the person with whom he intends to engage is presumed to

give rise to the risk in question. In instances where he is not certain as to the true identity of another, he should refrain from dealing with him. His behaviour as such would not impair the objective of promoting the institution of negotiable instruments. Either there would not be a negotiable instrument, the free transferability of which is intended to be promoted, or the proprietor of the instrument in question can exchange for value with another person, the identity of whom he is satisfied with and who is able to offer the proprietor the desired value with which he intends to exchange his document.

If the proprietor of negotiable instruments was discharged from the foregoing duty he would facilitate the coming of his documents into the hands of fraudulent persons. Ultimately, he would enable the latter to perpetrate their fraud and mislead bona fide third parties or he would enable the fraudulent persons to perpetrate their fraud against the drawee. In such an instance, the behaviour of the proprietor would result in an increase in the rate of loss occurrence. Once the rate of loss occurrence was increased, wealth would be misallocated. The party to whom the resulting loss is allocated would have to invest cost to repair the damage in instances where it could be avoided by the exercise of care.

II. By comparison, the North American legal system is more compatible with the proposed risk allocation rule. In instances where the proprietor of an instrument issues

it in favour of an impostor, the legal system under consideration allocates the resulting loss to the proprietor. It establishes liability against him. It establishes a good title in favour of the bona fide third party who derives his possession of the instrument through the indorsement in the name of the impersonated payee and it establishes a valid discharge in favour of the drawee who pays in reliance on such an indorsement. It entitles the former party to exercise a right of recourse against any or all liable parties including the proprietor who issued the instrument in favour of the impostor, whilst it entitles the drawee payor to charge to his customer the face value of the paid instrument.

The allocation of the risk arising from the issuance of a negotiable instrument in favour of an impostor, to the original true owner, is submitted to be efficient. In the instance under consideration the said party is presumed to be most at fault. His fault is illustrated in his failure to adequately identify the person with whom he intends to engage. Thus, it is reasonable to allocate to him the blame for causing the risk. If the proprietor of instruments, in the instances under consideration, was to be discharged of the duty to exercise care, the rate of loss occurrence would increase and ultimately wealth would be misallocated.[102]

However, the rule of the North American legal system in allocating the risk arising from the delivery and issuance of negotiable instruments to an impostor, does

not fall squarely within the proposed risk allocation rule. In instances where the risk arises from the delivery of a negotiable instrument to an impostor, the legal system under consideration allocates it inefficiently. This is due to the fact that it allocates the risk in question to either the the bona fide third party acquirer or to the drawee payor.[103]

It could be recalled that neither the the bona fide third party acquirer, nor the drawee payor could be blamed for causing the loss in the instance under consideration. They are not presumed to be in the position to provide, in an efficient manner, against the risk arising from the delivery of a negotiable instrument to an impostor. The allocation of the duty to exercise care that could provide against the risk in question, would either result in an economic detriment to the party to whom it is intended to be allocated, or it would result in a detriment to the institution of negotiable instruments.[104]

The party who is presumed to be in the position to provide against the risk arising from the delivery of a negotiable instrument to an impostor, is the proprietor of such a document i.e. its original true owner. He is in the position to provide against the said risk by the exercise of care in identifying the person with whom he intends to engage. If the proprietor of negotiable instruments was to be discharged of the duty to exercise the above mentioned care, he would be entitled to gain a windfall from his negligence and more significantly, he

would be encouraged to behave carelessly. Once proprietors of negotiable instruments are encouraged to behave carelessly, the rate of loss occurrence would increase and ultimately, wealth would be misallocated.

III. The inefficiency resulting from the Anglo-American legal systems' rule in allocating the risk arising from the delivery or the issuance of a negotiable instrument to an impostor, is due to their adherence to the intention theory.[105] They deem the intention of the proprietor of such a document as the relevant factor which establishes his liability on the instrument. In instances where he intends to issue the negotiable instrument in favour of the impostor, he is presumed to have accepted to bear the liability arising from his engagement in favour of the person with whom the impostor cashes the instrument. In instances where the proprietor does not intend to issue his negotiable instrument in favour of the impostor, such as the case when he delivers it to the latter as the agent of another, he is not presumed to have accepted the liability arising from his engagement in favour of the person with whom the impostor cashes it.

To state the obvious, the intention theory is inconvenient as a test for formulating the risk allocation rule. Its involvement results in an inconsistent application. This is due to the fact that the notion of intention is susceptible to an objective and a subjective interpretation. The subjective interpretation focuses on the actual intention of the party, whilst the objective

interpretation defines the intention of the party by examining it with that of an independent person. It presumes the intention of a person to exist when an independent person is able to infer it. In other words, the objective interpretation applies a legal fiction in order to infer the existence of intention on the part of the party under examination.

An example of the instance whereby the invocation of the intention theory could result in an inconsistent application, is that arising from the issuance of a negotiable instrument in favour of an impostor. In determining the effect of the indorsement by the hand of the impostor, in the name of the impersonated payee, the English legal system appears to focus on the actual intention of the proprietor of such a document i.e. the person who issues it in favour of an impostor.[106] Since, in fact, the issuer of such a document does not intend to engage with the impostor in his true character, he would not be presumed to transfer the property right of his instrument in favour of the said party. Accordingly, the impostor would not be able to indorse the acquired instrument by his own hand. His act as such would be deemed a forgery and, ultimately, it would be deemed inoperative for the purpose of transferring the property right of the instrument in question and it would be inoperative for the purpose of establishing a valid discharge.[107]

Prior to the U.C.C., in determining the effect of the

indorsement by the hand of the impostor in the name of the impersonated payee, some American courts inferred the existence of an intention on the part of the issuer of a negotiable instrument in favour of an impostor, to transfer the property right of such a document to the latter.[108] They approached such an inference by interpreting the intention of the issuer objectively. They were of the view that the proprietor of a negotiable instrument, at the time of issuing his document in favour of an impostor, intends to engage with the latter in person. He does not intend to engage with the impersonated payee as such. Accordingly, by issuing the negotiable instrument in favour of the impostor, the proprietor is presumed to intend to transfer the property right of the said document in favour of the latter. He is also presumed to authorise the said party to appropriate the issued instrument. Accordingly, he is presumed to authorise the impostor to transfer the property right of the instrument in favour of a third party and he is presumed to authorise him to demand payment from the drawee.

The inconvenience arising from the inconsistent interpretation of the intention theory are threefold. In the first place it could result in allocating risk in an inefficient manner. It could allocate the said risk in favour of the guilty party. Ultimately, it could give rise to a situation of moral hazard whereby wealth would be misallocated.[109] In the second place, the invocation

of the intention theory for the purpose of formulating the risk allocation rule results in importing legal fiction. This is deliberately made so as to avoid the hardship arising from its strict application.[110] In the third place, the inconsistent interpretation that could arise from the application of the intention theory results in an uncertainty as to the applicable risk allocation rule. Such a result is inconvenient in commerce. Either it gives rise to information shopping or it results in an increase in the rate of court settlement. Both results are economically detrimental. Their involvement necessitates the investment of cost and time. The investment of cost could result in an economic detriment to the party to whom it is allocated, whilst the investment of time could prevent the institution of negotiable instruments from fulfilling its intended function in an efficient manner.

The U.C.C. has partially renounced the intention theory as a test for formulating the risk allocation rule in the context of negotiable instruments. In instances where the proprietor of a negotiable instrument issues his document in favour of an impostor, the official comment to Article 3-405 U.C.C. militates against the contention that the intention theory operates as a basis for allocating the resulting loss to the original true owner i.e. the proprietor who issues the negotiable instrument in favour of the impostor. The official comment reads in this context:

> "2) Subsection 1a is new. It rejects decisions which distinguish between face to face imposture and imposture by mail and holds that where the parties deal by mail the dominant intent of the drawer is to deal with the name rather than the person so that the resulting instrument may be negotiated only by indorsement of the payee whose name has been taken in vain. The result of the distinction has been under some prior law, to throw the loss in the mail imposture forward to a subsequent holder or to the drawee. Since the maker or drawer believes the two to be one and the same, the two intentions cannot be separated and the 'dominant intent' is a fiction. The position here taken is that the loss regardless of the type of fraud which this particular impostor has committed, shall fall upon the maker or drawer."

Apparently, the basis according to which the North American legal system allocates the risk arising from the issuance of a negotiable instrument in favour of an impostor, to the original true owner, is the latter's failure to exercise care in engaging with strangers. It appears to allocate to the proprietor of a negotiable instrument the duty to adequately identify the person with whom he intends to engage. If he fails to comply with such a duty, it appears to presume that the proprietor has enabled the impostor to appropriate the acquired instrument for his own interest. Accordingly it appears to presume that the proprietor's conduct has enabled the impostor to transfer the property right of the instrument in favour of a bona fide third party and it appears to presume that the proprietor's conduct has enabled the said party to mislead the drawee in making payment.

In their current revision to Article 3 U.C.C., the American Law Institute and the National Conference on Codification of the Uniform State Laws extended the

renunciation of the intention theory to the instances where the proprietor of a negotiable instrument delivers his instrument to an impostor. In such an instance, the new Article 3 allocates the arising risk to the original true owner i.e. the proprietor who delivers his instrument to an impostor.[111] Such a risk is allocated to the original true owner, regardless of the intention attributable to him and regardless of his compliance with the duty of reasonable care. It draws a conclusive presumption that the original true owner who delivers a negotiable instrument to an impostor is liable for the resulting loss. That is to say, that the new Article 3 allocates to the proprietor of a negotiable instrument the duty to exercise a high standard of care. This is illustrated in the duty to adequately identify the person with whom he intends to engage.

The allocation of the risk arising from the delivery of a negotiable instrument to an impostor, to the proprietor who delivers his instrument to such a person is not unreasonable. It is substantially similar to the instance when the employee of another misleads the latter in issuing a negotiable instrument in favour of a fictitious payee. In both instances, the proprietor places his trust in fraudulent persons, the selection of whom and the engagement with whom he does not strictly verify. In both instances, the fraudulent person supplies the name of another in order to defraud the proprietor of a negotiable instrument to deliver the instrument to him and in both instances, the fraudulent

person does not intend to confer a benefit on the instrument in favour of the person whose name he supplies. Since, by virtue of Article 3-405 U.C.C.,[112] the risk arising from the issuance of a negotiable instrument in favour of a fictitious payee, is allocated to the original true owner, the same rule should be applied in instances where the instrument is delivered to an impostor who inserts the name of the payee by way of pretence only.

The Rule of an Incomplete Instrument

An incomplete instrument is the document which purports to function as a negotiable instrument i.e. bill of exchange, promissory note or cheque but which does not incorporate all of the particulars of a negotiable instrument. However, for a document to function as a negotiable instrument, it must be signed by its maker or drawer.[113] In this context, the concept of incomplete instrument is interpreted narrowly. It denotes the document which does not contain the name of the payee. An example of such a document arises when the proprietor of a cheque book places his signature on a cheque slip without indicating the person to whose favour it is intended to be payable.

The foregoing instance articulates the problem of conflicting entitlements. This is due to the fact that the non-insertion of the name of the payee renders the incomplete instrument more vulnerable to misuse in instances of its theft or interception. The thief or

finder of such a document would not have to forge any signature in order to perpetrate his fraud and, ultimately, misappropriate the value of the stolen or lost instrument. He would only have to fill in his name in the space designated for the name of the payee and indorse the instrument in favour of a third party or cash it with the drawee as if it had been issued in his favour.

The Scope of the Rule of an Incomplete Instrument

I. The Anglo-American legal systems are not in full agreement as to determining the instances whereby an incomplete instrument could circulate in the stream of commerce as a negotiable instrument in the full sense. The English legal system limits the instances whereby an incomplete instrument could circulate in the stream of commerce as a proper negotiable instrument, to those instances where the signatory of a blank document delivers it to another for the purpose of negotiation and the latter misuses his authority by exchanging it with a bona fide third party or by cashing it with the drawee in his favour. In such an instance, the legal system under consideration establishes a conclusive good title in favour of the bona fide third party acquirer, whilst it establishes a valid discharge in favour of the drawee payor. It entitles the former to enforce the face value of the acquired instrument against its signatory whilst it entitles the drawee payor to charge to him the face value of the paid instrument.114. It denies to the signatory

the right to discharge his liability by setting up as a defence his agent's misuse of authority. It deems the blank instrument as if it has been completed and negotiated in accordance with the authority given.

The effectiveness of the blank document in the hands of a bona fide acquirer as a proper negotiable instrument is incorporated in Section 20 B.E.A.. It establishes in favour of the said party a conclusive presumption that the acquired instrument is delivered and negotiated in accordance with the authority given. Section 20 in this respect reads:

> "20 1) Where a simple signature on a blanked stamped paper is delivered by the signer in order that it may be converted into a bill, it operates as a prima facie authority to fill it up as a complete fill for any amount the stamp will cover, using the signature for that of the drawer, or the acceptor or an indorser and in like manner, when a bill is wanting in any material particular, the person in possession of it has a prima facie authority to fill up the omission in any way he thinks fit.
>
> 2) In order that any such instrument when completed may be enforceable against any person who became a party thereto prior to its completion, it must be filled up within a reasonable time and strictly in accordance with the authority given. Reasonable time for this purpose is a question of fact.
> Provided that if any such instrument after completion is negotiated to a holder in due course, it shall be valid and effectual for all purposes in his hands and he may enforce it if it had been filled up within a reasonable time and strictly in accordance with the authority given."

Although the foregoing section is concerned with determining the effect of negotiating blank instruments in favour of holders in due course, courts extended the

application of the regulating rule in favour of bona fide third parties who might not satisfy the status of the holder in due course, such as the payee. This is approached by importing Common Law doctrines, such as estoppel. By virtue of section 97 B.E.A.,[115] Common Law doctrines are given full effect as long as they do not violate express provisions of the Act.

In Lloyds Bank v Cooke[116] the court applied the doctrine of estoppel in favour of a payee of a bill of exchange. It denied the drawer of a blank instrument, the right to challenge the payee's right of action on the instrument against him. The facts of Lloyds Bank v Cooke involved a blank stamped piece of paper, signed by Sanbrook as maker and delivered to Cooke, authorising him to fill the blanks of the said piece of paper for the amount of £250. Cooke, in fraud of Sanbrook, filled the blank piece of paper for the amount of £1000, inserted the name of the plaintiffs as payees and negotiated it to them as security for a money advance. Collins M.R., in delivering the judgement of the Court of Appeal, said after citing the relevant authorities that,

> "There is nothing in my opinion in the law as to negotiable instruments as contained in the Bills of Exchange Act 1882, to prevent the transaction in the present case from being subject to this Common Law doctrine of estoppel, because the document which was handed over for the purpose of securing the advance was in the form of a negotiable instrument."[117]

The doctrine of estoppel could also be utilised to

establish the presumption of regularity in favour of the drawee and ultimately establish in his favour a valid discharge, in instances where he makes payment in good faith and in accordance with the ordinary course of business. The application of the doctrine of estoppel in favour of the drawee payor does not confront any difficulties. The signatory of the blank document, in the instances under consideration, is presumed to be its maker or drawer. In his capacity as such, the signatory of the blank document is presumed to be in a contractual privity with the drawee. His contract of deposit with the latter provides the necessary basis for establishing his relationship with the drawee. Since the signatory of the blank document is in privity with the drawee, he owes the latter a duty to exercise care in the negotiation of his instruments.[118] If he fails to comply with such a duty, he would be liable for the loss that would be caused to the drawee. If the resulting loss was illustrated in the payment of a fraudulently completed instrument, the drawee payor may charge to his customer the said loss i.e. the full value of the presented instrument.

An example of the instance where the signatory of a blank instrument would be negligent in the negotiation, is when the said party entrusts a dishonest person with the job of negotiating his blank instrument. In such an instance, the signatory of the blank document would be empowering his agent to complete and transfer the property right of the blank instrument. He also would be enabling

him to misappropriate the value of the document in question in his favour. Finally, the signatory of the blank document would be enabling his agent to defraud another potential party, such as the drawee, in cashing the presented instrument. If the agent, to whom the job of negotiating the blank document is entrusted, misuses his authority and misleads the drawee in paying the document in question, the signatory of the blank document would be estopped from denying the authority of his agent to cash the instrument with the drawee and ultimately he would be made to bear the loss resulting from his agent's fraudulent practice.[119]

The application incorporated in section 20 B.E.A. and that incorporated in the Common Law doctrine of estoppel is restricted to the situations where the signatory of the blank document delivers it to another for the purpose of negotiation. If the blank document was lost or stolen, or it was delivered for the purpose of safe custody only, its thief, finder or the person with whom it is kept cannot negotiate it in favour of a bona fide third party and he cannot cash it with the drawee. His behaviour as such would be rendered void. Neither can it transfer the property right of the completed blank instrument in favour of a bona fide third party, nor can it provide the drawee with the authority to pay it. In such an instance the bona fide third party acquirer would not possess an enforceable right of action against the signatory of the blank document, whilst the drawee payor would not be able to charge to him the face value of the paid instrument.

In other words, the risk arising from the act of the thief, the finder or the agent with whom the blank document is kept, in completing the said instrument and negotiating it, is allocated to the bona fide third party acquirer or the drawee payor. They cannot enforce in their favour the liability of the signatory arising from his engagement on the blank document.

In Smith v Prosser,[120] the court incorporated in its decision the above mentioned application. It passed its judgement against the bona fide acquirer of a negotiable instrument which was completed and negotiated by the person with whom it was kept. It discharged the signatory from liability on the fraudulently completed instrument. The facts of Smith v Prosser were as follows: the defendant Prosser was engaged in mining activities in South Africa. Before his visit to England he executed two powers of attorney in favour of Wilson and Telfer. He also signed two unstamped pieces of paper which were lithographed forms of promissory notes. He delivered the two blank signed documents to Telfer for safe custody. He ordered the latter not to fill up the said documents until he so instructed him by telegram. Shortly after his departure Telfer, in fraud of Prosser, filled in the documents in question for a substantial amount and exchanged them for value with Smith who was a bona fide third party. The latter then attempted to enforce the acquired documents in England against their maker i.e. Prosser. The court in delivering its judgement observed

that for a signatory in blank to be held liable on the incomplete document, he must have intended it to circulate as a negotiable instrument. If he delivers it to his agent for safe custody, he is not estopped from denying his liability to the third party acquirer, albeit the latter behaves bona fide and for value. Vaughan Williams L.J. held in this respect:

> "In my judgement it is of the very essence of the liability of a person signing a blank instrument that the instrument should have been handed to the person to whom it was in fact handed, as an agent for the purpose of being used as a negotiable instrument and with the intention that it should be issued as such."[121]

Apparently, the theory underlying the English legal system's attitude in not extending the rule incorporated in Section 20 B.E.A. and the rule incorporated in the Common Law doctrine of estoppel, is the intention theory.[122] In instances where the signatory of the blank document does not deliver it to another for the purpose of negotiation, he is not presumed to have intended it to flow in the stream of commerce. Accordingly, he is not presumed to have intended himself to be liable on it. Thus, he should not be held answerable for a promise or undertaking to which he did not give effect. In the last analysis, his signature on the blank document should not be interpreted as establishing liability against him in favour of third parties whose involvement is not contemplated by him.

II. By comparison, the North American legal system does

not distinguish between instances where the signatory of a blank document delivers it to his agent for negotiation and those instances where the blank document is stolen or lost, or is delivered to another for safekeeping. In all instances of incomplete instruments, the legal system under consideration allocates the arising risk to the signatory. It establishes against him liability on the blank document in favour of a bona fide third party acquirer and the drawee payor. It presumes in favour of the former and in favour of any possessor a valid delivery. That is to say, that it presumes in favour of the said party, the holder status. It enables him to enforce the value incorporated in the acquired instrument against any or all signatories. It denies to the signatory against whom the instrument is sought to be enforced, the right to discharge his liability by setting up the defence of lack of delivery.[123]

Since every possessor of a blank document which has been completed is its holder, payment to him would discharge the drawee. The latter may charge to his customer the face value of the presented instrument, even if it was paid to the thief, the finder or to the person with whom it is kept. The signatory of the blank document may not challenge the drawee's act of payment by setting up the theft or loss of his instrument. Such a defence is personal and it can only be set up against the thief, the finder or the party who establishes his title to the instrument with knowledge of the theft or loss.[124]

The Compatibility of the Rule of the Anglo-American Legal Systems in Allocating the Risk Arising From Signing an Incomplete Instrument with the Proposed Risk Allocation Rule

I. The English legal system is submitted to allocate the risk arising from signing an incomplete instrument in a manner less compatible with the proposed risk allocation rule. This is due to the fact that in instances where the risk results from the theft, loss, or unauthorised use of an incomplete instrument, the legal system under consideration allocates it to either the bona fide third party acquirer or the drawee payor. It discharges the signatory of the blank document from the liability arising from his engagement on it. It denies the bona fide third party acquirer the right of enforcing the credit incorporated in the acquired instrument, against its signatory. It also denies to the drawee payor the right of charging to the said party, the face value of the paid instrument.

To state the obvious, neither the bona fide third party acquirer nor the drawee payor, could be blamed for causing the risk in question to arise. Neither of them is in the position to provide against the said risk in an efficient manner. This is due to the fact that when the stolen or intercepted incomplete instrument is completed and offered for a valuable exchange or presented for payment, it does not raise suspicion as to its regularity. It does not, also, indicate to the party to whom it is

offered, or to the person to whom it is presented, that the title of its possessor is invalid. Such a fact would not be available until the person in question shops for information.

The allocation of the duty of information shopping to the bona fide third party to whom a fraudulently completed, incomplete instrument is offered for a valuable exchange and the allocation of such a duty to the drawee, to whom the instrument in question is presented for payment, is inefficient. Information shopping involves both cost and time. In order for it to be justifiable, it should generate a practical enforceable value in favour of the person to whom it is intended to be allocated. Moreover, its allocation should not impair the function of the legal institution, the promotion of which is desirable.

The allocation of the duty of information shopping to the bona fide third party or to the drawee is detrimental. Its allocation to the former results in a misallocation of wealth to him. It requires him to invest cost and time, in situations where he is neither in the position to derive a practical enforceable value from the investment of cost and time, nor is he in the position to absorb them.[125] The allocation of the duty of information shopping to the drawee, by comparison, results in a detriment to the institution of negotiable instruments. Due to the involvement of time, information shopping prevents the liquidation of the negotiable instrument into money, on its day of maturity. That is to say that

information shopping prevents the document in question from fulfilling its function as a finance device. Due to the involvement of time, information shopping could operate against the genuine acquirer of a genuine instrument. It prevents him from satisfying his entitlement in a timely manner. Accordingly, it prevents him from managing his commercial interests in an economically efficient manner. It could force him to suspend or disturb his commercial engagements, the finance of which is dependent on the value enforceable from the acquired negotiable instrument. Finally, due to the involvement of time, information shopping could cause the bona fide third party acquirer to forego the opportunity to satisfy his entitlement from a valuable security.[126] This would occur when the time involved in the information shopping overlaps with the time limit within which the liability of the valuable security on the negotiable instrument could be raised.[127]

Due to the foregoing inconveniences, the allocation of the duty of information shopping to either the bona fide third party or the drawee payor could deter the commercial community from engaging in the business of acquiring negotiable instruments. Once the commercial community was deterred from acquiring negotiable instruments, the free circulation of such documents would be severely restricted and ultimately the objective of promoting the institution of bills of exchange, promissory notes and cheques would fail. It would not be capable of functioning as an efficient finance instrument.

The person best situated to provide against the risk arising from signing an incomplete instrument is the signatory of the blank document. This could be approached by the exercise of a high standard of care in the safe custody of such documents and by the enforcement of a strict test in selecting the person with whom he entrusts the job of safekeeping. The compliance with such care would prevent his instrument coming into the hands of a thief or a dishonest person. The compliance with such care would provide against the coming of instruments into the hands of remote persons. Ultimately it would provide against the causing of loss to innocent persons.

The allocation to the signatory of a blank document of the duty to exercise a high standard of care is not unreasonable. By placing his signature on a blank document, the signatory would be giving the said document currency. This is due to the fact that the placing of his signature attributes to him a contractual promise or undertaking. The immediate effect of such a promise or undertaking is that it establishes liability on the instrument.[128]

Since the placing of a signature on a blank instrument vests it with currency, the engagement on the instrument promotes the marketability of the said document. It induces the members of the commercial community to whom such a document is offered, to exchange it for value in favour of the possessor. Such a document is presumed to be readily marketable because at the time

of its tender it does not raise suspicion as to its regularity or the validity of the title of its possessor. At the time of its theft or interception, it does not indicate the person to whose favour it is intended to be payable. In such an instance, the thief, the finder, or the dishonest person would not have to forge any signature in order to perpetrate his fraudulent intention. He would only have to insert his name as the payee or insert the word bearer. In both instances he would be able to misappropriate its proceeds without exciting the suspicion of the third party with whom he intends to cash the stolen or intercepted blank instrument.

The invocation of the intention theory as a test for determining the risk allocation rule is inconvenient. It allocates to a potential competing party, such as the bona fide third party to whom a negotiable instrument is offered for a valuable exchange, and the drawee to whom it is presented for payment, the duty to investigate the true intention of the party whose liability is intended to be established. The inconvenience of the allocation of such a duty to either the bona fide third party or the drawee payor is twofold. Due to the involvement of time, it impairs the objective of promoting the institution of negotiable instrument. It prevents such documents from being freely transferable. It prevents them from being liquidated into money. Ultimately it prevents them from functioning as a payment device. Due to the involvement of cost, the allocation to the bona fide third party of the duty to investigate the true intention of the

signatory of the offered negotiable instrument results in an economic detriment to him. It does not generate a practical enforceable value to him. It results in a misallocation of wealth to such a party.

II. The North American legal system, by comparison, allocates the risk arising from the signing of a blank instrument in a manner compatible with the proposed risk allocation rule. It allocates the loss resulting from such a risk to the original true owner. Such an application allocates the loss to the person in the position to provide against it. It allocates the blame for the loss to the person who has facilitated its occurrence. It facilitates the free transferability of negotiable instruments. Finally, it promotes the function of the institution of such documents.

The Rule of Negligence

The law in the Anglo-American legal systems regulates instances whereby the negligence of the proprietor of a negotiable instrument could preclude him from denying the forgery of his signature, or the forgery of the signature of his intended transferee. In fact the law in the said legal systems deems the forged signature effective as if it is made by the hand of the proprietor, or by the hand of the intended transferee. Accordingly, it applies to it all the attributes of a valid signature. It vests it with the power to transfer the property right of the negotiable instrument which such a signature vitiates, in

favour of a third party. It vests it with the power to establish the liabilities incorporated in the instrument in question, in favour of the said party. Finally, it vests the drawee with the authority to pay the instrument in accordance with it i.e. the forged indorsement.

The Scope of the Rule of Negligence

I. The Anglo-American legal systems are not in full agreement as to what are the instances whereby the negligence of the proprietor could have an adverse impact on him. The English legal system restricts the application of negligence as a basis for allocating the risk arising from the forgery of a signature to the proprietor of a negotiable instrument, to those instances when the negligence of the proprietor takes the form of negligence in the transaction. Negligence in the transaction occurs when the proprietor of a negotiable instrument entrusts another with the job of negotiating his documents and when the employee, agent or trustee misuses his authority and misappropriates the instrument in question in his favour.[129] By entrusting another person with the job of negotiating negotiable instruments, the English legal system deems the proprietor of such a document to hold the former as his authorised agent. The proprietor may not then dispute his agent's authority to negotiate the instrument entrusted with him. He would be estopped from denying the binding nature of the latter's behaviour, as long as it falls within the delegated

authority. It is insignificant in this context whether or not the act of negotiation was made for the proprietor's own interest.[130]

In no other instance, does the English legal system appear to be willing to deem the negligence of the proprietor as a basis for allocating to him the risk arising from the forgery of a signature. It reinforces its general rule relating to forged signatures. It deems such a signature wholly inoperative. It divests it of the power to transfer the property right of the instrument which it vitiates, in favour of a third party. It divests the said signature of the power of establishing the liability incorporated in the instrument in favour of the said party. It divests the forged signature of the power to authorise the drawee to make payment. In other words, the incorporation of a forged signature results in allocating the arising loss to the bona fide third party acquirer or it results in allocating the risk in question to the drawee payor.[131] The negligence of the proprietor in the safe custody of his negotiable instrument and his negligence in the general running of his business does not affect the application of the above mentioned risk allocation rule.[132]

The theory underlying the English legal system's attitude, in not considering the negligence in the safe custody of negotiable instruments and the negligence in the general running of a business, as a sufficient basis for allocating the risk arising from the forgery of a

signature to the proprietor is twofold. The law in the legal system under consideration does not allocate to every person the duty to exercise care in favour of the whole world. The duty to exercise care is allocated to the person who is in privity or closely connected with another.[133] In such an instance, the former would be under a duty not to injure the person with whom he is in privity, or with whom he is closely connected.

In the English context of negotiable instruments, the proprietor of such documents is neither privy nor is he closely connected with the third party to whom the negotiable instrument would be offered for a valuable exchange.[134] Accordingly, he is under no duty to take the said party into consideration whilst he is directing his conduct, thus no liability could be established against him by reason that he failed to exercise reasonable care.

Secondly, in instances where a contractual privity or close connectedness exists between the proprietor and the person who sought to establish the former's liability, such as the case involving the proprietor of a negotiable instrument and the drawee, the English legal system does not deem the negligence of the former to be the proximate cause of the loss resulting from the forgery of a signature. It deems the conduct of the fraudulent person to be the immediate and proximate cause of the loss.[135] Accordingly, the proprietor may not be held fully liable for the loss resulting from the forgery.

Apparently, the English legal system affords the drawee payor a partial remedy against the negligent proprietor, provided that the latter is not his customer. In instances where the negligent proprietor is a customer of the drawee payor, the latter would have to establish the former's liability for the resulting loss on his contract with him. He would have to incorporate in the contract of deposit an express stipulation, the effect of which is to hold his customer liable for all or part of the loss resulting from his negligent conduct in the safekeeping of his instrument, or that resulting from his negligent conduct in the running of his business.[136]

The partial remedy which the English legal system affords the drawee payor against the negligent proprietor is illustrated in the former's right of recovering a portion of the loss resulting from the negligent behaviour of the former. By virtue of Section 1 of the 1945 Law Reforms Contributory Negligence Act,[137] in instances where the loss results from the conversion of someone's property, the bona fide convertor may reallocate a portion of the resulting loss to the proprietor whose careless behaviour has contributed to the causing of the loss. The application of the above-mentioned section is not affected by the 1977 Torts (Interference with Goods) Act.[138] Its significance is reinstated by virtue of Section 47 of the 1979 Banking Act. The said section entitles the bank to recover a part of the loss resulting

from the payment of a negotiable instrument vitiated by a forged indorsement. Section 47 reads,

> "In any circumstances in which proof of absence of negligence on the part of a banker would be a defence in proceedings by reason of Section 4 of the Cheques Act 1957, a defence of contributory negligence shall also be available to the banker notwithstanding the provision of Section 11(1) of the Torts (Interference with Goods) Act 1977."

II. By comparison, the North American legal system enlarges the instances whereby the negligence of the proprietor of a negotiable instrument could establish against him full liability for the loss resulting from the acquisition of payment of a negotiable instrument vitiated by a forged indorsement. By virtue of Article 3-406 U.C.C., the legal system under consideration holds the proprietor of a negotiable instrument liable for the loss, the occurrence of which has been substantially contributed to by his negligent conduct. The term "substantially contributes" is interpreted so as to denote the substantial factor test as incorporated in the Restatement - Second of the Law of Torts.[139] Accordingly, a particular behaviour is presumed to substantially contribute to the occurrence of loss when it is deemed to be so, by the reasonable man.[140] Such an interpretation is large enough to cover instances of negligence in the safe custody of negotiable instruments, instances of negligence in the negotiation as well as instances of negligence in the general running of a business.[141]

The North American legal system establishes the duty

to exercise care in favour of persons with whom the proprietor of a negotiable instrument is privy or closely connected and in favour of persons who are not in privity or closely connected with the proprietor. Article 3-406 U.C.C. establishes the rule of precluding the negligent proprietor from setting up the forgery of an indorsement as a defence in favour of the holder in due course i.e. the bona fide third party acquirer as well as the drawee payor. Article 3-406 U.C.C. reads:

> "Any person who by his negligence substantially contributes to a material alteration of the instrument or the making of an unauthorised signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business."

It appears that the requirement, that in order for the drawee payor to benefit from the foregoing preclusionary rule, he should behave in conformity with the reasonable commercial standards of the banking business, is interpreted narrowly. It does not appear to involve, in every instance, the allocation to the drawee payor of the duty to shop for information concerning the genuineness of the presented instrument, and the validity of the title of its possessor.[142] It appears that it involves the duty to shop for information, only in instances where the circumstances surrounding the instrument and its presentment raise suspicion as to its genuineness or the validity of the title of its possessor.

The Compatibility of the Rule of the Anglo-American Legal Systems in Allocating the Risk Arising From the Negligence of the Proprietor of a Negotiable Instrument, with the Proposed Risk Allocation Rule

I. The relevant factor which determines the compatibility of the rule of the legal system in question, in allocating the risk arising from the negligence of the proprietor of a negotiable instrument with the proposed risk allocation rule, is the scope of the instances in which the said legal system is willing to depart from its general risk allocation rule in favour of allocating the resulting loss to the proprietor of such a document. The allocation of the loss in question to the proprietor, results in allocating the blame for causing it to the party who is best situated to provide against its occurrence. The proprietor of a negotiable instrument is presumed to be in the best position to provide against the forgery of a signature and he is presumed to be in the best position to provide against the occurrence of loss because he is the person in control of the negotiable instrument. By exercising an effective control upon his instrument, he can provide against its coming into the hands of a dishonest person and ultimately he can prevent the latter from defrauding third parties as to the genuineness and regularity of the negotiable instrument.[143]

Since the English legal system restricts its departure from the general risk allocation rule, to the

instances where the proprietor of a negotiable instrument behaves with negligence in the negotiation of his document, it is presumed to allocate the risk resulting from the forgery of a signature in a manner less compatible with the proposed risk allocation rule. This is due to the fact that in instances where the proprietor of a negotiable instrument is negligent in the safe custody of his documents, or when he is negligent in the general running of his business, it allocates the loss in whole or in part to the bona fide third party acquirer or to the drawee payor. It denies to the former the right to establish a good title to the acquired instrument. It also denies to him the right of enforcing his entitlement against any liable party. Finally, it denies to the drawee payor the right of being completely discharged on the paid instrument. It holds him partially liable for the loss resulting from his payment.

It could be recalled, that neither the bona fide third party acquirer nor the drawee could be blamed, in whole or in part, for causing the forgery of a signature or for causing the loss to arise. Neither of them are in the position to provide against the said risk or loss in an efficient manner. The care which could provide against the risk or loss in question would result in a detriment, if it was to be allocated to either the bona fide third party acquirer or the drawee payor. Its allocation to the former would result in an economic detriment to him, in the sense that it requires him to invest cost and time in a manner that

would not generate to him a practical enforceable value.

The allocation of the duty to exercise care to the drawee payor results in a detriment to the institution of negotiable instruments. The compliance with such care prevents the document in question from fulfilling its function as an efficient finance device. Moreover, the allocation to the drawee of the duty to exercise care results in an adverse impact on the free circulation of negotiable instruments. Due to the involvement of time, it prevents the genuine acquirer of a genuine instrument from satisfying his entitlement in a favourable manner. Due to the involvement of time, it could cause the said party to forego the opportunity to satisfy his entitlement from a valuable security. In such instances, the commercial community might be deterred from engaging in the business of acquiring negotiable instruments. Ultimately, the objective of promoting such an institution would fail.

The allocation to the bona fide third party acquirer and the drawee payor, of the whole or a portion of the loss resulting from the forgery of a signature, would necessarily relieve the guilty party from the whole or a portion of the loss in question. The person who is presumed to be guilty of causing the forgery of a signature and for causing the loss to arise, is the careless proprietor. His guilt is illustrated in his failure to exercise care in the safe custody of his negotiable instrument and his failure to exercise care in the general running of his business. Had he exercised

such care, he would have prevented his instrument coming into the hands of a dishonest person and ultimately, he would have provided against the instance whereby a bona fide third party would be defrauded in his acquisition or payment.

The rule of exonerating the careless proprietor of a negotiable instrument of the whole or a portion of the loss, which has been facilitated by his failure to exercise care, is inefficient. It gives rise to moral hazard. It encourages proprietors of negotiable instruments to lower their standard of care. In such instances, the rate of loss occurrence would increase. In the last analysis, wealth would be misallocated. The person to whom loss is allocated would have to invest cost to repair the resulting damage in situations where its occurrence could be avoided by the exercise of care.

The theories underlying the English legal system's attitude in allocating the risk arising from the proprietor's failure to exercise care in the safe custody of his instrument and that arising from his failure to exercise care in the general running of his business, are outdated.[144] They are too rigid, artificial, inaccurate and unfair.[145] The general tendency in the law is, firstly, to establish the existence of a duty of care in favour of every person whose involvement is reasonably foreseeable and secondly, to shorten the chain of causation.[146] This is approached by the introduction of the notion of foresight. The immediate impact of such a notion is to establish a causal relationship between the

careless behaviour of one person and the resulting damage to the person whose involvement is reasonably foreseeable. It does not consider the immediateness or proximity of the injured person, or the injury itself, to be of significance in determining the existence of a causal relationship.

II. The North American legal system, by comparison, is more compatible with the proposed risk allocation rule. It enlarges the instances whereby the risk arising from the forgery of a signature is allocated to the proprietor of a negotiable instrument. It allocates the risk in question to the said party in every instance of the latter's negligence. It relaxes the element of causation so as to hold the negligent proprietor liable for the loss which has been facilitated by his careless behaviour. It also relaxes the duty of care requirement so as to establish it in favour of every person whose involvement in the negotiable instrument is foreseeable.[147]

The enlarging of the scope of the rule of negligence results in an efficient risk allocation rule. It allocates the risk arising from the forgery of a signature to the person who is in the position to provide against it. It provides against the occurrence of moral hazard. It creates an incentive to the person to whom it allocates the risk, to raise his standard of care. Accordingly, it avoids or reduces the instances of loss occurrence. Once the rate of loss occurrence is reduced, wealth would be allocated in a manner more compatible with the interest of

the market. Value would be allocated in a manner which generates the optimum utility.

The rule of the North American legal system in allocating the risk arising from the negligence of the proprietor of a negotiable instrument does not fall squarely within the proposed risk allocation rule. This is due to the fact that it allocates the loss resulting from the forgery of an indorsement to the drawee payor who fails to behave in conformity with the reasonable commercial standards of banking business. This would be the case even if it could be shown that the proprietor of an erroneously paid instrument was negligent in the safe custody of it or that he was negligent in the general running of his business which substantially contributed to the erroneous payment of the instrument.[148]

The incompatibility of the above-mentioned application with the proposed risk allocation rule is twofold. The duty to conform with the reasonable commercial standards of banking business is to some extent harsh. It either results in requiring the drawee to shop for information or it requires him to dishonour the presented instrument. The former course of action is detrimental to the institution of negotiable instruments. The suspicion which the drawee may possess as to the genuineness of the presented instrument or the validity of the title of its possessor might be erroneous. His engagement in the information shopping would accordingly prevent the liquidation of the presented instrument into money on its

day of maturity. Ultimately it could prevent the document in question from fulfilling its intended function in an efficient manner. The act of dishonour, however, is not recommended. In instances where the surrounding suspicions proved to be erroneous, the act of dishonour could damage the reputation of the maker or drawer of the negotiable instrument. Ultimately, it could hold the drawee payor liable for substantial damages.

In the second place, the drawee payor's failure to comply with the reasonable commercial standards of banking business is not the sole cause of the loss in instances where the proprietor of the erroneously paid instrument is guilty of negligence. The latter bears a part of the blame for causing the occurrence of the loss. This is illustrated in his failure to exercise care in the safe custody or the negotiation of his instrument or in the general running of his business. Had he exercised such care, he would have prevented his document coming into the hands of a dishonest person. Ultimately he would have prevented the latter from defrauding the drawee in paying it.

Since the North American legal system allocates the whole loss to the drawee payor, who fails to comply with the reasonable commercial standards of banking business, it is presumed to allocate the resulting loss in an inefficient manner. It totally exonerates the proprietor from liability in instances where he could have provided against it by the exercise of care. Such an application

could encourage the latter party to behave carelessly. Ultimately, it could give rise to moral hazard whereby wealth would be misallocated.

Summary

I. Since it is established that the efficient risk allocation rule in instances where the risk arises from the forgery of an indorsement is to allocate the resulting loss to the original true owner[149] of a negotiable instrument i.e. the person from whom such a document is stolen or lost, the most compatible legal system would be the one which allocates the resulting loss, in the instances under consideration, to the said party. Since the Continental Geneva legal systems allocate the risk in question to the original true owner, they are presumed to be the most compatible legal systems with the proposed risk allocation rule.[150] However, not all the legal systems falling within the umbrella of the Geneva legal family conform with the efficient risk allocation rule. The legal systems falling within the umbrella of the Geneva legal family are not in full agreement in determining the act necessary to require the drawee to refuse the payment of the stolen or lost negotiable instrument.[151]

It is submitted that the legal systems which deem the mere issuance of a stop payment order to be sufficient to compel the drawee to pay the stolen or lost instrument, are more compatible with the proposed risk allocation rule

than the legal systems which regulate the amortisation procedure.[152] The former manner of countermanding stolen or lost instruments enables the original true owner to provide against the occurrence of loss in an efficient manner, and it preserves in favour of the bona fide third party acquirer the advantages inherent in the negotiable instrument. In particular, it lifts from him the burden of establishing his entitlement to the acquired document.

II. The North American legal system is less compatible with the proposed risk allocation rule. Although it enlarges the instances in which it would depart from its general risk allocation rule in favour of allocating the risk of the forgery of indorsements to the original true owner,[153] it does not come close enough to the efficient risk allocation rule. In instances where the proprietor of a negotiable instrument delivers it to an impostor, the North American legal system allocates the loss resulting from the indorsement in the name of the payee to the bona fide third party acquirer, or to the drawee payor.[154] It is submitted that neither of the foregoing parties are in the position to provide against the resulting loss in an efficient manner. The care which could prevent the occurrence of loss would either result in an economic detriment to the party to whom it is intended to be allocated, or it could result in a detriment to the institution of negotiable instruments.

In instances where the risk of the forgery arises from the negligent behaviour of the original true owner,

the bona fide third party acquirer would have to assume the burden of establishing his case. He would have to establish the negligence of the proprietor and he would have to establish that the said negligence is a substantially contributing factor for causing the forgery of an indorsement.

Obviously, such a duty is harsh. It involves the investment of cost and time. In instances where the face value of the acquired instrument is small, the bona fide third party acquirer might not consider the establishment of the entitlement worth it. In such an instance, the loss arising from someone's negligence would rest with an innocent person. Such a result is inefficient. It establishes a windfall in favour of the guilty party. Accordingly, it could give rise to moral hazard.

In instances where the drawee payor does not behave in a manner compatible with the reasonable commercial standard of banking business, the North American legal system allocates the loss resulting from the payment of an instrument vitiated by a forged indorsement, to the drawee payor.[155] This would be the rule, even if the original true owner was guilty of negligence and his negligence as such has substantially contributed to the occurrence of loss. Such a rule is inefficient. Firstly, it allocates to the drawee payor the duty to exercise care in instances where such care could cause a detriment to the institution of negotiable instruments. And secondly, it exonerates the person who is in the position to provide against the occurrence of loss, totally from liability.

It allocates the whole blame for causing the loss to the person who cannot properly be considered as the sole liable party. By exonerating the guilty person totally from liability, the North American legal system is assumed to give rise to moral hazard. It is presumed to encourage proprietors of negotiable instruments to behave carelessly. Finally, it is presumed to cause a misallocation of wealth.

III. The English legal system, by comparison, is the least compatible with the proposed risk allocation rule. It restricts the departure from the general risk allocation rule to very limited instances.[156] In a significant portion of instances, it allocates the risk arising from the forgery of an indorsement in favour of the person who is in the position to provide against its occurrence, namely, the original true owner. It allocates the blame for causing it to the person who is not in the position to provide against the forgery of an indorsement, in an efficient manner. By allocating the risk in question in favour of the guilty party, the English legal system is presumed firstly, to impair the objective of promoting the institution of negotiable instruments and secondly, it is presumed to give rise to moral hazard. It encourages proprietors of negotiable instruments to behave carelessly and ultimately, it is presumed to give rise to a misallocation of wealth.

The Compatibility of the Rule of UNCITRAL Convention/draft Convention on International Negotiable Instruments in Allocating the Risk of the Forgery of Indorsements, with the Proposed Risk Allocation Rule

I. UNCITRAL Convention/draft Convention allocates the risk of the forgery of an indorsement initially, to the original true owner i.e. the person from whom the negotiable instrument was stolen or lost. It does not deem the forged indorsement to interrupt the chain of negotiation. It deems such a signature capable of transferring the property right of the document in question. Accordingly, it deems such a signature capable of establishing the holder status in favour of the thief or finder, as well as a bona fide third party acquirer.[157]

By establishing the holder status in favour of every person who establishes his title to the negotiable instrument through an uninterrupted chain of signatures, even if any of the said signatures was forged, the Convention/draft Convention entitles the holder to enforce the face value of the acquired instrument conclusively in his favour. It entitles him to exercise a right of recourse against any or all signatories.[158] It denies to the signatory against whom the instrument is sought to be enforced, the right to discharge his liability towards the holder, by setting up the defence of the forgery of an indorsement. Such a defence can only be set up against the holder who knew of the forgery or who committed the forgery himself, or who participated in such conduct.[159]

Since every person who establishes his title to the negotiable instrument through an uninterrupted chain of signatures, satisfies the holder status, the payment of the face value of the instrument to him discharges the payor. UNCITRAL Convention/draft Convention does not allocate to the drawee the duty to examine the genuineness of the signatures incorporated in the presented instrument, nor does it allocate to him the duty to examine the validity of the title of its possessor. He has only to observe the regularity of such a document.[160] That is to say, that the drawee would only have to examine the four corners of the instrument in question. Provided that the presented instrument is regular, the payment of its face value may not be contested by either the maker or the original true owner. The former may not demand a recredit of his account, whilst the original true owner may not demand a fresh payment from the drawee.

The drawee's act of payment may be contested however, if it could be shown that the said party knew that the person to whose favour the proceeds of the presented instrument is intended to be paid, was the forger or its thief, or that he participated in the theft or the forgery of the instrument.[161]

The allocation of the loss resulting from the forgery of an indorsement to the original true owner, does not conclusively resolve the problem of risk allocation. UNCITRAL Convention/draft Convention entitles the original true owner to claim from the immediate taker from the forger, compensation equal to the loss suffered by him as

a result of the forgery of an indorsement.[162] Apparently, his right to claim compensation from the immediate taker from the forger cannot be set up as a counter-claim, so as to defeat the latter's right of recourse against him. He may only raise it in a separate action.[163]

In some instances, the right to claim compensation for the loss resulting from the forgery of an indorsement, may be raised by the original true owner against the drawee payor. This would arise when the former establishes that the drawee failed to exercise reasonable care in providing against the occurrence of loss.[164] It is submitted that the original true owner's right of action against the drawee is "off the instrument".[165] This is due to the fact that the duty of care allocated to the drawee on the instrument does not involve the provision against the occurrence of loss in the broad sense. It only involves the examination of the four corners of the presented instrument. If such a duty is satisfied, the act of payment would discharge the drawee on the instrument. This would be the rule even if the payment of the instrument is made in favour of the thief or finder.[166]

Finally the immediate taker from the forger as well as the drawee payor may defeat the original true owner's right of claiming compensation. This would be possible when the former could establish that the original true owner has, by his conduct, impliedly accepted the forged signature or that he has, by his conduct, represented that

the forged signature is his. Such conduct holds the original true owner liable as if he had placed the signature in question on the instrument. Article 34 of the Convention on International Bills of Exchange and Promissory Notes reads:

> "A forged signature on any instrument does not impose any liability on the person whose signature was forged. However, if he consents to be bound by the forged signature or represents that it is his own he is liable as if he had signed the instrument himself."[167]

II. The initial allocation of the risk of the forgery of an indorsement to the original true owner is compatible with the efficient risk allocation rule. It allocates the blame for causing the loss to the person who is in the position to provide against it. The original true owner is presumed to be in the position to provide against the forgery of an indorsement because the said fraudulent conduct occurs whilst the negotiable instrument is in his control. By the exercise of an effective control, he could have prevented his instrument coming into the hands of a dishonest person and ultimately, he could have prevented the latter from defrauding a bona fide third party in his acquisition or payment.

The rule of establishing the holder status in favour of every person who establishes his title to the negotiable instrument through an uninterrupted chain of signatures, even if any of the incorporated signatures is forged, is also compatible with the efficient risk allocation rule. It lowers the standard of care that

ought to be exercised by the person to whom a negotiable instrument is offered for a valuable exchange. It does not allocate to him the duty to investigate the history of the negotiable instrument. Such an application allocates to the person under examination the duty of care, the compliance with which would not result in an economic detriment to him. It relieves him of the duty to invest cost and time which do not generate a practical enforceable value to him, nor could they be absorbed by him. By lowering the standard of care that ought to be exercised, by the person to whom a negotiable instrument is offered, UNCITRAL Convention/draft Convention is presumed to promote the function of the institution of negotiable instruments as a finance device. It facilitates the free transferability of negotiable instruments and it facilitates the liquidation of such documents into money.

Finally, the rule of confining the duty of the drawee to examining the regularity of the presented instrument is also compatible with the efficient risk allocation rule. Firstly, it facilitates the promotion of the institution of negotiable instruments as a substitute for money and secondly, it provides against causing an economic detriment to a bona fide third party. The rule under consideration promotes the function of the institution of negotiable instruments as a finance device, because it liquidates such documents into money on their day of maturity. Such a rule is deemed to provide against the causing of a detriment to the bona fide third party

because it informs him in a timely manner of the fate of the instrument. In instances where it indicates to him that the presented instrument is invalid, it enables him to exercise his right of recourse against a valuable security.

III. The incompatibility of the ultimate rule of UNCITRAL Convention/draft Convention in allocating the risk of the forgery of indorsements with the proposed risk allocation rule is fourfold. In the first place, the rule of disentitling the original true owner to raise in the action based on the negotiable instrument, against the immediate taker from the forger, as a counter claim, his right to obtain compensation equal to the loss resulting to him by the forgery of an indorsement, gives rise to a situation of multiplicity of actions. On the one hand, it gives rise to a cause of action based on the negotiable instrument, in favour of the immediate taker from the forger, against the original true owner. On the other hand, it gives rise to an independent cause of action in favour of the original true owner against the immediate taker from the forger.

The creation of a situation of multiplicity of actions is inefficient in instances where the intended result could be approached by a single cause of action. Its involvement gives rise to the increase of transaction cost and the investment of time. Both cost and time are valuable assets in commerce. They are considered to be elements of value maximisation. Members of the

commercial community take them into account in running their businesses; they invest cost and time in a manner that would generate the optimum value.

Transaction cost and time are not value maximising in situations of multiplicity of actions. They create uncertainty in determining the applicable rule. They cause the parties in question to suspend their commercial arrangements. Ultimately, they cause them to forego the opportunity to manage their commercial interests in a favourable manner and they cause the said parties to forego the opportunity to invest cost and time in channels where the optimal value could be enforced.

An example of the instance whereby cost and time would be saved without impairing the intended result of the risk allocation rule is when the original true owner of a negotiable instrument is entitled to raise his right to claim compensation in the action based on the negotiable instrument. In such an instance, the situation of multiplicity of actions would be replaced by a single cause of action. The accommodation of the original true owner's right of raising his counter claim for compensation against the immediate taker from the forger, in the action based on the negotiable instrument, approaches the same result which the present solution incorporated in UNCITRAL Convention/draft Convention intends to approach. It allocates the loss arising from the forgery of an indorsement to the immediate taker from the forger. It defeats his cause of action on the negotiable instrument by entitling the original true owner

to set up as a counter claim, his right to obtain compensation from the former, for the loss that would result to him had he been compelled to pay the face value of the stolen or lost instrument.

In the second place, the rule of allocating the ultimate loss resulting from the forgery of an indorsement to the immediate taker from the forger is inefficient. The said party is by no means in a different position than his successors. The four corners of the offered instrument do not raise suspicion as to its validity, nor do they indicate that the person offering the instrument is the forger. The only method through which the third party to whom the negotiable instrument is offered for a valuable exchange could unveil the true status of the document in question or the true identity of the offeror, is by information shopping.

The allocation to the third party of the duty of information shopping is detrimental. It requires him to invest cost and time. The investment of cost and time in the course of information shopping does not generate a practical enforceable value in favour of the bona fide third party. Due to his capacity as a consumer, the party in question is not normally in the position to absorb the evolving cost. In other words, the allocation of the duty of information shopping to the third party, results in a misallocation of wealth to him.

A further difficulty of information shopping is that it impairs the objective of promoting the function of the institution of negotiable instruments. Due to the

involvement of time, it restricts the free transferability of such documents and due to the involvement of time, it prevents the negotiable instrument from functioning as a payment device. That is to say that it prevents the said document from being liquidated into money.

Such a difficulty could operate against the genuine acquirer of a genuine instrument. It could prevent him from satisfying his entitlement in an efficient manner. It could cause him to suspend or disturb his commercial engagements, the finance of which is dependent on the value incorporated in his instrument. Ultimately, it could deter the commercial community from engaging in the business of acquiring negotiable instruments, whereby the objective of promoting the institution of such documents would fail.[168]

Finally, the allocation of the risk of the forgery of indorsements to the immediate taker from the forger, divests the establishment of the holder status in favour of the said party, of its value. It damages his reasonable expectation. It does not establish in his favour a good title to the proceeds of the acquired instrument. It holds him liable to the original true owner to repay as compensation the receipted proceeds.

In the third place, the rule of allocating to the drawee the duty to exercise reasonable care in the provision against the occurrence of loss, is unduly harsh. Obviously, the duty to exercise reasonable care involves more than the examination of the four corners of the presented instrument. Definitely, it involves the

carrying out of enquiries in instances where the circumstances surrounding the instrument in question raise suspicion as to its regularity or the validity of the title of its possessor. It could involve the duty of information shopping in every instance where a negotiable instrument is presented for payment.

The duty to carry out enquiries beyond the four corners of the presented instrument could result in an adverse impact on the institution of negotiable instruments, as well as the interest of a bona fide third party acquirer. Due to the involvement of time, the carrying out of enquiries restricts the presented instrument from fulfilling its intended function as an efficient finance device. It could prevent it from being liquidated into money immediately. Due to the involvement of time, the carrying out of enquiries could prevent the genuine acquirer of a genuine instrument from satisfying his entitlement in an economically efficient manner. It could also cause him to forego the opportunity to satisfy his entitlement from a valuable security.

In the fourth place, in instances where the relevant existing legal rules divert, the establishment of liability against the original true owner on the basis of his implied acceptance or representation, is not presumed to have a far reaching effect on the ultimate risk allocation rule in all legal systems. This is due to the fact that the determination whether or not a particular conduct attributes an implied acceptance or representation

to the party in question, is closely related with the existence of a duty of care and the notion of proximity.[169] An implied acceptance or representation would normally be inferred when the person to whom it is intended to be attributed is under a duty to exercise reasonable care in his conduct, so as not to lead another person to believe that he had accepted to be bound by a legal act such as the engagement on a negotiable instrument, or that he had represented that the act in question is his.

The legal system which restricts the allocation of the duty to exercise reasonable care in favour of a limited category of persons, such as the English legal system,[170] would not be willing to depart from the ultimate risk allocation rule, in favour of allocating the risk of the forgery of indorsements to the original true owner. Accordingly, a significant portion of instances where the requirements of an efficient rule dictate the allocation of the resulting loss to the original true owner, would result in allocating it to a person who is not in the position to provide against it, such as the bona fide third party acquirer and the drawee payor. In such instances, the risk in question would be allocated in favour of the person who bears the blame for causing it, namely, the original true owner. Such an application would encourage proprietors of negotiable instruments to behave carelessly. Ultimately, it would give rise to a situation of misallocation of wealth.

CHAPTER EIGHT

BACK NOTES - (1.-170.)

1. As a general rule the North American legal system restricts the application of the doctrine of bona fide purchase to instances where the title of the prior transferor or transferors was voidable. In no other instances may the bona fide third party acquirer claim in his favour a perfect title to the property in conflict, independent of that of the prior transferor or transferors. In instances where the title of the latter party was null and void and in instances where it was of a limited capacity, the title of the immediate and subsequent transferee i.e. the acquirer, would be subject to the same defects which vitiate the title of the prior transferor. Notwithstanding his bona fides, the party who possesses an enforceable interest in denying the good title protection in favour of the subsequent acquirer, may impeach the latter party's title to the property in question by setting up the defences and claims vitiating the said title.
See for example Articles 2-402 and 2-403 U.C.C., and see also -
Gilmore, Commercial Doctrine of Good Faith Purchase, (1954), 63 Yale L. J., 1059.
Franklin, Security of Acquisition and of Transaction, La Possession Vaut Titre et Bona Fide Purchase. (1932), 6 Tulane L. Rev., 589.
Walter, Recovery of Stolen Paper Money in the Louisiana Civil Code, (1961), XXI Louisiana L. Rev., 482.
Note, Sales Bona Fide Purchaser - La Possession Vaut Titre, (1949), Tulane L. Rev., 420.

The foregoing general rule, namely that parties with null and void title cannot transfer a better title in favour of bona fide third parties, and ultimately the rule that, the latter party may not in such an instance claim in their favour a perfect title to the fraudulently transferred property, apply to the law of negotiable instruments. This could be inferred from the fact that the satisfaction of the holder status is restricted to the party who establishes his title to the negotiable instrument through issue or indorsement, i.e. negotiation. It is submitted that for the purpose of effecting a valid transfer of the property right of such a document, the act of negotiation must be made in the hand of the original true owner, i.e. the maker of the document or its intended payee, and the said act must involve the act of delivery in addition to the signature of the true owner.
cf. Articles 3-102 and 3-202 U.C.C.
Thus the thief or finder of a stolen or lost negotiable instrument, due to the lack of negotiation, cannot qualify as the holder of such a document.

The satisfaction of the holder status is the tool through which the attributes of negotiability come to application. That is to say the party who purports to satisfy the said status may:

1) enforce the credit incorporated in the negotiable instrument, in his own name,
2) establish in his favour an unimpeachable title to the said document,
3) transfer the document in question in favour of third parties and
4) confer the protected holder status in favour of the latter.

In instances where holder status is not satisfied none of the foregoing attributes would apply. In particular the party who does not satisfy the holder status cannot by fraudulently transferring the negotiable instrument establish the said status in favour of a third party. Since the thief or finder of a stolen or lost negotiable instrument does not satisfy the holder status, he is incapable of conferring it in favour of a third party. The maxim, "nemo dat quod non habet" applies. Accordingly the acquirer from the thief or finder may not enforce in his favour the foregoing negotiability attributes.
cf. White, Some Petty Complaints about Article 3, (1967), 65 Mich. L. Rev., 1315.
Whaley, Forged Indorsements and the U.C.C.'s Holder, (1972), 6 Indiana L. Rev., 45.

2. See n. immediately above.

3. The acquirer of a negotiable instrument who receives its payment on a forged indorsement is deemed by law, a convertor. He is presumed to have received what in theory belong to the original true owner, i.e. the party from whom the instrument was stolen or lost. By virtue of Article 3-419, U.C.C., and due to his status as a convertor, the acquirer of such a document would have to revert its proceeds to the original true owner and by virtue of Article 3-417 U.C.C. the said party would have to revert the obtained proceeds to the drawee payor. The basis for the acquirer's liability to the drawee payor is of a contractual nature. The law imposes upon the former party a series of warranties in favour of the drawee payor. In particular it imposes upon him the warranty of good title, cf. Article 3-419 1(b) U.C.C. That is to say that the law deems the acquirer to warrant to the drawee that his title is not vitiated by a forged indorsement. In instances where the title of the said party proves to be vitiated by a forged indorsement, the acquirer is deemed to have breached the warranty of good title. In such an instance the acquirer/recipient is presumed not to be entitled to the paid proceeds. Accordingly he would have to revert the same to the drawee payor.

4. This is expressly mentioned in Article 3-404 U.C.C. 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; ..."

5. For a more detailed analysis of the inoperative attribute of forged indorsements and its impact on the negotiable instrument see pp.235-237 supra.

6. By virtue of Article 3-419 1(c) U.C.C. the drawee who pays a negotiable instrument on a forged indorsement is deemed to be a convertor. Accordingly his customer as well as the original true owner, i.e. the party from whom the paid instrument was stolen or lost may compel the drawee payor to recredit his customer's account with the debited amount as if payment had not been made, or he would have to make a fresh payment in favour of the original true owner.

7. See n. immediately above.

8. The inoperativeness attribute of forged indorsements could be found from the reading of Article 3-404 U.C.C.; for the provision of this article see n.4.

9. For a more detailed analysis of the inoperativeness of forged indorsements, its implication and its impact on the liability of the drawee payor vis-à-vis his customer and the original true owner see pp.272-274 supra.

10. cf. Official Comment 3 to Article 3-417 U.C.C.
Corker, Risk of Loss from Forged Instruments, (1951), 4 Stan. L. Rev., 24.
Comment, Allocation of Losses from Check Forgeries, (1953), 62 Yale L. J., 417.
Miguel Antonio Sanchez, Forged Indorsements under the UNCITRAL Draft Convention on International Cheques, (1983), J. Comp. L., 599.
Roy P. Creedon, Forgeries and Material Alterations. Allocation of Risks under the U.C.C., Bos. U.L.R., 536.

11. Like the North American, the English legal system restricts the application of the doctrine of bona fide purchase to instances where the title of the prior transferor or transferors to a particular property, the acquisition of which give rise to a situation of conflicting entitlements, was voidable. In no other instance does the legal system under consideration confer in favour of the subsequent acquirer, a title to the property in question, better than that of his prior transferor or transferors. In instances where the title of the latter party was null and void, or in instances where it was of a limited interest, such as that of the trustee, it establishes in favour of the subsequent acquirer the same title as that enjoyed by his prior

transferor or transferors. Accordingly, it entitles the other competing party who is interested not to have the property right to the property in question established in favour of its subsequent acquirer to challenge the latter's title by setting up the defects and defences vitiating it.
cf. Sections 21 and 23 of 1979 Sale of Goods Act and see authorities cited in,
Fridman, Sale of Goods, (1966), pp.118-121.
Schmitthoff, The Sale of Goods, (1966), pp.103-110 and authorities cited n.1.

The foregoing rule, namely that persons with null and void title cannot transfer a better title than their's to third parties, applies to the law of negotiable instruments. This could be inferred from the restricted definition of the holder status. The holder status as could be noted is the tool through which the attributes of the negotiability concept could come to application. In particular, it enforces the doctrine of bona fide purchase in the context of negotiable instruments. It confers upon the bona fide third party acquirer a perfect and unimpeachable title notwithstanding the defect vitiating the title of his prior transferor or transferors.

Like the North American's, the English legal system establishes the holder status in favour of whoever acquires a negotiable instrument through issue or indorsement i.e. negotiation. For a particular act to function as a negotiation, it must involve the delivery of the instrument in addition to the signature of its obligor, cf. Sections 2 and 31 B.E.A.
Thus the person who does not acquire the instrument in question through negotiation as described above, such as the thief or finder, may not satisfy the holder status. Accordingly he cannot establish such a status by mere transfer in favour of a third party. The maxim, nemo dat quod non habet, applies. Since the acquirer from the thief or finder does not establish the holder status, he cannot claim in his favour the advantages of holder in due course status, cf. Section 29 B.E.A.
Accordingly he may neither enforce the right incorporated in the acquired instrument against a party prior to the thief or finder, nor may he retain the proceeds of such a document in instances of payment. cf. Section 24 B.E.A.

12. See n. immediately above.

13. cf. Section 24 B.E.A. For the reading of this section and its impact on the bona fide acquirer of a negotiable instrument vis-à-vis parties prior to the forgery see pp.235-237 supra.

14. The inoperative attribute of forged indorsements and its implications are incorporated in Section 24 B.E.A. Section 24 B.E.A. 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 ..."

15. For a more detailed analysis concerning the impact of forged indorsements on the negotiable instrument which they vitiate and their impact on the rights and obligations of the parties engaging on it see pp.235-237 supra.

16. Section 60 B.E.A. derogates from the general rule incorporated in Section 24 B.E.A. It establishes in favour of the drawee payor banker a valid discharge as between himself and his customer or the original true owner, notwithstanding the fact that the presented and paid instrument was vitiated by a forged indorsement, provided that the said party acts in good faith in accordance with the reasonable standard of banking practice and relies in his act of payment on a prima facie regular chain of indorsements. For the reading of Section 60 B.E.A. and its application see p.689 infra together with accompanying notes.

17. cf. Cocks v Masterman (1829) 9 B & C 902.
London and River Plate Bank v Bank of Liverpool [1896] 1 QB 7.
Imperial Bank of Canada v Bank of Hamilton [1903) A.C.49.
R.E. Jones Ltd. v Waring & Gillow Ltd. [1926] A.C.670.
National Westminster Bank Ltd. v Barclays Bank International Ltd. and Another [1975] QB 654.
Barclays Bank Ltd. v Simms, Son & Cooke (Southern) Ltd. and Sowman [1979] 3 All E.R. 522.
For the facts of the foregoing cases and the findings of the courts see pp.261-270 supra.

18. Parties effectuating the transfer of a negotiable instrument normally stand in a suretyship capacity. They engage to pay the promise incorporated in their document when and only when it is dishonoured by the prima facie primarily liable party and when the holder complies with the statutory duties of presentment, drawing up protest and/or giving notice of non-payment. The failure to comply with such a duty could discharge the secondarily liable party such as the indorsor and the drawer. The holder of a negotiable instrument would be guilty of not complying with the above mentioned duties if he fails to effect them within the statutory time allowed. By law, the time within which the duty of presentment, drawing up protest and/or giving notice of non-payment would have to be effectuated is limited to one or two days following the maturity day of the instrument. The failure to act within the said period would necessarily deprive the holder of the right to enforce the promise incorporated in

the instrument against his immediate transferor. cf. sections 45, 48, 49, 51 and 55 B.E.A.

19. cf. Imperial Bank of Canada v Bank of Hamilton [1903] A.C.49.
National Westminster Bank Ltd. v Barclays Bank International Ltd. and Another [1975] QB 654.
Barclays Bank Ltd. v Simms, Son & Cooke (Southern) Ltd. and Sowman [1979] 3 All E.R. 522.

20. cf. Thompson v Giles (1824) 21 B & C 422.
Gaden v Newfoundland Savings Bank [1899] A.C.281, 287.
Great Western Rly. Co. v London & County Banking Co. Ltd. [1901] A.C.414.
Capital and Counties Bank Ltd. v Gordon [1903] A.C.240.
North and South Wales Bank Ltd. v Macbeth [1908] A.C.137.
Morison v London County and Westminster Bank Ltd. [1914] 3 KB 356.
Lloyds Bank Ltd. v Chartered Bank of India Australia and China [1929] 1 KB 40.

21. cf. Section 60 B.E.A. This section 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."

22. See note immediately above. For a more detailed examination of the impact of the payment of a negotiable instrument vitiated by a forged indorsement on the drawee payor banker and its impact on the rights and obligations of the said party vis-à-vis himself and his customer or the original true owner see pp.274-275 supra.

23. The inoperative attribute of forged indorsements is incorporated in Section 24 B.E.A. For the reading of Section 24 B.E.A. cf. n.14 above.

24. cf. Section 24 B.E.A. For a more detailed analysis concerning the implications of the said section see pp.272-274 supra.

25. cf. Section 60 B.E.A. For the reading of this section see n.21 above.

26. Charles v Blackwell (1877) 2 C.P.D. 151, 46 L.J.C.P. 368, 36 L.T. 195, 25 W.R. 472.
Friedrich Kessler, Forged Indorsements, (1938), 47 Yale L. J., p.869.

27. Friedrich Kessler, Forged Indorsements, Ibid, p.868. The report of Sir Mackenzie Chalmers submitted to the League of Nations Economic Committee 1923, documented in

the reports of experts for the purpose of the Unification of the Law relating to Bills of Exchange and Promissory Notes, 1923, p.103.

28. cf. second paragraph Article 16 G.U.L.(Bills) and Article 20 G.U.L.(Cheques).
Second paragraph Article 16 G.U.L.(Bills) reads,
"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."
As far as Article 20 G.U.L.(Cheques) is concerned, its provision is worded substantially similar to the second paragraph of Article 16 G.U.L.(Bills).
For a more detailed analysis of the second paragraph of Article 16 and its implications see pp.237-241 supra.

29. See n. immediately above.

30. cf. Articles 9, 15 and 47 G.U.L.(Bills) the latter Article reads as follows,
"All drawers acceptors endorsers or guarantors by aval of a bill of exchange are jointly and severally liable to the holder.

The holder has the right of proceeding against all these persons individually or collectively without being required to observe the order in which they have become bound.

The same right is possessed by any person signing the bill who has taken it up and paid it.

Proceeding against one of the parties liable do not prevent proceedings against the others even though they may be subsequent to the party first proceeded against."

31. cf. second paragraph Article 16 G.U.L.(Bills), Article 20 G.U.L.(Cheques), see n.28 above.

32. cf. Article 40 G.U.L.(Bills) it 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 endorsements but not the signatures of the endorsers."

33. cf. Article 40 G.U.L.(Bills) and Article 35 G.U.L.(Cheques). For the reading of the former see footnote immediately above. As to the applicability of the rule incorporated in Article 40 G.U.L.(Bills) to the Uniform Law on Cheques, cf. the Minutes to the Geneva Convention on the Uniform Law relating to Bills of Exchange, Promissory Notes and Cheques, 2nd session, L.N. Doc. No. C.194 M.77 1931 II B, pp.233-258.
See also the remarks of the Drafting Committee on Article 35.

34. See pp.47-48 supra.

35. cf. Article 7 G.U.L.(Bills) and Article 10 G.U.L.(Cheques). The former article 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, the obligations of the other persons who signed it are none the less valid."

Article 10 G.U.L.(Cheques) is worded substantially similarly to Article 7 G.U.L.(Bills). The only variation is the bill of exchange is substituted for the word "cheque".

36. For a more detailed analysis concerning the impact of forged indorsements on the negotiable instrument which they vitiate and their impact on the rights and obligations of the parties engaged on it see pp.238-241 and 275-277 supra.

37. See authorities cited in n.27 above.

38. Article 16 G.U.L.(Bills) 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 ecrits). 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."

The counterpart of Article 16 G.U.L.(Bills) in the Convention on Uniform Laws relating to Cheques is Articles 19-21.

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 indorsors."

39. For the fact that the Continental Geneva legal systems apply the reasonable man test in determining whether or not the bona fide third party acquirer or the drawee was grossly negligent in his acquisition or payment see:-

The minutes to the Geneva Convention on the Unification of the laws relating to Bills of Exchange, Promissory Notes and Cheques 1st Session, L.N. Doc. No. C.628 M.249 1930 II, pp.197-201.
Balough, Critical Remarks on the Law of Bills of Exchange of the Geneva Convention, (1935), X Tulane L. Rev.
Albassam, Qaidat Tatthir Alduffue Fi Maidan Alawraq Altijaria, (1969), p.144.

40. The law in Germany is an example of the legal system which deems the publication of the theft or loss of a negotiable instrument in an official gazette to be sufficient to inform the members of the public of such fact and ultimately put them on guard.
cf. Crauford, Differences between the English and the German Law Relating to Negotiable Instruments, (1957), 6 Int. Comp. L.Q., p.438.

41. The rule that the issuance of a stop payment order does not per se suffice to direct the drawee to dishonour the instrument in respect of which the stop payment order has been issued, was discussed at the Geneva Conference on the Unification of the Laws Relating to Bills of Exchange, Promissory Notes and Cheques, 2nd Session, L. N. Doc. No. C.194 M.77 1931 II B, pp.233-249. At the conference the Italians proposed that the drawee should not be made to abide by his customer's order to stop the payment of the cheque in instances where the possessor of the said cheque could establish that he satisfies the lawful holder status. In such an instance, the drawee may ignore his customer's stop payment order and pay the cheque in favour of its holder. His payment as such should be capable of establishing in his favour a valid discharge. Accordingly, the customer should be entitled to challenge the drawee's act of payment and he should be denied the right of demanding a recredit of his account.

Other legal systems such as France, expressed their disagreement with the Italian proposal. They were of the view that the issue whether or not the possessor of a cheque satisfies the lawful holder status in situations where the property right to the cheque is in conflict, is a matter which should be left to the judiciary to decide. The drawee does not possess a judicial capacity hence he should not be involved in making such a decision. (Ibid. p.242). Accordingly, he should abide by his customer's stop payment order and dishonour the presented cheque.

Finally, the Conference favoured the Italian proposal. It decided to deal with this particular issue in the same manner as it was dealt with in Article 40(3) of the Convention on the Uniform Laws relating to Bills of Exchange and Promissory Notes. That is to say that the drawee should be concerned with the regularity of the cheque only (Ibid. p.252). Thus if a vitiated cheque has been presented to him by a person purporting to be its lawful holder, the drawee may pay it and he may establish

in his favour a valid discharge notwithstanding the fact that his customer has issued a stop payment order.

However, The Conference preserved to the Contracting states the right to regulate in their national laws the instances in which cheques could be countermanded, its effect as well as the procedures necessary to procure it. cf. Article 16 of the Convention on the Reservations to the Convention on the Uniform Laws relating to Cheques.

In the light of the Contracting states' right to regulate in their national laws the procedure and the effect of countermand, some legal systems such as France could end up denying the drawee the right to disregard his customer's stop payment order. That is to say that they could end up establishing liability against the drawee for not complying with the stop payment order.

42. The legal systems which adopt the amortisation procedure are mainly those which belong to the Germanic legal group such as Yugoslavia, Czechoslovakia, Romania, Austria, Switzerland and Germany. For an overview of the Continental Geneva legal systems which are in favour of the amortisation procedure see the Minutes to the Geneva Conference on the Laws relating to Bills of Exchange, Promissory Notes and Cheques, 2nd Session, L. N. Doc. No. C.194 M.77 1931 II B, pp.242-246.

43. cf. The Minutes to the Geneva Conference on the Unification of the Laws relating to Bills of Exchange, Promissory Notes and Cheques, 2nd Session, L. N. Doc. No. C.194 M.77 1931 II B, pp.242-246.

44. An example of the legal system which requires the holder to secure a court order in order to compel the drawee to pay the face value of his instrument is the law in France.
cf. Farnsworth, The Check in France and the United States - A Comparative Study, (1961-62), 36 Tulane L. Rev., p.360.

45. For the reading of Articles 16 and 40 G.U.L.(Bills) see n.38 above.

46. As to the application of the reasonable man test in determining whether or not the bona fide third party acquirer or the drawee payor was negligent in his behaviour see n.39 above.

47. cf. Authorities cited in n.39 above.

48. Ibid.

49. cf. The report of the Drafting Committee of the Geneva Convention on the Uniform Laws relating to Bills of Exchange and Promissory Notes.

50. cf. A.M. Honoré, Causation and Remoteness of Damages, (1983), II Int. Enc. of Comp. L. S.173.

Recently, the law in France evidenced a development in the context of strict liability. It shifted from the apportionment of liability rule to the all or nothing liability rule. In instances where the fault of the injured party did not amount to force majeure, the law in France seems, in light of the recent development, to hold the strictly liable party fully liable for the resulting loss. It does not seem to consider the fault of the injured party per se a ground for reducing the liability of the strictly liable party.

There are some indications that the recent development is restricted in its application. Its immediate impact mostly influenced the cases of car accidents.
cf. Desmares Civ. 2e 21 juill. 1982 D 1982 44a concl. Charbonnie.

Where the case in question does not fall within the category of car accidents, it seems that courts in France are reluctant to extend the application of the decision in the Desmares case.
cf. Guillaume Civ. 2e fév. 1982 GAZ.PAL. 1982 2 som 317.

From the foregoing, it seems that in the absence of sufficient authority it could not be categorically determined that the recent development which France evidenced in the law of tort extends to the risk arising in the context of negotiable instruments. Until such authority is set forth it could fairly be stated that the apportionment of liability rule applies to determining the allocation of risk in the context of negotiable instruments.

51. For a detailed examination of the care which the original true owner could provide in order to prevent the forgery of an indorsement and the occurrence of loss see pp.601-605 supra.

52. For a more detailed account of the argument that the allocation of the risk of forged indorsements to the bona fide third party acquirer or to the drawee payor would result in allocating it to a party who is incapable of providing against it in an economically efficient manner or that it could result in allocating the said risk in a manner incompatible with the special nature of negotiable instruments see pp.606-614 supra.

53. cf. pp.617-620 and 622-624 supra.

54. Some may argue that the allocation of the risk of forged indorsements to either the bona fide third party acquirer or the drawee payor does not impair the objective of promoting the function of the institution of negotiable instruments as a substitute for money. The increase in

the volume of negotiable instrument dealing in the Anglo-American legal systems is illustrative of this fact. The number of negotiable instruments circulating through banking channels in the said legal system, is greater than those circulating in the banking channels of the Continental Geneva legal systems.

In reply it could be observed that the increase in the volume of negotiable instrument dealings in the Anglo-American legal systems is not due to their manner of allocating the risk of the forgery of indorsements, rather it is due to economic reality and the understanding of the people engaged in the negotiation and acquisition of negotiable instruments. cf. pp. 619-620 supra.

55. cf. pp.634-638 supra.

Some may argue that the allocation of the risk of forged indorsements in favour of the bona fide third party acquirer and the drawee payor does not necessarily result in the promotion of the negotiability attribute of negotiable instruments. On the contrary, such a rule could restrict the issuance of negotiable instruments and ultimately it could restrict the function of the institution of such documents as a substitute for money. The slight increase in the volume of negotiable instrument dealings in the Continental Geneva legal systems is illustrative of this fact. Had the allocation of the risk in question in favour of the bona fide third party acquirer and the drawee payor been considered as a relevant factor in promoting the negotiability attribute of negotiable instruments, the number of negotiable instruments circulating in the banking channels of the Continental Geneva legal systems should have far exceeded the number circulating in the banking channels of the Anglo-American legal systems.

In reply, it could be observed that the slight increase in the volume of negotiable instrument dealings in the Continental Geneva legal systems is not due to their allocation of the risk of forged indorsements to the original true owner. In fact the reasons for the slight increase are mainly twofold. In the first place, people in the Continental Geneva legal systems still consider cash money as the real currency of the land. They are more willing to discharge their financial obligations by way of cash money than their counterparts in the Anglo-American legal systems. In the second place, the system of guarantee cards does not function in the Continental Geneva legal systems. Accordingly, people are reluctant to accept negotiable instruments mainly from strangers. Such a precautionary measure is observed in order to avoid the acquisition of negotiable instruments issued against insufficient funds.

56. For a brief outline as to the basis according to which the majority of the Continental Geneva legal systems apportion the loss resulting from the forgery of an

indorsement between the grossly negligent acquirer/payor and the original true owner see pp.701-705.

57. An example of the legal systems which requires the securing of a court order in order to stop the payment of the stolen or lost instrument is the law of Germany, cf. p.699.

58. The fact that the amortisation procedure results in allocating the burden of litigation to the bona fide third party acquirer is a necessary consequence of establishing in favour of the original true owner, i.e. the person from whom the instrument in conflict was stolen or lost, the right of securing a court order for the purpose of preventing the drawee from paying the face value of the document in question in favour of its possessor.
cf. p.700 above for determining the relationship between the amortisation procedure and the securing of a court order for the purpose of stopping the payment of the stolen or lost instrument.

The establishment of the right to obtain a court order in favour of the original true owner is presumed to result in allocating the burden of litigation to the bona fide third party acquirer because court orders in the first instance under consideration are ex parte procedure. They are secured by the unilateral involvement of the applicant. The representation of the other competing party is not of the essence. This becomes particularly apparent in instances where the securing of the court order is for the purpose of stopping the payment of a stolen or lost cheque. At the time of the loss of the instrument in question, the third party acquirer would not be known, moreover he might not even exist. Accordingly, there would not be a particular party who could be notified of the amortisation procedure and hence there would not be another party represented other than the original true owner.

By the time when the stolen or lost instrument comes into the hands of a bona fide third party the right of the said party to enforce the face value of such a document would be restrained by the court order. In order to have the court order lifted, he would have to persuade the court involved in the issuing of the stop payment order of his entitlement to the face value of the acquired document. This could not be accomplished unless the bona fide third party acquirer litigates his case. In such an instance the original true owner i.e. the person from whom the instrument in conflict was stolen or lost, would stand as a defendant whilst the bona fide third party acquirer would have to establish his claim.

59. An example of the legal system which establishes in favour of the bona fide third party the right to secure a court order so as to lift the stop payment order is the law in France see pp.700-701 supra.

60. cf. Official Comment 1 to Article 3-405 U.C.C. The decision in The Bank of England v Vagliano Bros. [1891] A.C.107. For the facts of the case and the decision of the court see text.

61. [1891] A.C.107.

62. Ibid. 153.

63. cf. the decision in Clutton v Attenborough & Son [1897] A.C.90.

64. [1905] 1 KB 795.

65. [1891] A.C.107.
For the facts of the case and the decision of the court see pp.713-714 supra.

66. Ibid.
The decision in Vinden v Hughes was subsequently followed by the House of Lords in North & South Wales Bank v Macbeth [1908] A.C.137.

67. Section 7(3) B.E.A. reads:-
"Where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer."

Sections 9(3) & (4) of the N.I.L. are the counterpart of Article 7(3) B.E.A. Article 9 read in part:-
"The instrument is payable to bearer ...
(3) when it is payable to the order of a fictitious or non-existing person and such fact was known to the persons making it so payable or
(4) when the name of the payee does not purport to be the name of any person ..."

68. cf. cases cited in Morris, Fictitious Payees on Checks requiring Dual Signatures, (1961), Wisc. L. Rev., p.443.
cf. cases cited in 99 A.L.R. p.439 et seq.

69. Ibid.

70. cf. Sections 2, 21 and 31 B.E.A.,
and Articles 1-201(29) and 3-202 U.C.C.

71. cf. Section 29, 38 and 59 B.E.A., and Articles 3-302, 3-305, 3-413, 3-414, 3-603 U.C.C.

72. Ibid.

73. For a detailed account of the proprietor's capability to provide against the forgery of an indorsement and the occurrence of loss, see pp.596-597 and pp.601-603 supra.

74. cf. pp.603-605 supra.

75. For a more detailed account of the fact that the bona fide third party acquirer is not in the position to provide against the forgery of indorsements and the occurrence of loss cf. pp.606-610 supra.

76. cf. pp.622-624.

77. cf. pp.723-725.

78. For the definition of manageable care and its distinction from reasonable care see n.210 Ch. 6.

79. For a brief account of the incompatibility of the general risk allocation rule of the Anglo-American legal systems, with the proposed risk allocation rule, cf. pp.705-706 supra.

80. cf. pp.715-716 supra.

81. cf. The decision in Vinden v Hughes [1905] 1 KB 795. For the facts of the case and the rule laid down by the court see pp.715-716 supra.

82. cf. pp.724-727 supra.

83. cf. pp.723-724 supra.

84. cf. pp.716-717 supra.

85. cf. pp.723-724 supra.

86. The rule that the impersonation of another as the authorised agent of a third person does not constitute a situation of impersonated payee and ultimately the rule regulating such a situation would not have an application is expressly mentioned in the official comment to Article 3-405 U.C.C. It excludes from the scope of the article the situation where one person represents himself to be the agent of another and induces a third person to deliver a negotiable instrument to him.

The Official Comment in this context reads:-

"Impostor refers to impersonation and does not extend to a false representation that the party is the authorised agent of the payee. The maker or drawer who takes the precaution of making the instrument payable to the principal is entitled to have his indorsement."

87. The fact that the intention theory is the basis of the attitude of the North American legal system in distinguishing between the issuance of a negotiable instrument in favour of an impostor and the delivery of such an instrument to him could be inferred from the Official Comment to Article 3-405. It expressly emphasizes the relevance of the intention of the signatory to have the negotiable instrument indorsed by the hand of the principal i.e. the person whose agent the impostor represents himself to be. For the reading of the

relevant part of the official comment see note immediately above.

88. cf. Official Comment 2 to Article 3-405 U.C.C. and Article 3-404 U.C.C.

89. For the reading of Section 7(3) B.E.A. see p.69 above.

90. [1905] 1 KB 795.
For the facts of the case and the decision of the court cf. pp.715-716 supra.

91. cf. the decision in Vinden v Hughes [1905] 1 KB 795.

92. The rule that forged indorsements are divested of any practical value in the sense that they do not transfer the property right of the negotiable instrument which they vitiate and they do not operate as a valid authority to the drawee to pay in accordance with them is incorporated in Section 24 B.E.A. For the reading of Section 24 B.E.A. and its application cf. pp.235-237 and 272-274 supra.

93. Article 3-111 U.C.C. is the counterpart of Section 8(3) B.E.A. Article 3-111 reads ...
"An instrument is payable to bearer when by its terms it is payable to
(a) bearer or the order of bearer, or
(b) a specified person or bearer, or
(c) "cash" or the order of "cash" or any other indication which does not purport to designate a specific payee."

94. For the reading of Section 7(3) B.E.A. see p.717 supra.

95. [1905] 1 KB 795.
For the facts of the case and the decision of the court cf. pp.715-716 above.

96. cf. Section 31 B.E.A. and Article 3-202 and the Official Comment to Article 3-405 U.C.C.

97. For the definition of forgery cf. p.198 supra.

98. cf. Section 24 B.E.A. and Article 3-404 U.C.C.

99. For a more detailed account of the fact that the allocation of the duty to shop for information to the bona fide third party acquirer results in a misallocation of wealth to him cf. pp.607-610 supra.

100. cf. Wilson v United Counties Bank Ltd. [1920] A.C.102 112,
Pagets Law of Banking, Ninth Edition, p.240,
Byles, Bills of Exchange, 25th Edition, pp.269-270.
cf. also Article 4-402 U.C.C.

101. cf. pp.617-620 and pp.622-624 supra.

102. cf. pp.745-746 supra.

103. cf. pp.733-735 supra.

104. cf. pp.743-745 supra.

105. cf. pp.735-739 supra.

106. cf. p.738-739 supra.

107. cf. The decision in Vinden v Hughes [1905] 1 KB 795 cf. also the discussion pp.736-738 supra.

108. cf. Ryan v Bank of Italy Nat'l Trust & Sav. Ass'n 289, p.863, Cal.Dist. C+App 1930, Robertson v Coleman 4 N.E.619 (Mass.1886).

109. cf. pp.745-746 supra.

110. The import of legal fiction in order to relax the unreasonableness of the application of the intention theory is illustrated in the attitude of the courts of the United States in attributing to the issuer of a negotiable instrument in favour of an impostor, the intention to engage with the latter in person.
cf. p.751 and accompanying notes.

111. Rubin, Policies and Issues in the Proposed Revision of Articles 3 and 4 of the U.C.C., (1988), 43 The Bus. Law., p.648.

112. For the reading of Article 3-405 U.C.C. and its application to the situation of fictitious payee cf. p.717.

113. cf. Section 3 B.E.A. and Article 3-104 U.C.C.

114. cf. Sections 20, 38 and 59 B.E.A.,
Articles 3-115, 3-306 and 3-603 U.C.C.

115. Section 97 B.E.A. reads in part,
"(2) The rules of common law, including the law merchant, save insofar as they are inconsistent with the express provisions of this Act, shall continue to apply to bills of exchange, promissory notes and cheques.

116. [1907] 1 KB 794.

117. Ibid. p.803.

118. The rule that the signatory of a blank document owes the drawee a duty to exercise care in the negotiation of his document is well established in the English legal system. It is incorporated in the decision of the courts in:
Young v Grote (1827) 4 Bing.253;

Kepitigalla Rubber Estates v National Bank of India Ltd. [1909] 2 KB 1010;
Scholfield v The Earl of Londesborough [1896] A.C.514;
London Joint Stock Bank v Macmillan and Arthur [1918] A.C.777.

119. cf. Young v Grote (1827) 4 Bing.253.
London Joint Stock Bank v Macmillan and Arthur [1918] A.C.777.

120. [1907] 2 KB 735.

121. Ibid. p.744.

122. The fact that the intention theory underlies the attitude of the English legal system in not establishing liability in negligence against the signatory of a blank document who delivers it to his agent for safe custody and the latter fraudulently completes it and negotiates it to a bona fide third party, could be inferred from the decision in Smith v Prosser [1907] 2 KB 735. For the facts of this case and the rule laid down by Vaughan Williams L.J. see text and note immediately above.

123. The defence of lack of delivery in the North American legal system is personal. It cannot be set up against a bona fide third party acquirer. It can only be set up against the fraudulent person or the person who takes the negotiable instrument up with knowledge of its irregularity. cf. Articles 3-305 and 3-306 U.C.C.

124. cf. Article 3-305 and 3-306 U.C.C.
The former reads:-

"To the extent that the holder is a holder in due course he takes the instrument free from

(1) all claims to it on the part of any person; and

(2) all defences of any party to the instrument with whom the holder has not dealt except

(a) infancy, to the extent that it is a defence to a simple contract; and

(b) such other incapacity, or duress, or illegality of the transaction as renders the obligation of the party a nullity; and

(c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and

(d) discharge in insolvency proceedings; and

(e) any other discharge of which the holder has notice when he takes the instrument."

Article 3-306 U.C.C. reads,
"Unless he has the rights of a holder in due course any person takes the instrument subject to:

(a) all valid claims to it on the part of any person; and

(b) all defences of any party which would be available in an action on a simple contract; and

(c) the defences of want or failure of consideration, non-performance of any condition precedent, non delivery, or delivery for a special purpose; and

(d) the defence that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defence to any party liable thereon unless the third person himself defends the action for such party."

125. cf. pp.607-610 supra.

126. cf. pp.622-624 supra.

127. For an illustration of the instance where the shopping for information could cause the bona fide third party acquirer to forego the opportunity of satisfying the entitlement incorporated in the negotiable instrument, from a valuable security cf. pp.355-357 supra.

128. cf. Sections 54 and 55 B.E.A. and Articles 3-513 and 3-514 U.C.C.

129. cf. Young v Grote (1827) 4 Bing. 253.
London Joint Stock Bank v Macmillan and Arthur [1918] A.C.777.
Lloyds Bank v Cooke [1907] 1 KB 794.

130. Ibid.

131. cf. The Bank of Ireland v Evans' Charities Trustees (1855) 5 HL Cas 389.
Kepitigalla Rubber Estates Ltd. v National Bank of India Ltd. [1909] 2 KB 1010.
London Joint Stock Bank v Macmillan and Arthur [1918] A.C.777.
Wealden Woodlands (Kent) Ltd. v National Westminster Bank Ltd. [1983] QBD 133 NLJ 719 (Transcript: Nunnery).
Tai Hing Cotton Mill Ltd. v Lui Chong Hing Bank and Others [1986] A.C.80.

For the facts of the above mentioned cases and the rule laid down cf. pp.410-415, 430-432 and 495-501.

132. Ibid.

133. cf. The proposition of Blackburn J. in Swan v North British Australasian Co. (1863) 2 H & C 175.
For the reading of the proposition and its applicability to English law see pp.399-400.

134. For a more detailed analysis of the determination of the status of the bona fide third party acquirer vis-à-vis himself and the remote signatory on a negotiable instrument such as the drawer see pp.400-404 supra.

As to the rule that the remote signatory on a negotiable instrument does not owe the bona fide third party acquirer a duty of care,
cf. Scholfield v the Earl of Londesborough [1896] A.C.514,
London Joint Stock Bank v Macmillan and Arthur [1918] A.C.777.
For a reading of the relevant passage of the above mentioned see pp.400-404.

135. cf. The Bank of Ireland v Evans' Charities Trustees (1855) 5 HL Cas 389.
London Joint Stock Bank v Macmillan and Arthur [1918] A.C.777.
For the reading of the relevant passage of the above mentioned cases see pp. 430-432.

136. cf. Kepitigalla Rubber Estates Ltd. v The National Bank of India [1909] 2 KB 1010.
Tai Hing Cotton Mill Ltd. v Lui Chong Hing Bank Ltd. [1986] A.C.80.
For the reading of the relevant passage see pp.504-505.

137. Section 1 of the 1945 Law Reforms Contributory Negligence Act reads in part:

"Where any person suffers damage as a result partly of his own fault and partly of the fault of any other person or persons a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage but the damages recoverable in respect thereof shall be reduced to such an extent as the court thinks just and equitable having regard to the claimant share in the responsibility for the damage."

138. Section 11 of the 1977 Torts (Interference with Goods) Act reads in part:-

"Contributory negligence is no defence in proceedings founded on conversion or on intentional prejudice to goods."

139. For a detailed account of the definition of the term "substantially contributes" and its relationship with the Restatement Second of the Law of Torts see pp.451-452 together with accompanying n.

140. See n.109-111, Ch.6.

141. cf. Official Comment to Article 3-406 U.C.C.

142. cf. Thompson Maple Products v Citizens National Bank of Corry 211 Pa Super 42 (1967).
Commercial Credit Equipment Corp. v The First Alabama Bank of Montgomery 6363 Fed. Rep. 2d 1051 (1981).

143. For a detailed account of the argument that the proprietor of a negotiable instrument is in the position to provide against the forgery of an indorsement see pp.596-597 and 601-603.

144. For a detailed account of the theories underlying the English attitude in not establishing liability against the negligent signatory of a negotiable instrument see pp.415-436 supra.

145. For a detailed analysis of the validity of the theories underlying the attitude of the English legal system see pp.415-436 supra.

146. For a detailed account of the evolution of the law of negligence see pp.404-408 and 436-437 supra.

147. See pp.774-775.

148. See p.775.

149. See 631-634 supra.

150. For a brief account of the general attitude of the Continental Geneva legal systems, in allocating the risk of the forgery of indorsements and for a detailed account of the compatibility of the said rule with the proposed risk allocation rule see pp.692-705, 706-710.

151. For a brief examination in determining the necessary act for stopping the payment of a stolen or lost negotiable instrument in the various Continental Geneva legal systems see pp.698-701.

152. For a brief account in determining the compatibility of the attitude of the various Continental Geneva legal systems in regulating the manner of stopping the payment of a stolen or lost negotiable instrument, with the proposed risk allocation rule see pp.708-710.

153. cf. pp.721-722, 741-742, 762-763 and 774-775.

154. cf. pp.733-735.

155. cf. p.775.

156. cf. pp.714-715, 756-762, 770-774.

157. cf. Article 15 of the Convention on International Bills of Exchange and International Promissory Notes and Article 16 of the Draft Convention on International Cheques.

The former article 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 past 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."

158. cf. Article 69 of the Convention on International Bills of Exchange and Promissory Notes and Article 58 of the Draft Convention on International Cheques. The former article reads:-
"The holder may exercise his rights on the instrument against any 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."

159. cf. Article 28 of the Convention on International Bills of Exchange and International Promissory Notes. It 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."

By comparison the draft Convention on International Cheques increases the holder's vulnerability to the claims of the signatory against whom he intends to enforce his instrument i.e. cheque. It entitles the latter to set up against the holder who does not qualify as the protected holder all claims which he possesses on the instrument, cf. Article 27(2).
The said subsection reads:-
"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."

160. cf. Articles 15 and 72 of the Convention on International Bills of Exchange and Promissory Notes and Articles 16 and 67(2) of the draft Convention on International Cheques.
Article 72 of the Convention 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
a) At or after maturity; or
b) Before maturity, upon dishonour by non-acceptance."

161. cf. Article 72 of the Convention on International Bills of Exchange and International Promissory Notes and Article 60 of the Draft Convention on International Cheques.

The former Article reads in part:-

"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."

162. cf. Article 25 of the Convention on International Bills of Exchange and International Promissory Notes and Article 25 of the Draft Convention on International Cheques.

The former article 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."

163. cf. U.N. Document no. A/CN.9/213, 1982, p.51. and U.N. Document no. A/CN.9/214, 1982, p.44.

164. cf. Article 25(3) of the Convention on International Bills of Exchange and International Promissory Notes.

The above subsection reads:-

"3) Furthermore, a party on 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."

165. For the meaning of the term "off the instrument" and its origin see p.247 supra.

166. cf. Articles 15 and 72 of the Convention on International Bills of Exchange and International Promissory Notes and Articles 16 and 60 of the Draft Convention on International Cheques.

For the reading of the relevant articles see notes 157 and 160 above.

167. The counterpart of Article 34 of the Convention on International Bills of Exchange and International Promissory Notes is Article 32 of the Draft Convention on International Cheques.

168. cf. pp.622-624 supra.

169. For a brief analysis of the fact that the implication of acceptance or representation is closely related to the existence of the duty of care and the notion of proximity see pp.545-546 supra.

170. For a detailed account of the fact that the English legal system restricts the allocation of the duty to exercise care in favour of a limited category of persons cf. pp.398-404, 410-415 supra.

CHAPTER NINE

CONFLICT OF LAWS.

INTRODUCTION

Like multi-party contracts, the dealing in negotiable instruments gives rise to a number of potential situations of conflict of laws. The acts of issuance, indorsement, guaranty, acquisition, collection, acceptance and payment might not all occur in a single legal system.[1] Accordingly, the determination of the liability and the entitlements of the involved parties, which would arise from a particular act, might conflict. One legal system might establish a valid discharge in favour of the signatory, against whom the instrument is intended to be enforced, whilst another legal system might establish liability against him.[2] From the foregoing, it could be concluded that the involvement of several legal systems could result in an incompatible risk allocation rule. In such an instance, it would be necessary to determine the proper law. The determination of the proper law should however, be compatible with the considerations underlying the promotion of the legal institution in question. In the context of negotiable instruments, the determination of the proper law should result in facilitating the function of such documents, it should protect the reasonable expectations of the potential competing parties, it should accommodate the interests of commerce, it should provide against moral hazard[3] and, finally, it

should allocate the resulting loss to the party who is in the position to provide against it in an economically efficient manner.[4]

The Proper Law in Determining Liability on Negotiable Instruments

I. Party autonomy, to a greater or lesser degree is accepted as a valid principle of law, in almost every legal system. Its application is not confined to the rules of the civil or commercial law. Its significance could be traced to the rules of the private international law.[5]

In the legal systems under consideration, parties to a given transaction, with certain exceptions,[6] are free to determine the law governing their rights and liabilities. The right to choose the applicable law is upheld because it meets the reasonable expectation of the parties in question. Persons accept to engage in a transaction and abide by its consequences when and only when they are able to predict the effect thereof. In doing so, they place reasonable reliance on the relevant existing substantive rules. If the forum was to ignore the said reliance and impose another set of substantive rules as the governing law, the original transaction between the parties might be altered. The parties might find themselves bound by a contract to which they have not agreed. Thus, in order to maintain the original agreement and its effect, the reasonable expectation of the parties should be consulted.

This cannot be achieved by merely protecting the expectation interest from the standpoint of the substantive rule, but also by preserving it from the standpoint of the private international law.

II. Normally negotiable instruments do not incorporate in their four corners the proper law of the underlying transaction. The immediate parties to a particular transaction do not mention in the negotiable instrument, through which they intend to settle their reciprocal rights and liabilities, the proper law of their contract. As far as their inter-relationship is concerned, they can always invoke the application of the proper law by which they have consented to be bound. They can demand the forum to determine their reciprocal rights and liabilities by applying the rules of the mutually intended proper law.

The tendency of not incorporating, in the four corners of the negotiable instrument, the proper law, is to facilitate the free transferability of such documents and ultimately, to promote their marketability. The incorporation of the proper law restricts the free transferability of a negotiable instrument because it allocates to the person to whom it is offered for a valuable exchange the duty to shop for information as to the enforceable rule.

The duty of information shopping results in a hardship to the person in question, especially in instances where he resides in a legal system enforcing rules which are different to those enforced in the

incorporated proper law. In such an instance, information shopping requires the person to whom the negotiable instrument is offered, to invest cost and time. The person in question might not consider the engagement in such a duty efficient. He might consider the investment of cost to represent a misallocation of wealth to him and he might consider the investment of time to disturb his commercial interests. It is submitted that the foregoing inconveniences could discourage the acquisition of negotiable instruments. Ultimately the institution of such documents would fail to fulfil its intended function as an efficient finance instrument.

Where No Choice Can Be Inferred

I. In the absence of express or inferred tacit choice, the tendency in the various legal systems is to create a presumption as to the law governing the rights and liability of the parties.[7] The presumption created however, is but a legislative objective and abstract reading of the mind of the parties to a given transaction. It attempts to select the law that reasonable parties would have chosen to govern the transaction and the rights and liability flowing from it, had they contemplated it. Thus, in order for the presumption to satisfy the intention of the parties it would have to meet the "reasonable" expectation of the said parties.

II. Most of the engagements incorporated in negotiable instruments such as the drawing, indorsement and the

guaranty are sui generis. Their formation may take place in one locality whilst their performance i.e. the payment of the monetary obligation may take place in another locality. An example of such an instance is the cheque which purports to be drawn in England, indorsed and guaranteed in France and made payable in Germany. In the Anglo-American and the Continental Geneva legal systems, the act of drawing, indorsement and guaranty are presumed to be formed in the locality where the relevant signature is affixed[8] i.e. England and France respectively. Nevertheless, the performance of the principal obligation i.e. the payment of the face value of the instrument, such as the cheque, as far as the above example is concerned, is intended by all parties to be made in Germany.

III. Due to the special nature of the engagement on negotiable instruments, two theories are advanced in determining the proper law[9] i.e. the law which expresses more efficiently the reasonable expectation of the parties in question. One theory favours the lex loci solutionis whilst the other favours the lex loci contractus.[10] The advocates of the former theory consider the law of the place in which the instrument is intended to be payable, consistent with the reasonable expectations of the party to such a document. It is argued, that since the said party intended his instrument to be payable in a locality other than that in which he engaged, he is presumed to be more acquainted with the law of the place of performance.[11]

As a further argument in favour of the lex loci solutionis, it is suggested that the lex loci contractus might be accidental. That is to say, that the party to a negotiable instrument might not have a substantial close-connectedness with the law of the place of contracting.[12] An example of such an instance occurs when a French stockbroker arranges by correspondence with a large English company such as British Telecom to buy some of its offered shares. By way of securing the payment of the shares, the French stockbroker arranges with British Telecom to issue in its favour a French inland cheque. Later, the French stockbroker decides to visit England for a holiday. Before he boards the ferry, the French stockbroker prepares the cheque. He writes the sum for which he arranged to buy the shares, makes the cheque payable to British Telecom and dates it. Shortly after his arrival in Dover, the French stockbroker signs the cheque and posts it to the payee by registered mail.

In such an instance, the placing of the signature on the cheque in England is accidental. The preparation of the contract of sale, as well as the cheque took place in France. The sudden decision to visit England for a holiday and the affixing of the signature on the cheque in Dover do not presume that the French stockbroker has consented to submit himself to English law or that he is presumed to establish a substantial close-connectedness with English law.

Finally, as a further objection to determining the lex loci contractus as the proper law of the engagements

on negotiable instruments, it could be argued that the determination of the said rule evidences uncertainty in instances of contracting by correspondence. This is due to the fact that the existing legal systems are in disagreement as to the time and place in which the contract by correspondence is presumed to be concluded. The English legal system, for an example, is of the view that the contract by correspondence is presumed to be concluded when the acceptance is dispatched to the offeror and it is presumed to be concluded at the place of dispatch.[13] The French legal system is of the view that the contract by correspondence is presumed to be concluded when it is communicated to the offeror and it is presumed to be concluded at the place where the latter receives the acceptance.[14] The German legal system, by comparison is of the view that the contract by correspondence is presumed to be concluded when the acceptance is made available to the offeror and it is presumed to be concluded at the place where the latter designates as his legal residence.[15]

Due to the foregoing diversity, an inconsistent application could result. One forum could conclude that the contract in question is presumed to be concluded in a particular jurisdiction and it could be concluded that the law of that jurisdiction is presumed to be the lex loci contractus, whilst another forum belonging to a different legal system might come to a different conclusion. It might conclude that the said contract is presumed to be concluded in another jurisdiction and ultimately it might

conclude that the law of the said jurisdiction is presumed to be the lex loci contractus.

Such an instance could occur when an English businessman intends to purchase a French farmhouse from a French estate agent. In the course of negotiation, the former writes a letter to the French estate agent requesting details about the advertised house. The estate agent remits to the English businessman a leaflet, together with the required price. The English businessman fancies the deal and remits a formal bid for the house. The estate agent receives the bid, communicates it to the landlord and arranges to conclude the deal with the English businessman. The estate agent remits to the latter a formal letter expressing its acceptance to sell the house to him. Shortly after, the landlord receives a higher bid. Accordingly, he advises the estate agent to cancel the deal with the English businessman. The estate agent next telexes to the English businessman informing him of the cancellation of the deal. Eventually, the telex reaches the English businessman first. Later he receives the remitted letter in which the estate agent had expressed its acceptance of his offered bid.

In instance such as the above, the relevant issues is the determination of the relationship between the estate agent and the English businessman. By virtue of English law, the French estate agent and the English businessman are presumed to have entered a contract of sale. This is because the estate agent has remitted its acceptance to

the English businessman. By such an act it is presumed to have concluded the contract of sale with the English businessman.[16] Accordingly, it cannot renege from such a position unilaterally. By virtue of French law, no legal relationship exists between the French estate agent and the English businessman. This is because the former has communicated to the English businessman the cancellation of the deal before the letter of acceptance reaches him. By such an act, the estate agent is presumed to have rendered the letter of acceptance of no legal effect.[17]

In instances such as the above, if the case was brought before an English forum, the holding would be in favour of the English businessman. He would be entitled to enforce the contract of sale in his favour. If, by comparison, the case in question was brought before a French court, the holding would be in favour of the estate agent. It would not be held liable to the English businessman for the disputed contract of sale.

It is submitted that the uncertainty arising from the instances such as the above is illustrated in determining the relationship between the competing parties. It could be argued that such uncertainty is inconvenient in commerce. It increases court settlement. The increase in court settlement gives rise to the investment of cost and time in an economically inefficient manner. It cause the competing parties to forego the opportunity to utilise their wealth in channels where an optimum value could be obtained.

To state the obvious, the foregoing objection does

not materialise in the context of negotiable instruments. This is due to two reasons. In the first place, the engagements on negotiable instruments are formed i.e. concluded, by the mere placing of the signature or by the placing of the signature plus the delivery of the document in question.[18] That is to say, that once the negotiable instrument leaves the hand of the signatory, the law in the major legal systems creates a prima facie prescription that the assignment on such a document has been concluded. Thus the competing parties would not be confronted with the difficulty of determining the time of the formation of the engagement on the negotiable instrument.

In the second place, the law in the major legal systems creates a presumptive rule as to the place of contracting. The Anglo-American legal systems presume the place of delivery as the place of contracting. The Continental Geneva legal systems presume the place where the signature is affixed as the place of contracting.[19] By such an approach, the law determines with predictability and certainty the applicable rule. Ultimately, the competing parties would not be confronted with the difficulty of determining their relationship.

IV. As far as the first argument is concerned, it could be replied that such an argument does not represent a serious objection to considering the lex loci contractus as the law which meets the reasonable expectations of the person engaging on a negotiable instrument and ultimately it does not represent a serious objection to considering

the said law as the proper law of the engagement on such a document. In the majority of instances, the lex loci contractus is not accidental. It coincides with the law of the place with which the signatory of a negotiable instrument is presumed to be most familiar. This is due to the fact that the said law is intertwined with the lex loci domicile i.e. the law of the place where the signatory in question is domiciled or the law of the place where his business is domiciled. Since the lex loci contractus coincides with the law of the place with which the signatory on a negotiable instrument is presumed to be most familiar, it is presumed to meet the reasonable expectation of such a party.

The fact that the lex loci contractus meets the reasonable expectations of the signatory on a negotiable instrument. is reinforced by the fact that in the majority of instances the signatory on a negotiable instrument is secondarily liable.[20] His liability does not crystallize unless and until the drawee dishonours the issued, indorsed or guaranteed instrument.[21] In such instances only, the holder of the negotiable instrument may enforce the acquired document against the signatories such as the drawer, indorsor and guarantor. This is done by exercising a right of recourse against any or all of the said parties. The enforcement of the monetary obligation by way of recourse suggests that the signatory on a negotiable instrument does not undertake to perform his individual obligation at the drawee's place of business as such. Rather, at the critical time, the signatory in

question undertakes to pay the face value of his instrument at his own place of business. Since the place of business of the signatory is intertwined with his place of contracting, it could be concluded that, in actual fact the place of contracting coincides with the place of performing the obligation arising from the individual engagement on the negotiable instrument. Such a conclusion indicates that the lex loci contractus meets more efficiently the reasonable expectation of the signatory on the negotiable instrument. Accordingly, the determination of the said law as the proper law, conforms with his intention to have his liability regulated by its rules.

In instances where the lex loci contractus proves to be accidental, such as the case in the above example,[22] and the signatory on the negotiable instrument does not wish to submit himself to its rule, he should alert the mind of the third party who may come in contact with such a document, as to his intention. He should, at the time of his engagement, incorporate in the negotiable instrument, the proper law. The determination of the proper law does not only concern the signatory himself. Rather it concerns the third party who comes in contact with the negotiable instrument. It enables him to determine the extent of the liability of the signatory. Thus, if the signatory does not express his intention on the negotiable instrument as to the proper law, his behaviour could jeopardize the bona fide third party. It would subject him to the rules of the law, the application

of which he would not reasonably anticipate. The four corners of the offered instrument do not, in the absence of an express stipulation, indicate that the signatory in question intends to submit himself to a set of legal rules different from those enforced in the lex loci contractus. In such an instance, the bona fide third party could be subjected to defences and claims of which he had no knowledge, and of which it would not be reasonable to expect him to have knowledge.

The allocation to the bona fide third party of the duty to shop for information concerning the actual intention of the signatory on the negotiable instrument, is inefficient. Due to the involvement of time, it prevents the negotiable instrument from fulfilling its intended function. It prevents such a document from circulating freely in the stream of commerce and ultimately, it prevents it from functioning as a substitute for money.[23]

Moreover, due to the involvement of cost, the allocation to the bona fide third party of the duty to shop for information, could result in an economic detriment to him. It requires him to invest cost in situations where no practical enforceable value could be obtained inconsideration. Such a result could deter the commercial community from engaging in the business of acquiring negotiable instruments. Ultimately, the objective of promoting the institution of such documents would fail.[24]

From the foregoing, it could be concluded, in

instances where the signatory on a negotiable instrument does not express his intention to submit himself to a set of rules different from those incorporated in the lex loci contractus, the latter law should be determined as the proper law of his engagement. Such an application protects the reasonable expectations of a bona fide third party and it achieves more efficiently the objective of promoting the institution of negotiable instruments. The determination of the lex loci contractus as the proper law is not, however, unreasonable, as far as the signatory is concerned. On the one hand, his failure to express his intention on the negotiable instrument, establishes against him an implied acceptance of the rules of the law in question. On the other hand, he ought to bear the risk of misleading a bona fide third party as to the proper law. The failure to incorporate the proper law in the negotiable instrument is presumed to mislead a bona fide third party, because it represents to the latter that the engagement on the offered document is made at the place of the business of the signatory. Accordingly, it represents to him that the signatory in question has a substantial close connection with the lex loci contractus.

The Scope of the Lex Loci Contractus

I. The lex loci contractus should not possess an overall application as the proper law of the engagement on the negotiable instrument. In instances where it could result in an undue hardship to a third party whose contact

with the instrument in question is foreseeable, the lex loci contractus should give way in favour of another law. The law which is intended to replace the lex loci contractus should be reasonable. It should meet the reasonable expectations of the competing parties and it should accommodate the notion of economic efficiency. It should not result in an undue hardship to the party in question. The fulfilment of the foregoing requirement would encourage the negotiation and acquisition of negotiable instruments. Ultimately, it would promote the function of the institution of such documents as a substitute for money.

The lex loci contractus could result in an undue hardship to a third party when it is applied to determine the requirements of enforcing the liability of the signatory of a negotiable instrument. The hardship resulting from the application of the lex loci contractus to the instance under consideration is twofold. On the one hand, it allocates to the third party the duty to shop for information concerning the rules of a foreign law. On the other hand, it allocates to such a party the duty to comply with the said rules. The allocation of the foregoing duties becomes more onerous when the offered negotiable instrument incorporates several engagements. In such an instance, the third party would have to determine the rules of the law of each engagement and he would have to comply with the rules of the said laws.

An example of the instance where the allocation to the third party of the duty to determine the rules of the

foreign law and the duty to comply with it could result in an undue hardship, arises when an English person, such as John Alex, takes up in France a certified cheque drawn in Deutsche marks from his German classmate, as a consideration for the car which he sold to the latter. Shortly after his acquisition of the cheque, John Alex leaves for England. There he learns that a friend of his, David Dove, intends to visit West Germany for a holiday. Accordingly, he negotiates the cheque to David Dove by indorsing it to him. In Germany, the latter indorses the cheque to the hotel in which he stays, as a down-payment for the period which he intends to spend there. The manager of the German hotel indorses the cheque in the name of the business to a German bank for collection. The latter presents the cheque to the drawee bank for payment. Finally, due to an oversight as to the sufficiency of the drawer's account, the drawee bank dishonours the cheque.

In instances such as the above, the negotiable instrument incorporates several engagements. Each engagement is formed in a legal system different from that in which the other engagements are formed. For an example, the making of the cheque, as far as the above illustration is concerned, is formed in France. The first indorsement is formed in England, whilst the second indorsement and the indorsement for collection are formed in West Germany.

Moreover, the involvement of several legal systems could result in determining the liability arising from the

engagement on the negotiable instrument in a manner different from that applied in the other legal systems. It could require the compliance with certain duties and formalities for the purpose of enforcing the liability of the signatory in question. Other legal systems, by comparison, might differ in determining the required duties and formalities. They might not consider the requirements which the former legal system favours, as essential for the enforcement of the liability of the signatory. Accordingly, they might preserve the liability of the latter on the negotiable instrument in instances where the other legal system might discharge him.

As far as the above illustration is concerned, the French, English and German legal systems are not in full agreement in determining when the bona fide third party acquirer, such as the German hotel, can enforce the liability of the signatories on the cheque in instances of dishonour. The French legal system i.e. the law of the place where the act of making the cheque occurred, holds the drawer of such a document liable on it, as long as he does not sustain a loss from its payment. The third party acquirer would not forfeit his right of recourse against the drawer, even if he fails to comply with the duties of presentment, drawing up protest or giving notice of dishonour.[25] The drawer of a cheque is not presumed to sustain a loss from the payment of the monetary obligation in favour of the lawful holder i.e. acquirer, in instances where the drawee, due to an oversight,

refuses the payment of the cheque. The credit against which the instrument in question is drawn remains intact in the hands of the drawee.

The English legal system, i.e. the law of the place where the first indorsement is formed, does not enforce the liability of the indorsor, such as John Alex, unless the acquirer of the instrument, such as the German hotel, notifies the former of the dishonour of the instrument in question, arranges for the drawing up of protest and communicates the certificate of protest to him.[26] For the notice of dishonour, the drawing up of protest and its communication to the indorsor to be effective, in the sense that it could raise the liability of the latter on the negotiable instrument, the act of notification should be made within the next day following the day of dishonour,[27] whilst the drawing up of a protest may be made any day between the day of noting and the day of filing the action against the signatory whose liability is intended to be enforced.[28] If the acquirer fails to comply with the foregoing time limits, he forfeits his right of recourse on the negotiable instrument. The indorsor would be discharged on it. The said rule would apply even if the failure to give timely notice of dishonour or the failure to draw up protest in a timely manner does not result in a loss to the indorsor.[29]

Finally, the German legal system i.e. the law of the place where the second indorsement on the cheque is formed does not enforce the liability of the indorsor, such as David Dove, unless the acquirer of the instrument i.e.

cheque, arranges for the drawing up of protest of the non-payment, communicates the certificate of protest to the indorsor and notifies the latter of the dishonour.[30] For the drawing up of protest, the communication of its certificate to the indorsor and the giving of a notice of dishonour to be effective, the act of drawing up protest and its communication should be made within one day following the day of maturity of the instrument, whilst the giving of a notice of dishonour should be made within four days following the day of protest.[31] The failure to comply with the time limit in drawing up protest and communicating it to the indorsor, discharges absolutely the liability of the said party on the negotiable instrument. Accordingly, the negligent acquirer forfeits his right of recourse on the instrument against the indorsor.[32] By comparison, the failure to give notice of dishonour does not discharge the indorsor totally from liability. He is discharged to the extent of the loss resulting to him from the negligence of the acquirer.[33]

In instances such as the above, if the lex loci contractus was to be applied as the proper law of the engagement on the negotiable instrument, it would result in an undue hardship to the third party acquirer. In order to enforce the liability arising from the engagement on the negotiable instrument in his favour, the said party would, firstly, have to shop for information concerning the rules of the lex loci contractus of each engagement, and secondly, he would have to observe the said rules. As far as the above example is concerned,[34] the German

hotelier would firstly have to determine the rules of French, English and German law, concerning the enforcement of the liability of secondarily liable parties, and secondly, he would have to meet the requirements set out in each legal system, and finally, he would have to observe the time limit prescribed in them. The failure to comply with such duties, could cost him the forfeiture of his right of recourse on the negotiable instrument. Ultimately, it could cost him the forfeiture of a valuable security.

The hardship resulting from information shopping and the observance of the rules of dissimilar legal systems is twofold. On the one hand, information shopping involves the investment of both cost and time. The investment of cost could result in an economic detriment to the third party acquirer. It might not generate an enforceable value to him. This becomes more apparent when the legal system, the rules of which are required to be investigated, is not expected to be of great relevance; such as the case where the payment of the negotiable instrument is intended to be made in a different legal system. In such an instance, the investment of cost would take the form of misallocation of wealth.[35]

The investment of time also results in an economic detriment to the third party acquirer. It prevents him from satisfying the entitlement incorporated in the acquired instrument in an economically favourable manner. It prevents him from liquidating his instrument into money on its day of maturity. Ultimately, it could cause him

to suspend or disturb his commercial engagements, the finance of which is dependent on the credit incorporated in the acquired instrument.[36]

On the other hand, the observance of the rules of dissimilar legal systems complicates and delays the process of the enforcement of liability. It is submitted that the said results are inconvenient in commerce in general and they are inconvenient in the context of negotiable instruments in particular. They are at variance with simplicity and expedience. Both speed and simplicity are valuable assets in commerce, their immediate impact is that they save time. In such an instance, the element of time could be invested in channels that could generate the optimum value.

It is submitted that the foregoing inconveniences are detrimental to the institution of negotiable instruments. Firstly, they prevent negotiable instruments from fulfilling their intended function as a finance device. Secondly, they may deter the commercial community from engaging in the business of acquiring such documents. In the last analysis, the free transferability of negotiable instruments could be restricted and the objective of promoting the institution of such documents could fail.

II. In order to avoid the foregoing result, the lex loci contractus should be replaced with a more reasonable law. The said law should satisfy the reasonable expectations of the competing parties, namely the third party acquirer and the signatories on the negotiable instrument. The law of

the place of acquisition is not presumed to meet the reasonable expectations of each of the competing parties. In particular, it does not meet the reasonable expectations of the signatory on a negotiable instrument. Due to the special nature of such a document, its acquisition could occur in any place in the world. Accordingly, it is unreasonable to expect the signatory to know the rules of every legal system. It is also unreasonable to subject him to the rules of the legal system in question.

III. It is submitted that the law which satisfies the reasonable expectations of the signatory as well as the third party acquirer is the lex loci solutionis i.e. the law of the place where the payment of the negotiable instrument is initially promised or undertaken to be made. The lex loci solutionis in this sense corresponds with the law of the place of the business of the drawee. Such a law is presumed to meet the reasonable expectations of the competing parties because it coincides with the law which they are presumed to have intended to submit themselves. By engaging to make the credit against which the negotiable instrument is drawn, available at the drawee's place of business, the signatory is presumed to have accepted to submit himself to the law of that place. By accepting to collect the credit against which the acquired instrument is drawn, at the drawee's place of business, the third party acquirer is presumed to have consented to submit himself to the rules of that law.

Finally, the application of the lex loci solutionis as the law regulating the enforcement of the liability of the signatory of the negotiable instrument, avoids the hardship resulting from the application of the lex loci contractus. It allocates to the third party acquirer the duty to observe a single set of rules, namely that of the law of the place of payment. The observation of a single set of rules achieves predictability, certainty, uniformity, simplicity and expedience. The promotion of the foregoing considerations is compatible with economic efficiency. It results in cutting cost and saving time. Accordingly, cost and time would be invested in channels which could generate the optimum value.

Summary

In determining the proper law of the engagements on negotiable instruments, regard should be taken of the intention and the reasonable expectations of the parties so engaging. Accordingly, the signatory on a negotiable instrument should be entitled to choose the proper law. In order not to jeopardize the reasonable expectations of third parties whose contact with the negotiable instrument is reasonably foreseeable, the selection of the proper law should be express and it should be incorporated in the body of the instrument.

Where no express or implied choice could be inferred, the the lex loci contractus should, in the absence of compelling considerations, be interpreted as the proper

law of the engagements on negotiable instruments. Due to the fact that it coincides with the law of the actual place of performance of the individual obligation, it is presumed to satisfy the reasonable expectations, as well as the intention, of the signatory.

The considerations which militate against the general application of the the lex loci contractus as the proper law of all aspects relating to the engagements on negotiable instruments, as far as this work is concerned, are the promotion of the institution of negotiable instruments, the reasonable expectations of other competing parties, the interests of commerce in general and economic efficiency.[37] In instances where the lex loci contractus is incompatible with the considerations in question, it should give way in favour of a more compatible law.

An example where the lex loci contractus is incompatible with the considerations underlying the institution of negotiable instruments is the determination of the requirements of enforcing the liability arising from the engagement on the negotiable instrument. The application of the lex loci contractus to the issue in question damages the reasonable expectation of the bona fide third party acquirer and it results in an economic detriment to him. Ultimately, it could deter him from acquiring negotiable instruments whereby the objective of promoting the function of the institution of such documents would fail.[38]

The law which could satisfy more efficiently the

considerations underlying the institution of negotiable instruments is submitted to be the lex loci solutionis. Its application results in a predictable, certain, uniform, simple and speedily enforceable rule. Moreover, its application satisfies the reasonable expectations of the competing parties, namely, the signatory on the negotiable instrument and its acquirer.[39] Finally, the application of the lex loci solutionis avoids the hardship which could result to the third party acquirer by the application of the lex loci contractus. It does not allocate to him the duty to invest cost and time in a detrimental manner. From the foregoing, it could be concluded that the lex loci solutionis should be applied as the proper law in determining the requirements of enforcing the liability arising from the engagement on the negotiable instrument.

The Attitude of the Anglo-American and the Continental Geneva Legal Systems in Determining the Proper Law of the Engagements on Negotiable Instruments

I. The Anglo-American and the Continental Geneva legal systems are in agreement that the parties to a particular transaction are free to choose the proper law to govern their relationship.[40] It is submitted that there is nothing in the law of either legal system which militates against the establishment of such a right in the context of negotiable instruments.

The legal systems under consideration are also in agreement that the lex loci contractus is the proper law

of the engagements on negotiable instruments. They determine the establishment of liability by reference to the rules of the said law. Section 72 B.E.A. illustrates the English legal system's incorporation of the general rule. Subsection (2) of the above mentioned section reads:

> "2) Subject to the provisions of this Act, the "interpretation" of the drawing, indorsement, acceptance or acceptance supra protest of a bill is determined by the law of the place where such a contract is made provided that where an inland bill is indorsed in a foreign country the indorsement shall as regards the payor be interpreted according to the law of the United Kingdom."[41]

As far as the North American legal system is concerned, the general rule relating to the determination of the proper law of the engagements on negotiable instruments is incorporated in the Restatement of the Law Second on the Conflict of Laws. Article 215 of the Restatement reads:

> The obligations of an indorsee of a draft or note and of a drawer of a draft, are determined, except as stated in Subsection (2) and in Sections 216-217, by the local law of the state where he delivered the instrument. That state is presumptively the state where the instrument is dated, if such a state is indicated, and, in the absence of notice to the contrary on the instrument, this presumption is conclusive with respect to a holder in due course."

Finally, the relevant provision in the Continental Geneva legal systems is that found in the Conventions on the Conflict of Laws. As far as the convention regulating the rules on the Conflict of Laws pertaining to

Bills of Exchange and Promissory Notes is concerned, the general rule in determining the proper law of the engagement on the documents in question is incorporated in Article 4. The said article reads in part:

> "... The effects of the obligation of the acceptor of a bill of exchange or maker of a promissory note are determined by the law of the place in which these instruments are payable.
> The effects of the signatures of the other parties liable on a bill of exchange or promissory note are determined by the law of the country in which is situated the place where the signatures were affixed.[42]

II. Although the legal systems under consideration are in agreement that the proper law of the engagement on the negotiable instrument is the lex loci contractus, they are in disagreement as to the determination of the place of contracting. The Anglo-American legal systems appear to presume that the place of the delivery of the negotiable instrument is the place of contracting. This is expressly mentioned in Article 215 of the Restatement of the Law Second on the Conflict of Laws. Nevertheless, it rebuts such a presumption in favour of the holder in due course. It establishes a conclusive presumption that the place of dating the instrument is the place of contracting.[43] As far as the English legal system is concerned, the presumption that the place of contracting is the place of the delivery of the instrument could be inferred from subsection 2) of Section 72 B.E.A. It provides that the place of contracting is the place where the engagement on the negotiable instrument is made.[44]

In the English legal system, the engagement on the negotiable instrument such as that of the maker, drawer, indorsor, and acceptor is made when the instrument in which it is incorporated is delivered to the intended beneficiary, such as the payee, the indorsee, or the drawer.[45] If the signature on the negotiable instrument is not followed by the delivery of the document in which it is incorporated, it would not function as a contract. Secondly, it would not establish liability against the signatory.

In the Continental Geneva legal systems, the place of contracting is conclusively presumed to be that of the place where the signature on the negotiable instrument is affixed. This is expressly mentioned in Article 4 of the Convention on the Conflict of Laws relating to Bills of Exchange and Promissory Notes.[46] In the legal systems under consideration, the actual delivery of the negotiable instrument by the signatory is not relevant to establish liability on such a document against the party in question. The mere placing of a signature suffices to establish liability against the signatory. Thus if a negotiable instrument was stolen from its original true owner and was delivered by its thief in favour of a bona fide third party, the latter may be entitled to enforce the face value of the acquired instrument against the original true owner who fixed his signature before its theft. The latter may not be heard to challenge the

acquirer's right of action by setting up the defence of the lack of delivery.[47]

III. Finally, the Anglo-American and the Continental Geneva legal systems are also in disagreement as to the scope of the lex loci contractus. The English and the Continental Geneva legal systems break away from the general rule in favour of applying the lex loci solutionis in determining the requirements of enforcing the liability arising from the engagement on the negotiable instruments. As far as the English legal system is concerned, the exception to the general rule is incorporated in Subsection 3) of Section 72 B.E.A. It expressly provides that the lex loci solutionis determines the requirements for enforcing the liability of the signatories on the negotiable instrument. The said subsection reads:

> "3) The duties of the holder with respect to presentment for acceptance or payment and the necessity for or sufficiency of a protest or notice of dishonour, or otherwise are determined by the law of the place where the act is done or the bill is dishonoured."[48]

As far as the Continental Geneva legal systems are concerned, the exception to the general application of the lex loci contractus could be inferred from the provisions of the conventions on the conflict of laws. For an example, Article 8 of the Convention on the Conflict of Laws Relating to Bills of Exchange and Promissory Notes reads:

> "The form of and the limits of time for protest as well as the form of the other measures necessary for the exercise or preservation of rights concerning bills of exchange or promissory notes are regulated by the laws of the country in which the protest must be drawn up or the measures in question taken."[49]

The predecessor of the Restatement of the Law Second on the Conflict of Laws was in line with the attitude of the English as well as the Continental Geneva legal systems. The Restatement of the American Law Institute relating to the Conflict of Laws did not extend the application of the lex loci contractus to the issue of determining the requirements of enforcing the liability arising from the engagement on negotiable instruments. It was of the opinion that such a matter should be regulated by the lex loci solutionis. The relevant provision in the A.L.I. Restatement is in Article 369. The said article reads in this context:

> "The law of the place of payment of a negotiable bill of exchange or promissory note determines the necessity and sufficiency of presentment for payment, of demand, of protest and notice of dishonour."

However, the Restatement of the Law Second on the Conflict of Laws did not retain the rule enforced in its predecessor. It is in favour of extending the scope of the lex loci contractus. It is of the view that the rules of the said law should determine the requirements for enforcing liability arising from the engagement on negotiable instruments.

The rule of enlarging the scope of the lex loci contractus to determine the requirements of enforcing liability is incorporated in the Official Comment to Article 215. In the course of determining the scope of the above mentioned article, the Official Comment illustrates the instance where the determination of the requirements of enforcing liability arises in the context of the Conflict of Laws. There it expressly provides that the lex loci contractus is the proper law. In this context illustration C(3) reads:

> "In state X, D, the drawer delivers to P a draft drawn upon A. P presents the draft to A in state Y and A accepts it. Thereafter in state Z, P indorses the bill to I and I indorses it to B. A fails to pay when B presents the draft to him for payment upon its due date. Y local law determines whether the draft is negotiable as to D, in other words, whether D can avail himself as against B of any personal defences he may have had against P. X local law also decides whether in order to hold D liable upon A's default, B must protest the draft and give D notice of dishonour."

The Compatibility of the Attitude of the Anglo-American and the Continental Geneva Legal Systems in Determining the Proper Law of the Engagements on Negotiable Instruments with the Proposed Proper Law

I. The attitude of the legal systems under consideration in determining the proper law of the engagements on negotiable instruments to some extent is inefficient. This is due to the fact that none of the said legal systems determines the proper law of such engagements in a manner compatible with the proposed proper law. The

inefficiency underlying the attitude of the English legal system is illustrated in its incorporation of the element of delivery in determining the place of contracting.[50] It deems the place where the delivery of the negotiable instrument occurs as the place of contracting. Accordingly, it deems the law of the place where the delivery occurs as the lex loci contractus.

The inefficiency resulting from the foregoing attitude is twofold. Firstly, its application could be detrimental to the institution of negotiable instruments. It could restrict the free circulation of bills of exchange, promissory notes and cheques. Ultimately, it could prevent them from fulfilling their intended function as a finance instrument.

The incorporation of the element of delivery in the determination of the proper law is presumed to cause a detriment to the institution of negotiable instruments because it allocates to the third person who may come in contact with such a document, the duty to shop for information as to the actual place of delivery. Such a duty becomes onerous when the act of delivery does not coincide with the act of signing. An example of such an instance is illustrated in the hypothetical relating to the purchase of shares from British Telecom by a French stockbroker.[51] For the purpose of the issue under examination, assume that the French stockbroker signs the cheque in France before boarding the ferry to England. After his arrival in Dover, the French stockbroker purchases an envelope and a first class stamp and delivers

the cheque to the main office of British Telecom. Assume further that the financial secretary, together with the authorised managers of the payee, indorse the cheque in the name of the company to an American company in consideration for the services and equipment supplied by the latter to British Telecom. Assume finally that the latter remits the cheque by mail to the main office of the American company in the United States.

In instances such as the above, the fixing of the maker's signature on the cheque occurred in France, whilst its delivery to British Telecom occurred in England. The four corners of the cheque do not indicate that the delivery of the cheque occurred in England. The third party acquirer such as the American company would never know, from the mere inspection of the cheque that the contract of making the cheque occurred in England.

If the American company was burdened with the duty of determining the actual place of delivery, it would have to shop for information to that effect. Information shopping involves the investment of cost and time.[52] Although the investment of cost is not so detrimental to the American company as far as the above example is concerned, the investment of time might well be detrimental. It causes the American company to forego the opportunity to utilise the credit incorporated in the cheque in a commercially favourable manner. It could cause the said company to suspend or disturb the commercial engagements, the finance of which is dependent on the credit incorporated in the cheque. Furthermore,

the time involved in the information shopping might well overlap with the time limit of enforcing the liability arising from the engagement on the negotiable instrument. Accordingly, it could cause the third party acquirer to forego the opportunity to satisfy its entitlements from a valuable security, such as British Telecom.[53]

It is submitted that the foregoing difficulties are detrimental to the institution of negotiable instruments. They could deter the commercial community from engaging in the business of acquiring negotiable instruments. Once the acquisition of negotiable instruments is discouraged, their free transferability would be restricted and ultimately the objective of promoting the institution of such documents would fail.

Another difficulty resulting from the incorporation of the element of delivery in the determination of the proper law of the engagement on the negotiable instrument, is that it could jeopardize the third person into whose possession the negotiable instrument may come. Either it would allocate to him the duty to shop for information so as to satisfy his conviction as to whether or not the signatory in question has in fact delivered the negotiable instrument, or it would allocate to him the risk arising from the misuse of such a document.

The incorporation of the element of delivery would result in allocating the risk arising from the misuse of the negotiable instrument to the third party acquirer because it does not establish liability against the signatory. Its execution by the hands of other than the

signatory would not attribute to the latter the formation of a contract. Such an act would not bind the party in question on the signature which it is intended to supplement. Accordingly, it would not establish liability against him in favour of the person into whose hands the instrument may come..[54]

The detriment resulting from the incorporation of the element of delivery becomes more apparent in instances where the third person into whose hands the instrument may come satisfies, by virtue of the law of the place of acquisition, the status of the protected holder. An example of such an instance is where the acquisition takes place in a legal system belonging to the Geneva legal family, such as France and Germany. In such an instance, the incorporation of the element of delivery in determining the proper law of the engagement on the negotiable instrument would damage the reasonable expectations of the acquirer. Due to the availability of the defence of lack of delivery against him, he would not enjoy the advantage of an unimpeachable title. Accordingly, his satisfaction of the protected holder status would be divested of any practical value.

The allocation to the third party acquirer of the duty to shop for information and the allocation to him of the risk resulting from the misuse of negotiable instruments are inefficient. Either they cause him to invest cost and time in an economically detrimental manner or they result in allocating the evolving loss in favour of the guilty party. The signatory from whom the

instrument was stolen or lost is presumed to be the guilty party for causing the loss resulting from the misuse of his instrument, because he is presumed to be in the position to provide against it. This could be approached by the exercise of care in the safe custody of such a document. By the exercise of the said care, he would prevent his instrument coming into the hands of a dishonest person, and ultimately he would prevent the said document from coming into a legal system where third parties could qualify for the protection arising from the application of the negotiability concept.[55] The allocation to the signatory of a negotiable instrument of the duty to anticipate the coming of his document to a legal system where third parties could qualify for the protection inherent in the negotiability concept is not unreasonable. Due to the special nature of such documents as a substitute for money, they are freely transferable in the stream of commerce. Accordingly, their coming into a foreign legal system is reasonably foreseeable.

If the signatory of a negotiable instrument was discharged from the liability resulting from the misuse of his instrument, he would be encouraged to behave carelessly. In such an instance, the rate of loss occurrence would increase. Once the rate of loss occurrence increased, wealth would be misallocated. The cost and time that would be invested to generate the optimum value would have to be invested so as to repair the resulting loss.

II. The inefficiency underlying the attitude of the North American legal system is twofold. Firstly, the presumption which it creates in favour of the holder in due course in determining the place of contracting, is not sufficiently compatible with the status of the said party. The dating of the negotiable instrument does not indicate the place of its incorporation. Accordingly, it does not reasonably indicate the law of the place of dating i.e. the presumptive law of contracting. In such an instance, the third party acquirer i.e. the holder in due course, would have to shop for information in order to determine the place of dating and he would have to shop for information to determine the proper law of the engagement on the acquired negotiable instrument. Due to the involvement of cost and time in the information shopping, the compliance with such a duty could result in a detriment to the third party acquirer. It could cause him to invest value without being able to obtain a valuable consideration for it or absorb it and it could cause him to forego the opportunity to utilise the credit incorporated in the acquired instrument in a commercially favourable manner. In other words, the allocation to the third party acquirer of the duty to shop for information as to the place of dating of the instrument, could result in a misallocation of wealth to him. Such a result could deter the commercial community from engaging in the business of acquiring negotiable instruments whereby the objective of promoting the function of the institution of such documents would fail.

Secondly, the application of the lex loci contractus in determining the requirements of the enforcement of the liability arising from the engagement on the negotiable instrument results in an undue hardship to the third party acquirer. On the one hand it allocates to him the duty to determine the rules of the proper law i.e. the lex loci contractus and on the other hand it allocates to him the duty to observe the requirements incorporated in the said law. The hardship resulting from the compliance with the foregoing duties involves cost, time and complications.[56] Such elements are inconvenient in commerce. In instances where they could be avoided, their involvement would result in a misallocation of wealth. They cause the commercial community to forego the opportunity to utilise them, in particular, cost and time, in channels where the optimum value could be obtained.

Cost, time and complicated procedures could be avoided in the course of enforcing the liability arising from the engagement on the negotiable instrument, when the third party acquirer is subjected to a single set of rules, such as that arising from the application of the lex loci solutionis.[57] In such an instance, the duty of information shopping and the observance of the requirements of enforcing liability would be confined to a single set of rules. Once the duty of determining the applicable rules and their observance is confined to a single set of rules, cost would be cut, time would be saved and a predictable, certain, uniform, simple

and expedient enforceable rule would be achieved.[58]

III. Finally, the inefficiency underlying the attitude of the Continental Geneva legal systems in determining the place of contracting is illustrated by its creation of the presumption that the place where the signature is affixed is the place of contracting. It appears that such a presumption is firstly, conclusive, and secondly, it is established in favour of every person into whose hands the instrument in which such a signature is incorporated, may come. Accordingly, it appears that the person to whom the signatory of negotiable instruments transfers the property right to the document, may invoke in his favour the above mentioned presumption. That is to say that the latter party may establish the liability of the signatory in reliance on the law of the place where the signature was affixed. The signatory may not rebut such a presumption by establishing that his engagement on the negotiable instrument has a substantial close-connectedness with another law and the person to whose favour he transferred the property right of such a document was aware, or ought to have been aware, of his intention to subject his engagement to the rule of that law.

The reason which could lead parties to negotiable instruments to raise the issue of the proper law is, that the rules of the said law determine the reciprocal rights and liabilities on the negotiable instrument. On the one hand, the determination of the proper law results in

establishing or discharging liability on the instrument. On the other hand, determination of the proper law results in establishing or denying to the person into whose hands the negotiable instrument may come, the advantages inherent in the negotiability concept. The advantages inherent in the negotiability concept are:

1) the third party acquirer may enforce the face value of the acquired instrument in his own name,

2) the said party may establish an uninterrupted good title to the acquired instrument, and

3) he would not have to establish his claim to the document in question.[59]

The law establishes in his favour a prima facie case. The signatory against whom the instrument is intended to be enforced would have to establish the contrary in instances where he is interested in discharging himself from liability.

To state the obvious, the introduction of the negotiability concept and the introduction of the above mentioned advantages are intended to promote the free transferability of negotiable instruments and ultimately promote the function of such documents as an efficient finance device. The free transferability of negotiable instruments would be promoted when remote persons are encouraged to take up such documents. Accordingly, the advantages inherent in the negotiability concept becomes of significance when the negotiable instrument comes into the hands of a remote party.

As between immediate parties, such as the drawer and the payee or the indorsor and the immediate indorsee, the advantages inherent in the negotiability concept should not be extended to them. Due to their immediateness to each other, they are presumed to be aware of the actual intention of each other and they are presumed to be aware of the credibility of the rights and liabilities of each other. Accordingly, every party should be entitled to invoke his personal defences and claims against his immediate party.

From the foregoing, it could be concluded that the presumption that the place where the signature is affixed is the place of contracting, should be established in favour of remote parties only. As between immediate parties, the signatory against whom the instrument is intended to be enforced should be entitled to rebut the said presumption. He should be entitled to establish that the place of signature has no significant close-connectedness with the engagement on the negotiable instrument. He should be entitled to establish that the place of signature is accidental and the actual place of contracting occurred in another jurisdiction. Ultimately, the signatory of a negotiable instrument should be entitled to establish that the intended proper law of his engagement belongs to a different legal system. In such an instance, he should be entitled to demand the enforcement of the rules of the latter law in determining the effect of his engagement on the negotiable instrument.

The Proper Law in Determining the Property Right to Negotiable Instruments

I. The determination of the property right to a negotiable instrument is of significance. It resolves many questions relating to the problem of risk allocation in the context of negotiable instruments. It determines the person in whose favour the entitlement incorporated in the negotiable instrument should be established. It determines the person to whose favour the liability arising from the engagement on such a document is conferred and it determines the person to whose favour the face value of the document in question should be enforced.

In instances where the property right to a negotiable instrument is in conflict, the determination of the person to whose favour the entitlement in question should be established necessarily determines the fate of the competing person against whom the rule operates. It discharges or releases the signatories on the negotiable instrument from liability to him. It denies him the right of enforcing the payment of the negotiable instrument in his favour. In instances of erroneous payment, it holds him accountable to the payor or to the person to whom the property right to the negotiable instrument is established for the receipted proceeds. From the foregoing, it could be concluded that the establishment of the property right to a negotiable instrument in favour of one competing party would result in allocating the evolving loss to the other competing

party. The latter party would be denied the protected holder status and ultimately he would be denied the advantages inherent in the negotiability concept.

It has been established earlier that in instances where the property to a negotiable instrument is in conflict, it should be established in a manner compatible with the considerations underlying the risk allocation rule in the context of negotiable instruments. It should be established in a manner that would approach more efficiently the promotion of the institution of negotiable instruments, the reasonable expectations of potential competing parties, the interest of commerce, the provision against the occurrence of loss, the notion of economic efficiency and the notion of equity and justice.[60] Thus, where the determination of the proper law is called into question, it should take into account the satisfaction of the above mentioned considerations. Where the scope of the proper law is to determine the property right to the negotiable instrument, it should result in establishing the property right to such a document in a manner that would further the considerations underlying the risk allocation rule in the context of negotiable instruments.

II. It is submitted that the lex loci contractus should not be proposed as the proper law in determining the property right to negotiable instruments. Its application is detrimental to the institution of negotiable instruments/ It allocates to the person to whom the negotiable instrument is offered, the duty to

shop for information concerning the laws of the lex loci contractus. In instances where the rules of the said law require the genuineness of the chain of signatures for the transferability of the negotiable instrument. the person to whom such an instrument is offered, would be under a duty to shop for information concerning the genuineness of the incorporated signature, the intention of the signatory in question, the status of the offered instrument, as well as the validity of the title of its possessor.

The allocation of the duty of information shopping involves cost and time. The involvement of cost is illustrated in the assumption of expenses in the course of gathering the facts relating to the status of the acquired instrument and the status of its possessor. The involvement of time is illustrated in the period of time that would have to be invested to collect the relevant information. The investment of cost and time does not normally generate a practical enforceable value in favour of the person to whom the negotiable instrument is offered. Moreover, the said person is not, in many instances, in the position to absorb the evolving cost and time. In fact, they result in a misallocation of wealth to him. They cause him to suspend or disturb his commercial engagements, the finance of which is dependent on the value intended to be offered in consideration for the negotiable instrument or it causes him to suspend or disturb his commercial arrangements, the finance of which is dependent on the value incorporated in the offered instrument. Ultimately, the investment of cost and time

arising from the information shopping causes the person to whom the negotiable instrument is offered to forego the opportunity to invest cost and time in channels which would satisfy his commercial interests in a favourable manner.

Due to the above mentioned inconveniences, the commercial community in the legal system where the negotiable instrument is offered, might be discouraged from engaging in the business of acquiring negotiable instruments. Such a result, firstly, restricts the free transferability of negotiable instruments and, secondly, it could operate against the genuine acquirer of a genuine instrument. It disturbs his reasonable expectations in the sense that it could prevent him from liquidating his instrument into money. Once negotiable instruments were prevented from being liquidated into money, they would fail to fulfil their function as a finance device. Ultimately, the objective of promoting the institution of such documents would fail.

III. The lex loci solutionis should not also be proposed as the proper law in determining the property right to negotiable instruments. In many instances, its involvement might not have a sufficient relationship with the act of transfer. The act of transfer might occur in a jurisdiction different from that where the place of payment is intended to be made. If the law of the latter was to determine the property right to the negotiable instrument, the person to whom the instrument in question

is offered would have to shop for information concerning the rules of the lex loci solutionis. Like that resulting from the lex loci contractus, the application of the lex loci solutionis could be detrimental to the institution of negotiable instruments. It could discourage the acquisition of such documents and ultimately it could prevent the fulfilment of its function as a finance instrument.

An example of the instances where the place of payment might not be related with the act of transfer is illustrated when an American art dealer arranges with his agent in France to purchase a masterpiece, which is planned to be sold at an auction in Paris. In order to facilitate the acquisition of the required masterpiece, the former purchases a cashier's cheque from Chase Manhattan Bank. He makes the cheque payable to his agent and remits it to him. A dishonest employee of the latter receives the cheque, forges his employer's signature and indorses it to his own favour. The dishonest employee next cashes the cheque with a bank for a banker's draft. Finally, the dishonest employee takes the banker's draft and immediately leaves the country for Brazil. There he indorses the banker's draft to his accomplice. The latter deposits it with his bank and misappropriates its proceeds with the dishonest employee.

In the North American legal system, cashier's cheques are two party instruments. They are similar to promissory notes in that their maker and drawee are one person, namely, the issuing bank, such as Chase Manhattan,

as far as the above example is concerned. Due to their special nature as two party instruments, their place of issuance and their place of payment is the drawee's own place of business, such as the United States. In the example under consideration, however, the act of transfer occurred outside the United States. The cashier's check was remitted to France and there it was indorsed and cashed for the banker's draft.

In instances such as the above, if the property right to the negotiable instrument, such as the cashier's cheque has to be determined by the rules of the lex loci solutionis, such as the law of the United States, the person to whom the instrument is offered would have to shop for information concerning the rules of the said law. Accordingly, he would have to shop for information concerning the person to whose favour the instrument is initially delivered, the person to whose favour the former intended to deliver the instrument, the genuineness of the indorsement of the transferee and the validity of the title of the possessor. The engagement in such a duty is detrimental to the institution of negotiable instruments. Due to the involvement of time, it prevents the negotiable instrument from fulfilling its function as a finance device. It prevents such a document from being liquidated into money in a timely manner. Such a result could operate against the genuine acquirer, such as when the possessor of the cashier's cheque is the agent of the American art dealer, as far as the above example is concerned. In such an instance, the reasonable

expectations of the genuine acquirer would be disturbed. He would be prevented from managing his business in a commercially favourable manner. Accordingly, he would be discouraged from engaging in the business of acquiring negotiable instruments. Ultimately, the objective of promoting the institution of such documents would fail.

IV. By comparison, the lex situs, i.e. the law of the place of the acquisition of the negotiable instrument is compatible with the considerations underlying the institution of negotiable instruments. Its application meets the reasonable expectations of the parties involved in the negotiation and acquisition of such documents. The compatibility of the rules of the lex situs with the reasonable expectations of the acquirer is obvious. Normally, the acquisition of negotiable instruments occurs in the place where the acquirer is domiciled. There the said party is presumed to be cognisant with the rules of the law of that place. Accordingly, it would be reasonable to subject him to the rules of the said law. In instances where the acquisition occurs in a foreign legal system, such as when the acquirer takes up a negotiable instrument whilst he is on a business trip, the said party is presumed to have consented to submit himself to the rules of the legal system in which the act of acquisition took place. In such an instance it would also be reasonable to subject the acquirer to the law of the legal system in question.

The compatibility of the application of the lex situs

with the reasonable expectations of the signatory on a negotiable instrument arises from the special nature of such a document. Due to its special nature as a substitute for money, it is presumed to be freely transferable in the stream of commerce. By setting it free in the stream of commerce, the signatory ought to foresee its coming into legal systems where a third person could, by acquiring it, qualify as its lawful holder i.e. proprietor. By setting his document free in the stream of commerce the signatory is presumed to have consented to submit himself to the rules of the legal system where the said document may come.

Finally, the presumption that the signatory has consented to submit himself to the rules of a foreign legal system becomes apparent in instances where he voluntarily remits his document to another person resident in the said legal system. An example of such an instance is illustrated in the hypothetical relating to the purchase of a masterpiece from an auction in Paris.[61] In that hypothetical, it was assumed that the American art dealer has voluntarily elected to remit the cashier's cheque to his agent in France. Since the French law does not deem the forgery of an indorsement to interrupt the chain of negotiation, and it does not deem such a signature to invalidate the title of the person into whose hands the instrument may bona fide come,[62] the American art dealer is presumed to have consented to be bound by the rules of the said law. Accordingly, it would be reasonable to subject him to the rules of the French law

and ultimately to allocate to him the risk arising from the forgery of an indorsement.

The Attitude of the Anglo-American and the Continental Geneva Legal Systems in Determining the Law Governing the Property Right to Negotiable Instruments

I. The attitude of the Anglo-American and the Continental Geneva legal systems is consistent with the objective of promoting the negotiability attribute of negotiable instruments, as well as protecting the interest of commerce and allocating risk efficiently. The law in the said legal systems is in agreement that questions relating to the property right to negotiable instruments should be determined by reference to the lex situs of the instrument in question. The said law, accordingly, shall determine the status of the acquirer.

The first English case which was confronted with the question as to the law governing the property right to negotiable instruments is **Alcock v Smith.**[63] This case involved two negotiable instruments drawn and payable in the U.K. Both instruments, namely, a cheque and a bill of exchange, were made payable to A and Co. in Norway. The payee indorsed both instruments to one N. N indorsed the instruments in blank and handed them to S, an agent of A. and J. Alcock and Co. the plaintiffs, an English firm. One G, a creditor of the Alcocks, obtained a judgement against Alcocks. In the course of satisfying the judgement, and long after the instruments were overdue,

the cheque and the bill were arrested and sold in an auction to L. Meyer. The latter sold the two instruments to K bank in Sweden. The Swedish bank indorsed the cheque and the bill to the National Bank of Scotland in the United Kingdom for collection. The collecting bank presented the two instruments to Smith, the drawee, for payment. The Alcocks obtained an injunction restraining the payment of the two instruments.[64]

The plaintiffs argued that the judgement obtained in Norway in favour of G was defective, on account of the court's refusal to conduct a re-hearing of the trial as requested by Alcock's advocate, S. They argued that, because of the said defect, the judgement was not enforceable in England. Since the judgement was defective, the sale by auction did not remedy the defect. And since the sale was conducted long after the instruments were due, the purchaser took the instruments subject to the defect vitiating them, as Section 36 of the B.E.A.[65] explicitly declares. Finally, since Meyer's title to the instruments was defective, and because of their overdue nature, no third party could obtain a perfect title to the instruments. Hence, K's, the Swedish bank's, title to the instruments was defective, and they failed to satisfy the protected holder-in-due course status.[66]

In reply, the Swedish bank, K, established that the court proceedings in Norway were proper and enforceable in English courts. Secondly, and more significantly, K bank established that, according to the law of Sweden,

notwithstanding the fact that the two instruments were overdue, the sale by auction under the court's order conferred a perfect title to the instruments in favour of the purchaser. And since K had no knowledge of the circumstances surrounding the sale, they are deemed to have acted bona fide. According to the law of Norway, as well as that of Sweden, they obtain a good title to the instruments free from equity.[67]

Romer J., before whom the case was heard, had to decide the main dispute, namely, the property right to the two instruments and the status of the Swedish bank. The Judge refuted the plaintiff's contention that Section 36 B.E.A. governs the point in question. Romer J., held that Section 36 B.E.A. is declaratory of the English law. Its application does not extend to govern transfers which took place in a foreign jurisdiction. He based his decision on general principles of the law. Questions relating to the validity of transfer and its effect are to be determined by the law where the act of transfer takes place. In instances of choses in action, such as negotiable instruments, due to their special nature as chattels, the place of the transfer is the situs of the instrument, thus the lex situs determines the property right to the instrument in question and determines the status of the possessor.[68] The Judge, in light of the foregoing, gave judgement against the plaintiff. The Court of Appeal affirmed.[69]

Embiricos v Anglo Austrian Bank[70] is the next relevant case. It involved a cheque drawn by a Rumanian

bank in Rumania on an English bank. The cheque was payable to L and M Embiricos in Rumania. The payees indorsed the cheque to G Embiricos and Co., an English firm. A dishonest clerk of the payees intercepted the cheque, forged the indorsee's name, i.e. G. Embiricos and Co., and cashed the cheque with a bank in Vienna. The Viennese bank telexed to the drawer, the Rumanian bank enquiring about the state of the cheque. Upon the drawer's assurance the Viennese bank cashed the cheque and indorsed it to the Anglo-Austrian Bank in the U.K. for collection.[71]

Here again, the main point in dispute is the property of the cheque. The Court of Appeal unanimously upheld the Viennese bank's right of property to the cheque. The majority of the court based their decision on general principles of the law. They held that where chattels are involved, such as negotiable instruments, the property right to them must be determined by reference to the lex situs.[72] Accordingly, the court ruled on the question relating to the property of the forged cheque by reference to the law of Austria. Since, in the law of Austria, good title could be established in favour of bona fide third parties, notwithstanding the forgery, the court gave judgement in favour of the Vienna bank. The holding in Alcock v Smith was followed.[73]

II. In the United States, the relevant case is United States v Guaranty Trust Company.[74] This case involved a cheque drawn by the United States Veterans Bureau on the

Treasurer of the United States. The cheque was made payable to a Jugoslavian resident and delivered there. The post was stolen, the signature of the payee was forged, the cheque passed through several hands and finally came to the branch of the defendant Guaranty Trust Co. in Jugoslavia. The branch indorsed the cheque to its home office in the United States. The Company presented the cheque and obtained payment from the Treasurer. Later the forgery was discovered and the Treasurer sought to claim a refund from the Guaranty Trust.[75]

The Court, in deciding the question relating to the property right to the cheque, gave judgement in favour of the defendant, Guaranty Trust. It held that the property of the cheque must be determined in accordance with the law of Jugoslavia, i.e. the law where the transfer took place and the lex situs of the cheque at the time of the transfer. Since the law of Jugoslavia confers good title to bona fide third parties, notwithstanding the forgery, the cheque is deemed the property of Guaranty Trust.

The Restatement of the Law Second relating to the Conflict of Laws incorporated the decision in United States v Guaranty Trust.[76] Section 216 provides that the lex situs of the instrument at the time of transfer governs the property right to the instrument in question. Accordingly, the said law determines the status of the possessor. Section 216 reads:

> "(1) the local law of the state where a negotiable instrument was at the time of the transfer of an interest in the instrument determines the validity and effect of the transfer as between persons who were not both parties to the transfer.

> (2) The local law of the state where the instrument was at the time of its transfer to a person determines whether that person holds the instrument in due course."

III. The Geneva Conventions on the Settlement of some problems relating to the Conflict of Laws do not address the problem relating to the property right to negotiable instruments. Nevertheless, the national laws of the G.U.L. member states incorporate the general principle found in the Anglo-American legal systems. It is submitted that where the property of moveables, including documents of title and negotiable instruments is in dispute, the applicable proper law is the lex situs of the moveables or documents, as the case may be.[77] Such interpretation is in line with the substantive rules incorporated in the Geneva legal systems, the objective of which is to further the cash-like nature of negotiable instruments and ultimately promote their negotiability attribute.

The Law Determining the Property Right to Negotiable Instruments and the Law Regulating the Engagements on Such Documents - A Case for Conflict

I. In the immediately previous section, it has been established that the lex situs of the negotiable instrument should be the proper law in determining the property right to such a document and ultimately, it should be the proper law in determining the status of its acquirer.[78] By comparison, it has been suggested earlier

that as a general rule the lex loci contractus should be the proper law regulating the engagements on negotiable instruments.[79] However, the application of the above laws might conflict. There are instances whereby the rules of the lex situs could establish the property right to the negotiable instrument, in favour of its acquirer, whilst the rules of the lex loci contractus would not enforce the liability against the signatory in favour of the acquirer. It could entitle the former to set up against the acquirer, defences and claims the impact of which is to defeat the latter's right of action against the signatory. In such an instance, the lex loci contractus would divest the satisfaction of the holder status of its practical value. It denies him the advantage of an unimpeachable title and ultimately it denies him the right of enforcing the credit incorporated in the acquired instrument exclusively in his favour.

Such an instance would occur when the engagement on the negotiable instrument is formed in a legal system belonging to the Anglo-American legal family, whilst its acquisition takes place in a legal system belonging to the Geneva legal family. In the legal system where the engagement on the negotiable instrument is presumed to be formed, the law requires the genuineness of the chain of signatures for the purpose of effecting an operative transfer of the property right to the negotiable instrument. If a forged indorsement intervenes, it would interrupt the chain of negotiation. That is to say that it would not be able to transfer the property right to the

negotiable instrument in favour of a third person. The property right to such a document remains with the person from whom it was stolen or lost. The third person into whose hands the instrument may come would not quality as its holder. Accordingly, he would not be able to enforce the credit incorporated in it, in his favour. The signatory against whom the instrument is intended to be enforced may defeat the acquirer's right of action by setting up the forgery of an indorsement as a real defence.[80]

In the legal system where the negotiable instrument is presumed to be acquired, the law does not deem the forged signature to interrupt the chain of negotiation. The property right of such a document remains transferable even if it was vitiated by a forged indorsement. That is to say that the forged indorsement, in the legal system under consideration, is capable of divesting the original true owner of the property right to his instrument and it is capable of establishing it in favour of a bona fide third person. It establishes in favour of the latter the lawful holder status whereby it confers upon him all the advantages inherent in the negotiability concept. It enables him to enforce the credit incorporated in the acquired instrument, in his own name and, more significantly, it enables him to obtain an unimpeachable title to it. It enables him to enforce the incorporated credit against any or all signatories whereas it denies to the latter the right of challenging his right of action by

setting up the defence of the forgery of the indorsement.[81]

II. The case of conflict becomes more apparent when the document which the forged indorsement is presumed to vitiate is surreptitiously removed from the legal system in which the engagement on the document is presumed to be formed, to the legal system in which it is presumed to be bona fide acquired. In the legal system where the engagement on the negotiable instrument is presumed to be formed, the law deems the act of delivery by the signatory essential for the purpose of transferring the property right to the negotiable instrument. If the instrument was stolen, the legal system under consideration would not deem the said document to have been issued or negotiated. Accordingly, it would not deem the property right to the stolen instrument to have been intended to be transferred. Thus, if such an instrument comes into the possession of a third person, the said party would not satisfy the holder status. The acquired instrument remains the property of the person from whom it was stolen. Ultimately, its acquirer would not be able to enforce the credit incorporated in the instrument against its signatory. The latter may defeat the acquirer's right of action by setting up the defence of the lack of delivery.[82]

In the legal system where the stolen instrument is presumed to be acquired, the law does not deem the actual delivery essential for the purpose of negotiating a negotiable instrument. The law in the legal system under

consideration conclusively presumes an effective delivery in favour of the person into whose possession the instrument may bona fide come. Such a rule applies, even if the instrument in question was stolen from its original true owner. The bona fide acquirer may establish a good title to it. He may enforce the credit incorporated in it against any or all signatories. The signatory against whom the instrument is intended to be enforced may not defeat the acquirer's right of action by setting up against him the defence of the lack of delivery.[83]

An example of the instance where the surreptitious removal of an instrument could give rise to a case of conflict between the rule of the lex loci contractus and the rules of the lex situs is illustrated when a construction firm operating in England arranges to purchase construction equipment from a supplier situated in the same locality. By way of payment the treasurer of the former issues an inland cheque in favour of the supplier. The treasurer places the cheque together with a covering letter in an envelope, prints on it the address of the supplier, delivers it to the firm's messenger boy, an Argentinian national and instructs him to remit the parcel to the supplier. The messenger opens the envelope, takes the cheque, indorses it in the name of the supplier, makes it payable to himself and reindorses it to his wife. The messenger boy remits the cheque to his wife in Buenos Aires. He misrepresents to her that he works for the supplier. His wife takes the cheque to a bank and indorses it to the latter in exchange for cash.

The case of conflict represented in the above example is illustrated in the fact that the lex loci contractus of the making of the cheque i.e. English law, does not deem the delivery of the cheque to the messenger boy to constitute issuance.[84] The delivery of the cheque to the latter was not for the purpose of transferring the property right of the cheque, rather it was for the purpose of remitting it to the intended payee i.e. the supplier. In such an instance, the messenger boy is not intended to establish an enforceable interest in the cheque. Accordingly, he is not presumed to be in the position to establish such an interest in favour of a third party. In the last analysis, he is not presumed to establish the holder status in favour of the person to whom he negotiated the cheque.

By comparison, the lex situs i.e. the law of Argentina, as far as the above example is concerned, establishes the holder status in favour of the cashing bank. Its law, in the context, is identical to the Geneva Conventions on the Uniform Laws relating to Bills of exchange, Promissory Notes and Cheques. It does not deem the actual delivery essential for the transferability of the property right to the cheque. It establishes a good title to the cheque in favour of a bona fide third party acquirer, even if he derives his possession to it from or through the thief. It entitles him to enforce the credit incorporated in the acquired cheque against its signatories, such as the English construction firm. It denies to the latter the right of challenging the

acquirer's right of action by setting up the defence of the lack of delivery.[85]

III. The problem presented in instances such as the above is related to the determination of the proper law. In such an instance, it should be determined which of the competing laws should prevail. That is to say that it should be determined which of the competing laws should be applied to determine the liability arising from the engagement on the negotiable instrument, which of the competing laws should be applied to determine the person to whom the liability arising from the engagement on such a document should be established and which of the competing laws should be applied to determine the manner of allocating the risk arising from the engagement on the negotiable instrument.

It is submitted that in order for the proposed proper law to be efficient, it should satisfy the considerations underlying the risk allocation rule in the context of negotiable instruments. It should satisfy the objective of promoting the institution of negotiable instruments, the reasonable expectations of potential competing parties, the interests of commerce, the notion of economic efficiency, and it should satisfy the notion of equity and justice.[86]

IV. It is submitted that the above-mentioned considerations would be satisfied more efficiently when the person into whose possession the stolen instrument comes, was made subject to the rules of the law where the

act of acquisition took place. In such an instance, the reasonable expectations of such a party would be satisfied. He would be made subject to the rules of the law with which he is presumed to be most cognisant, or to the rules of the law to which he is presumed to have consented to submit himself.

In instances where the person into whose possession the stolen instrument comes, is made subject to the rules of the place where the acquisition takes place, the said party would be relieved of the duty of information shopping. Accordingly, he would not have to invest cost and time in a manner detrimental to him. Rather, he would be afforded the opportunity to invest the said cost and time in channels where the optimum value could be obtained. Once the person into whose possession the stolen instrument comes was relieved of the duty of information shopping and he was made subject to the rules of the law where the acquisition takes place, he would be encouraged to engage in such an activity in instances where the proper law would establish a good title in his favour. In such an instance, the free transferability of negotiable instruments would be facilitated and ultimately, the objective of promoting the institution of such documents would be achieved.

The application of the rules of the lex situs is not unreasonable, as far as the signatory of a negotiable instrument is concerned. Due to the special nature of the document on which he engages, the signatory ought to foresee the probability that such a document would come

into a legal system enforcing different rules. Ultimately, he ought to foresee the probability that the rules of the said law would apply.

If the signatory wished to safeguard his interests against his instrument coming into a legal system, the application of whose law could result in a detriment to him, he ought to take the necessary precautionary measures to that effect. Due to his status as a person in control of the negotiable instrument, he is presumed to be in the position to provide such precautionary measures. This could be approached either by the exercise of care in the safe custody and negotiation of his instrument or by negativing or restricting its negotiability attribute.[87]

The exercise of care in the safe custody and negotiation of negotiable instruments is not unduly onerous to the signatory. In the first place, such care is directed towards safeguarding a valuable property.[88] In the second place, its provision generates an enforceable value to him. It increases his reliability in the market; it encourages the commercial community to advance credit to him, it promotes his business and, ultimately, it encourages him to spread the cost arising from the provision of care, among the customers as well as the employees of his business.[89]

If the signatory fails to exercise care, or to negative or restrict the negotiability attribute of his instrument, he is presumed to have consented to the risk resulting from his conduct. If his instrument comes into a legal system, the application of the law of which is

detrimental to him, he is presumed to have consented to submit himself to the said law. In such an instance, it would be reasonable to subject him to the rules of the foreign legal system.

If the liability of the signatory was to be determined by the rules of the lex loci contractus, he might be encouraged to behave carelessly. Such a result would occur in instances where the lex loci contractus relaxes the liability of the signatory. An example of the law which would relax the duty to exercise care is that enforced in the English legal system.[90] In such an instance, the proper law would give rise to moral hazard; ultimately, its application would result in a misallocation of wealth.

From the foregoing, it could be concluded that when the lex loci contractus and the lex situs conflict, the latter law should be applied as the proper law. Its rules should determine the liability on the negotiable instrument. They should determine the person to whose favour the liability should be established and they should determine the manner of allocating the risk arising from the engagement on the negotiable instrument.

The Attitude of the Anglo-American and the Continental Geneva Legal Systems in Determining the Proper Law in the Case of Conflict

I. In determining the proper law of the negotiable instrument in the case of conflict, the Anglo-American

legal systems distinguish between situations where the document in question is voluntarily delivered to a foreign legal system and situations where it is surreptitiously removed from one legal system to another. As to the former instance, the legal systems under consideration are in agreement that the lex situs is the proper law in determining the liability arising from the engagement on a negotiable instrument. They deem the rules of the law of the said place i.e. where the act of transfer and acquisition takes place, to determine the status of the acquirer. In instances where it establishes the holder status in his favour, it restricts the application of the lex loci contractus. In particular, it restricts the admissibility of defences and claims arising from the application of the rules in the latter law. That is to say that the legal systems under consideration determine the defences that could be set up against the acquirer in a manner compatible with the rules of the lex situs. In instances where it establishes a property right to the negotiable instrument in favour of the acquirer, it denies to the signatory the right to set up defences and claims that would otherwise be available in the lex loci contractus.[91]

II. In instances where the negotiable instrument is surreptitiously removed from one legal system to another, the Anglo-American legal systems are in disagreement in determining the proper law. The English legal system is of the view that the lex situs determines the status of

the acquirer. It imports the same rule which it applies to the case of voluntary delivery.[92] Nevertheless, it does not appear to import the same consequences which it applies in the case of voluntary delivery. In particular it does not appear to entitle the acquirer to exercise a right of recourse against the signatory from whom the instrument was stolen. The reading of 72(2) B.E.A. suggests that a person is not liable on a negotiable instrument unless he signs it and delivers it.[93] If the said person does not deliver the instrument on which he places his signature, he would not be deemed to have engaged upon it. Accordingly, he would not be bound by it and ultimately the person into whose possession the instrument comes may not enforce its face value against him.

Apparently, the theory underlying the English attitude is identical to that which formulates its substantive rules. They deem the intention of the signatory as the relevant factor in establishing liability on the instrument against him.[94] It deems the intention of the signatory to exist when he delivers the instrument upon which he places his signature. They deem such an intention to be lacking when the said party does not deliver the instrument in question.

III. The North American legal system breaks away from the rule which it applies in the case of voluntary delivery. In instances where the negotiable instrument is surreptitiously removed from one jurisdiction to another,

the legal system under consideration applies the lex loci contractus as the proper law. It does not deem the property right to the undelivered stolen instrument to pass to a third party.[95] It does not establish the holder status in favour of the latter even if his acquisition takes place in a legal system which establishes a good title to him. In the last analysis, the legal system under consideration determines the defences and claims that could be set up against the acquirer by reference to the face value of the said law.

Apparently, the origin of the rule of the North American legal system is derived from the common law rule enforced in New York.[96] The rule in question distinguishes between situations involving foreign instruments and situations involving inland instruments. The foreign instrument is the document which is intended to be circulated outside the jurisdiction in which it was originated. Inland instruments are those instruments which are intended to be circulated domestically. The voluntary delivery of the instrument to a foreign jurisdiction characterises the document in question as a foreign instrument, whilst its delivery within the jurisdiction in which it was originated characterises it as an inland instrument. The status of the acquirer of the former category of instrument is determined by the law of the lex situs, whilst the status of the acquirer of an inland instrument is determined by the lex loci contractus.[97] This would be the rule even if the acquisition occurred in a foreign jurisdiction.

The New York rule is analogised with the rule applied to chattels.[98] The surreptitious removal of a chattel by an unauthorized person does not deprive the original true owner of the chattel in question of the right of claiming the surrender of the chattel. This rule would apply even if the chattel in question had been taken to another jurisdiction, whereby good title could be established in favour of a bona fide acquirer. The latter, notwithstanding the rules applicable in his jurisdiction, is compelled to give up the stolen property. His good faith purchase does not afford him good title, as against the original true owner.[99]

IV. By comparison, the Continental Geneva legal systems do not appear to distinguish between situations of voluntary delivery and situations of non-delivery. In both instances, they deem the lex loci contractus as the proper law of the negotiable instrument. Its rules determine the liability on negotiable instruments and its effect. Accordingly, the rules of the lex loci contractus determine the defences and claims that could be set up against the acquirer of a negotiable instrument.

Nevertheless, the Geneva Conventions on the Conflict of Laws reserve to the Contracting States the right of not applying the rules incorporated in the said Conventions; in instances where the application of what would otherwise be construed as the proper law, is the law of a non-contracting state. Article 10 of the Convention on the Conflict of Laws relating to Bills of Exchange and

Promissory Notes reads in this context:

> "Each of the High Contracting Parties reserves to itself the right not to apply the principles of private international law contained in the present convention so far as concerns:
>
> 1) An obligation undertaken outside the territory of one of the High Contracting Parties."[100]

From the foregoing it could reasonably be inferred that the Contracting States to the Geneva Conventions may refuse to apply the lex loci contractus when it does not belong to a legal system ratifying the Geneva Conventions which regulate the substantive rules relating to negotiable instruments. An example of such an instance is when the lex loci contractus is the law of a legal system belonging to the Anglo-American legal family. In such an instance, the Contracting State may apply the rules of its substantive law. Accordingly, it may determine the effect of an engagement assumed in a foreign legal system in a manner compatible with the rules of its own substantive law.

The Compatibility of the Attitude of the Anglo-American and the Continental Geneva Legal Systems in Determining the Proper Law in the Case of Conflict with the Proposed Solution

I. The compatibility of the attitude of the Anglo-American systems in determining the proper law in the case of conflict with the proposed solution varies according to the situation in which the conflict arises. In instances where the negotiable instrument is voluntarily delivered

by the signatory to another jurisdiction where a different set of rules applies, the legal systems under consideration are presumed to subscribe to a rule compatible with the proposed solution. They deem the lex situs as the proper law. They determine the status of the acquirer and ultimately they determine the admissibility of defences and claims in accordance with the rules of the said law. Such an application is compatible with the reasonable expectations of the competing parties. Moreover, it could further the promotion of the institution of negotiable instruments and it could result in allocating the risk arising from the misuse of such documents in a manner compatible with economic efficiency. That is to say that the application of the lex situs could result in allocating the risk in question to the person who is in the best position to provide against it.[101]

II. In instances where the negotiable instrument was surreptitiously removed from one jurisdiction to another, the North American legal system is presumed to subscribe to the rule least compatible with the proposed solution. It extends the scope of the lex loci contractus to an area which is presumed to fall within the jurisdiction of the lex situs. It determines the defences and claims which could be set up against the acquirer in accordance with the rules of the lex loci contractus.[102] Such an application could impair the status of the said party. By subjecting him to the rules of the lex loci contractus,

he could be divested of any practical value established in his favour by the lex situs. He would be made subject to the rules of the law with which he is not presumed to be cognisant or closely connected. In such an instance, he would be made subject to the rules of the law to which he is not presumed to have consented to submit himself.

If the scope of the lex loci contractus is extended beyond its proper limits, the person into whose hands the instrument may come would be burdened with the duty of information shopping. He would have to investigate the history of the offered instrument. He would have to satisfy himself whether or not the chain of the incorporated signatures is genuine, whether or not the signatories in question have intended the instrument to circulate freely in the stream of commerce and whether or not the possessor of the negotiable instrument is its proprietor.

Since the above information is not readily available from the mere inspection of the four corners of the offered instrument, the duty of information shopping would involve the investment of cost and time. For the allocation of the duty to invest cost and time to be efficient, it must be value maximising. That is to say that it should generate a practical enforceable value to the person to whom it is intended to be allocated or it should not cause an economic detriment to him. Such a detriment would arise when the person to whom the duty of the investment of cost and time is allocated is not in the position to absorb it.[103]

The investment of cost and time arising from information shopping is not value maximising, as far as the person to whom a negotiable instrument is offered is concerned. They do not generate to him a practical enforceable value. Due to his status as an acquirer, the party in question is not normally in the position to absorb the cost and time evolving from information shopping. On the contrary, the investment of cost and time results in him suffering a misallocation of wealth. They cause him to forego the opportunity to utilise the value incorporated in the offered instrument or the value with which he intends to exchange the instrument in question in an economically favourable manner. They cause him to suspend or disturb his commercial arrangements. Ultimately, they cause him to forego the opportunity to manage his business in an efficient manner.[104]

Due to the foregoing, the commercial community could be discouraged from engaging in the business of acquiring negotiable instruments. In such an instance the rate of acquiring negotiable instruments would be restricted. Once the rate of acquiring negotiable instruments is restricted, such documents would fail to function as a substitute for money. Ultimately, the objective of promoting their function as a finance device would fail.

III. The attitude of the English legal system in determining the proper law in the case of conflict is more compatible with the proposed solution. It deems the lex

situs the proper law in determining the status of the acquirer. The rules of the lex situs would determine the status of the acquirer even if the instrument in question was surreptitiously removed from one jurisdiction to another.[105] Thus, if the rules of the lex situs establish the lawful holder status in favour of the acquirer, the legal system under consideration would be willing to recognise such a holding. It would enable the acquirer to demand the payment of the face value of the acquired instrument from the drawee. It would entitle him to retain the proceeds of the payment and it would enable him to enforce the credit incorporated in the instrument against all prior parties.

It is submitted that the application of the lex situs conforms with the reasonable expectations of the acquirer as well as the signatories on the negotiable instrument. It applies the law to which they are presumed to have consented to submit themselves. Moreover, the application of such a law could facilitate the free circulation of negotiable instruments, it could fulfil in an efficient manner the intended function of such documents and it could promote their finance-like nature.[106]

The application of the lex situs could result in allocating the risk arising from the issue of a negotiable instrument in a manner compatible with economic efficiency. It could result in allocating the risk in question to the person who is in the best position to provide against it. Such an application would, firstly,

result in value maximisation and secondly, it would provide against moral hazard.[107]

However, the attitude of the English legal system in determining the proper law in case of conflict does not fall squarely within the proposed solution. It does not establish liability on the negotiable instrument against the signatory from whom the document in question was stolen. In instances where the signatory does not voluntarily deliver the instrument upon which he places his signature, the English legal system does not deem him a party to the said document. Accordingly, the lawful holder of such a document may not enforce the credit incorporated in the acquired instrument against the signatory from whom it was stolen.[108]

The inefficiency resulting from the foregoing application is twofold. In the first place, it allocates to the person to whom a negotiable instrument is offered the duty to shop for information concerning the history of the offered instrument. He would have to satisfy himself whether or not such a document has been issued or negotiated i.e. delivered by the signatory. Since such information is not readily available, by the mere inspection of the four corners of the instrument, the person to whom it is offered would have to invest cost and time.

To state the obvious, the investment of cost and time is detrimental to the person to whom the negotiable instrument is offered, as well as the institution of negotiable instruments. The detriment resulting to the

person to whom the instrument is offered is illustrated in the misallocation of wealth to him. The detriment resulting to the institution of negotiable instruments is that the involvement of time prevents the document in question from being freely transferable. Such a result would prevent the negotiable instrument from fulfilling its intended function as a finance device.[109] Accordingly, the person engaging in the business of acquiring negotiable instruments would not be able to liquidate them into money in a timely manner. Ultimately, he would not be able to manage his commercial interest in an efficient manner. He might have to suspend or disturb his commercial engagements. Such an application could discourage him from engaging in such a business whereby the function of promoting the institution of negotiable instruments would fail.

In the second place, the non-establishment of liability against the signatory who does not deliver the negotiable instrument could result in an inefficient allocation of risk. The risk arising from the misuse of a negotiable instrument might be allocated to the bona fide third party acquirer. Such an instance would occur when the signatory from whom the negotiable instrument was stolen, is the only signatory on it. An example of such an instance is when John Alex fixes his signature on a cheque and leaves it lying on his desk in an unlocked office. In instances such as the foregoing, the English legal system would not establish liability on the cheque against John Alex. Due to the fact that the cheque was

not delivered by him, he is not deemed to be a party to it. Thus, if a dishonest person enters the office, steals the cheque, indorses it in his favour and re-indorses it to a bona fide third person residing in another legal system, the latter would not be able to enforce the credit incorporated in the cheque against John Alex. This would be the rule even if the legal system in which the acquisition took place establishes the holder status in favour of the acquirer. In instances where John Alex learns of the theft and stops the payment of the cheque the resulting loss would be allocated to the bona fide third party acquirer.

In instances such as the above, the bona fide third party acquirer should not bear the risk arising from the theft of an undelivered instrument. He is not in the position to provide against the risk in question in an efficient manner. The care that could provide against the occurrence of loss would be detrimental to such a party. Had it been allocated to him he would have to invest cost and time in a manner that would not generate a practical enforceable value to him. If he was to refrain from dealing with persons, the character of whom he is not familiar with, the objective of promoting the institution of negotiable instruments would suffer a setback. The free transferability of such documents would be restricted and ultimately, they would fail to fulfil their function as a finance device.

Finally, the allocation of the risk arising from the theft of an undelivered instrument to the bona fide third

party acquirer could result in a windfall in favour of the guilty party. He would be relieved of the loss to which his conduct is presumed to have contributed. The signatory from whom the instrument was stolen is presumed to be the guilty party because he is in the best position to provide against the occurrence of loss. This is due to the fact that at the time of the theft the instrument was under his control. By the exercise of an efficient control he would prevent his instrument coming into the hands of a dishonest person and by the exercise of an effective control he would prevent his instrument coming into the hands of bona fide third parties.

If the signatory of a stolen instrument was released from the duty of exercising care, he would be encouraged to behave carelessly. In such an instance the rate of loss occurrence would increase. Once loss occurrence is increased, wealth would be misallocated. Cost would have to be invested to repair the resulting damage in instances where it could be invested in channels where an optimum value could be obtained.

IV. By comparison, the attitude of the Continental Geneva legal systems in determining the proper law of the negotiable instrument in the case of conflict is most compatible with the proposed solution. Although it deems the lex loci contractus as the proper law, it is submitted that it satisfies in an efficient manner the considerations underlying the risk allocation rule, in the context of negotiable instruments. This is due to the

right established in the Conventions on the Conflict of Laws in favour of the Contracting States to replace the rules of the lex loci contractus with their own substantive rules.[110]

Since the substantive law of the Continental Geneva legal systems does not require actual delivery of the negotiable instrument for,

1) establishing liability against the signatory, and
2) transferring the property right to such a document,[111]

it is presumed to protect the interest of the bona fide third party acquirer. It is presumed to establish in favour of the said party a practical enforceable value to the negotiable instrument in instances of non-delivery. It would firstly, establish in his favour a good title to the acquired document, and secondly, it would establish to him the right to enforce the incorporated credit against any or all signatories. The signatory against whom the instrument is intended to be enforced, would not be entitled to defeat the acquirer's right of action, even if he could prove that the delivery of such a document has not been effected by him.

By establishing the above mentioned entitlements in favour of the third party acquirer, the substantive law of the Continental Geneva legal systems is presumed to approach an efficient risk allocation rule. By allocating the risk arising from the theft of a negotiable instrument to its signatory from whom it was stolen, the legal systems under consideration are presumed to allocate the risk in question to the person who is in the best

position to provide against it. The signatory from whom the instrument was stolen is presumed to be in the position to provide against the risk in question because at the time of its occurrence, he is in control of the instrument. By the exercise of care in its safe custody or negotiation, the signatory could prevent his instrument coming into the hands of a dishonest person and, ultimately, he could prevent its coming into the hands of a bona fide third party.[112]

The allocation to the signatory of the duty to exercise such care is neither unduly onerous, nor is it unreasonable. The exercise of care in the safe custody and negotiation of negotiable instruments is, firstly directed to protect a valuable property; secondly, it generates a practical enforceable value to him and, thirdly, it provides against the probability of the misuse of the negotiable instrument and the probability of the occurrence of loss.[113]

The allocation of the risk arising from the theft of a negotiable instrument to the signatory provides against moral hazard. It provides an incentive to such a person to maximise his standard of care. Once the standard of care is maximised, the rate of loss occurrence would be reduced. Accordingly, cost and time that would have been invested to repair the damage resulting from the misuse of negotiable instruments would be invested in channels which could generate the optimum value.

Finally, the allocation of the risk arising from the theft of a negotiable instrument, to the signatory, would

result in promoting the institution of such documents. It relieves the commercial community to whom negotiable instruments are offered of the duty of information shopping. Such a result could enable the commercial community to liquidate the acquired instrument in a commercially favourable manner. It would enable the members of such a community to utilise the credit incorporated in them in a manner which satisfies their commercial interests. Ultimately, it would encourage them to increase their acquisition. In such an instance, the free transferability of negotiable instruments would be promoted whereas the finance-like nature of such documents would be facilitated.

CHAPTER NINE

BACK NOTES - (1.-113.)

1. The reason underlying the fact that bills of exchange, promissory notes and cheques could be issued in one legal system whilst their indorsement, guaranty, acquisition, acceptance or payment could occur in another legal system, is that such documents are freely transferable in the stream of commerce. They derive their attribute as such from their special nature as a substitute for money. The fact that the dealings in negotiable instruments might not all occur in a single legal system is reinforced by the fact that their free transferability attribute is not affected by the intention of the initial parties to construe it as an inland document. That is to say, that although the initial parties of a negotiable instrument might have intended their document to circulate domestically, it could travel to another jurisdiction if its acquirer so wishes.

An example of the instance whereby a negotiable instrument could circulate outside the jurisdiction of its origin despite the intention of the initial parties to construe it as inland, is illustrated when an English resident, such as John Alex, sells his secondhand car to a local secondhand car firm. By way of payment, the latter issues a cheque on Barclays Bank in favour of John Alex. Alex indorses the cheque to his divorced wife as a discharge of child support indebtedness. The wife takes the children to France for a short holiday. She exchanges the cheque into French francs by indorsing it to a bank. The latter indorses the cheque to its correspondent in London for collection. Through the banking clearing system, the collecting bank presents the cheque to Barclays Bank for payment.

In the above illustration, the cheque, at the time of its issuance, was intended to be construed as inland. This could be inferred from the fact that the transaction which gave rise to it was local and the drawer, the initial payee as well as the drawee were all resident in England. Nevertheless, such an intention did not stop the cheque from travelling to France and from being cashed and indorsed for collection there. The wife managed to utilise the credit incorporated in the cheque by exchanging it for French francs, in a legal system different from that in which it was originally issued.

2. Examples of the instances where the determination of the liability on negotiable instruments and its enforcement could conflict are illustrated in the determination of the requirements of enforcing such a liability and the determination of the property right to negotiable instruments.

For an illustration of the instances where the determination of liability and its enforcement could give rise to a situation of conflict of laws and for a brief account of the manner employed in determining such issues in the Anglo-American and the Continental Geneva legal systems cf. pp.836-843, 863-869 infra.

3. For the definition of moral hazard and the manner of the provision against it cf. pp.162-163 supra.

4. For a detailed account of the significance of the above mentioned considerations in the context of negotiable instruments and for a detailed account of the efficient manner of approaching the said considerations cf. pp.100-175 supra.

5. For the incorporation of the principle of party autonomy in the Commercial and Civil Law -
cf. Printing and Numerical Co. v Sampson (1875) L.R. 19 Eq 465.
Articles 6 and 1134 of the French Code Civil
Article 305 German Civil Code
Cohn, I Manual of German Law, p.111.

The significance of party autonomy in the English Legal System has been eroded to some extent during this century. Nevertheless, it remains a dominating principle in the law of contract. For a classic work on the significance of party autonomy in the English context of Contract Law -
cf. Atiyah, The Rise and Fall of Freedom of Contract, (1988).

For the incorporation of the principle of party autonomy in the rules of private International Law -
cf. Vita Food Products, Inc. v Unus Shipping Co. Ltd. [1939] AC 277.

6. The exceptional instances according to which the forum would not be willing to sanction the parties' choice of law are when the choice is not made bona fide and when the rules of the chosen law violate the public policy of the forum.

7. An example of the tendency to infer, in the absence of an implied or express choice of law, a presumption that the parties to a particular transaction have intended that a specific law should regulate their respective relationship is that illustrated in the E.E.C. Convention of 1980 on the Applicable Law to Contractual Obligations. Article 3 of this convention determines, in the absence of express or implied choice, the law of the country with which the transaction in question has its closest connection, as the governing law. Article 4 of the same convention creates rebuttable presumptions as to the law that is deemed to be closely connected to the transaction. The main section of Article 4 is that which provides that it will be presumed that the contract is most closely

connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or (in the case of a corporation) its central administration or (in the case of a trader) his principal place of business or place of business through which performance is to be effected.

8. cf. Article 4 of the Geneva Convention on the Settlement of Some Problems on the Conflict of Laws relating to Bills of Exchange and Promissory Notes, and Article 6 of the Geneva Convention on the Settlement of Some Problems on the Conflict of Laws relating to cheques. cf. also Section 72(2) B.E.A. and Article 215 of the Restatement of the Law Second on the Conflict of Laws. For the reading of the relevant articles and sections and their implications see pp.847-848 infra.

9. In recent legislative work, a third theory has been recommended to determine the applicable law in instances where more than one legal system is involved. The modern theory determines the law of the place with which the transaction in question has its closest connection, to govern the obligations flowing from the said transaction. The E.E.C. Convention on the Applicable Law to Contractual Obligation 1980 is an illustration of such legislative work (see note 7 above).

The closest connection theory simpliciter, despite its plausibility, creates uncertainty as to the applicable law. It leaves the question of applicable law undetermined, or undeterminable until the court in question decides the matter. The want of certainty concerning the applicable law results in the uncertainty as to the applicable substantive rule. Accordingly, the reasonable expectation of the parties might not be met.

Unless the closest connection theory creates a presumption as to which law is deemed to have its closest connection with the transaction in question, commercial convenience will suffer a great damage. The law in which favour the presumption could be created is either the lex loci contractus, the lex loci solutionis or the lex situs. Deciding which of these laws should be favoured is a matter which must be determined with reference to the relevant considerations underlying the substantive rule in question.

The following discussion in the text is intended to establish this very point. The outcome of the following discussion should be understood to be in line with the closest connection theory.

10. The advocate of the lex loci solutionis theory is Storey, whilst Saviginier is the advocate of the said theory in the Germanic legal family.
See Lorenzen, Conflict of Laws on Bills and Notes, (1918), pp.103 and following.

11. Ibid.

12. Ibid.

13. cf. Adams v Lindsell (1818).

14. cf. Article 930 of the French Code Civil
de Marans v Deschamps, Cour d'appel of Orléans, 26 June 1885 D. 1886 11.

15. cf. T v S Reichsgerict, First Civil Senate, 3 January 1928 97 ERG2 336.
Von Mehren, The Civil Law System (1957).

16. See authority cited in note 129.

17. See authorities cited in note 14.

18. cf. Section 72 B.E.A.,
Article 215 of the Restatement of the Law Second on the Conflict of Laws.
Article 4 of the Geneva Convention on the Settlement of Some Problems on the Conflict of Laws relating to Bills of Exchange and Promissory Notes.
Article 5 of the Geneva Convention on the Settlement of Some Problems on the Conflict of Laws Relating to Cheques.

19. cf. pp.848-850 infra.

20. For the definition of secondary liability and for the determination of the parties who are secondarily liable on negotiable instruments see pp.52-53 supra.

21. cf. Section 55 B.E.A., Articles 3-513 and 3-514 U.C.C. and Articles 44, 45 and 47 G.U.L.(Bills) and Articles 40, 41 and 42 G.U.L.(Cheques).

22. For a detailed account of the facts of the example under consideration, see p.827 supra.

23. For a more detailed account of the argument that the involvement of time is detrimental to the institution of negotiable instruments cf. pp.175, 355-359, 622-624 supra.

24. For a more detailed account of the argument that the allocation to the bona fide third party acquirer of the duty to invest cost could result in an economic detriment to him and, ultimately, it could negatively affect the institution of negotiable instruments cf. pp.607-610 and 617-624 supra.

25. The French rule of establishing in favour of the negligent holder of a negotiable instrument, an effective right of recourse against the drawer of such a document, is but a mere application of the concept of "La provision". By virtue of the said concept, the drawer of a negotiable instrument remains liable on it as long as the fund against which his instrument is drawn is in the

hands of the drawee. Thus, if the holder fails to procure a timely presentment of the acquired instrument and he fails to procure a timely protest and notice of non-payment, he may exercise a right of recourse against the drawer in instances where, at the time of his recourse against the latter, the drawee is solvent. The solvency of the drawee indicates that the fund against which the instrument is drawn is available with the drawee. If the drawer was compelled to reimburse the holder, he would not, in the instance under consideration, sustain a loss.

The rule that drawers of negotiable instruments are liable on them in favour of the negligent acquirer could be inferred from the reading of Article 170 French Code de Commerce. This article 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".

For an overview of the concept of 'la provision' and its application in French law see n.16 Chapter 2.

26. cf. Sections 48 and 51 B.E.A.

27. cf. Section 49(12) B.E.A. It reads,
"12) The notice may be given as soon as the bill is dishonoured and must be given within a reasonable time thereafter.
In the absence of special circumstances, notice is not deemed to have been given within a reasonable time unless
a) where the person giving and the person to receive notice reside in the same place, the notice is given or sent off in time to reach the latter on the day after the dishonour of the bill.
b) where the person giving and the person to receive notice reside in different places, the notice is sent off on the day after the dishonour of the bill if there be a post at a convenient hour on that day, and if there be no such post on that day then by the next post thereafter."

28. cf. Sections 51(4) and 93 B.E.A. The former section reads,
"4) Subject to the provisions of this Act, when a bill is noted or protested [it may be noted on the day of its dishonour and must be noted not later than the next succeeding business day] when the bill has been duly noted, the protest may be subsequently extended as of the date of the noting."
Section 93 reads,
"For the purposes of this Act, where a bill or note is required to be protested within a specified time, or before some further proceeding is taken, it is sufficient that the bill has been noted for protest before the expiration of the specified time or the taking of the proceeding and the formal protest may be extended at any time thereafter as of the date of the noting."

29. cf. Sections 48 and 51(2) B.E.A. The former reads in part,

"Subject to the provisions of this Act, when a bill has been dishonoured by non-acceptance or by non-payment notice of dishonour must be given to the drawer and each indorser and any drawer or indorsor to whom such notice is not given is discharged; ..."

Section 51(2) reads,

2) Where a foreign bill, appearing on the face of it to be such, has been dishonoured by non-acceptance, and where such a bill which has not been previously dishonoured by non-acceptance, is dishonoured by non payment it must be duly protested for non payment. If it be not so protested, the drawer and indorsers are discharged. Where a bill does not appear on the face of it to be a foreign bill, protest thereof in cases of dishonour is unnecessary."

30. cf. Articles 41 and 42 G.U.L. (Cheques).
The rules regulating cheques in West Germany are identical to those incorporated in the Geneva Convention on the Uniform Law on Cheques. Germany in 1933 passed two laws ratifying the Geneva Conventions on the Uniform Law on Bills of Exchange Promissory Notes as well as cheques. Thus, the citation of the relevant provisions of the Geneva Conventions expresses the law in Germany.

31. cf. Articles 41 and 42 G.U.L.(Cheques). The former article reads,

"The protest or equivalent declaration must be made before the expiration of the limit of time for presentment.

If the cheque is presented on the last day of the limit of time, the protest may be drawn up or the equivalent declaration made on the first business day following."

Article 42 reads in part,

"The holder must give notice of non payment to his endorser and to the drawer within the four business days which follow the day on which the protest is drawn up or the equivalent declaration is made or, in case of a stipulation 'retour sans frais' the day of presentment."

32. cf. Article 40 G.U.L.(Cheques).
This article reads,

"The holder may exercise his right of recourse against the endorsers, the drawer and the other parties liable if the cheque on presentment in due time is not paid and if the refusal to pay is evidenced:
1) By a formal instrument (protest),
2) By a declaration written - and dated by the drawee on the cheque and specifying the day of presentment, or,
3) By a dated declaration made by a clearing house stating that the cheque has been delivered in due time and has not been paid."

33. cf. Article 42 G.U.L.(Cheques).
It reads in part,

"A person who does not give notice within the limit of time prescribed above does not forfeit his rights. He is liable for the damage, if any, caused by his negligence, but the amount of his liability shall not exceed the amount of the cheque."

34. For a detailed account of the facts of the example under consideration cf. pp.836-837.

35. For a detailed account of the argument that the allocation to the third party acquirer of the duty to invest cost could result in a detriment to him cf. pp.607-610 supra.

36. For a more detailed account of the argument that the investment of time is economically inefficient cf. pp.622-624 supra.

37. cf. pp.822-823 supra.

38. cf. pp.835-843 supra.

39. cf. pp.843-844 supra.

40. cf. Authorities cited in n.5 above.

41. The term interpretation is given a broad meaning. It is submitted that it extends to include the effects of the obligations of parties to a negotiable instrument
cf. Chalmers on Bills of Exchange 13 Edition p.241.

42. The counterpart of Article 4 of the Convention on the Settlement of Some Problems on the Conflict of Laws relating to Bills of Exchange and Promissory Notes is Article 5 of the Convention on the Settlement of Some Problems on the Conflict of Laws relating to Cheques.
The latter article reads,

"The law of the country in whose territory the obligations arising out of a cheque have been assumed shall determine the effects of such obligations."

43. For the reading of Article 215 of the Restatement of the Law Second on the Conflict of Laws cf. p.847 supra.

44. For the reading of Section 72(2) B.E.A. cf. p.846 supra.

45. cf. Sections 21 and 31 B.E.A.
The decision in Baxendale v Bennett (1878) 3 QB 525.
For a detailed account of the facts of this case and the relevant passage of the judgement of the court see p.432 supra.

46. For the reading of Article 4 and its counterpart in the Convention on the Settlement of Some Problems on the Conflict of Laws relating to Cheques - cf. p.848 and n.42 supra.

47. cf. Article 16 G.U.L.(Bills) and Article 21 G.U.L.(Cheques). The relevant paragraph of the former article reads,

"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."

48. The wording of Section 72(3) is criticized for its ambiguity. Nevertheless, the authoritative interpretation is in line with the text. The law governing the essentiality of giving notice and drawing up protest is the lex loci solutionis. The place of dishonour is always the place in which the instrument in question ought to be presented for payment i.e. the lex loci solutionis. For the proper construction of Section 72(3) see
Dicey and Morris, The Conflict of Laws, (1987), 11th Edit., p.1326 and following.
Wolff, Private International Law, (1977), pp.482,483.
Hirschfeld v Smith (1986) LR 1 C.P. 340.
Rothschild v Currie (1841) 1 QB 43.
Rouquette v Overmann (1875) LR 10 QB 525.
Horne v Rouquette (1878) 3 QB 514 (C.A.)

49. The place in which the certificate of protest must be drawn is the place where the instrument is presented for payment and subsequently dishonoured. Article 8 of the Convention on the Settlement of Some Problems on the Conflict of Laws relating to Cheques is the counterpart of Article 8 of the Convention relating to Bills of Exchange. The wording of both articles is identical.

50. For a brief account of the attitude of the English legal system in determining the place of contracting - cf.p.849 supra.

51. For a detailed account of the facts of the hypothetical under consideration - cf. p.827 supra.

52. For a more detailed account of the fact that the engagement in information shopping involves cost and time cf. pp.342-349 and 607-610 supra.

53. An example of the instance where the involvement of time in information shopping could overlap with the maturity date of the negotiable instrument and ultimately, it could cause the bona fide third party acquirer to forego the opportunity to satisfy the entitlement incorporated in his document from a valuable security - cf. pp.622-624 supra.

54. cf. Sections 20, 21 and 31 B.E.A.

55. For a more detailed account of the argument that the signatory from whom the instrument was stolen is in the position to provide against the misuse of his document - cf. pp.601-605 supra.

56. cf. pp.835-843 supra.

57. cf. pp.843-844 supra.

58. Ibid.

59. cf. p.36 supra.

60. cf. pp.100-138 supra.

61. For a detailed account of the facts of the hypothetical under consideration - cf. pp.867-868 supra.

62. cf. Articles 19-21 G.U.L.(Cheques).
The rules regulating cheques in France are identical as far as the manner of allocating the risk of the forgery of indorsements is concerned, with those incorporated in the Geneva Convention on the Uniform Law relating to Cheques. Thus the cross-reference to the Geneva Convention is in line with the existing law in France.

63. [1892] 1 Ch 238, 61 L.J. Ch 161; 65 L.T. 335.

64. [1892] 61 L.J. Ch. pp.162 and 163.

65. Section 36 B.E.A. para 2) reads:
"Where an overdue bill is negotiated, it can only be negotiated subject to any defect of title affecting it at its maturity and thenceforth no person who takes it can acquire or give a better than that which the person from whom he took it had."

66. Alcock v Smith [1892] 61 L.J. Ch., pp.163 and 164.

67. Ibid. p.164.

68. Ibid. p.165.

69. Alcock v Smith [1892] 1 Ch., p.238.

70. [1905] 1 KB 677; 74 L.J. KB 326, 92 L.T. 305, 53 WR 306, 10 Com Cas 99 affirming [1904] 2 KB 870.

71. [1905] 1 KB 677.

72. Ibid. p.680.

73. Ibid.

74. Supreme Court of the United States 1934, 293 US 340, 55 S.Ct. 221, 79 L.Ed 415, 95 ALR 651.

75. Ibid.

76. Supreme Court of the United States 1934, 293 US 340, 55 S.Ct. 221, 79 L.Ed 415, 95 ALR 751.

77. For an example see Cohn, 11 Manual of German Law, pp.138 and 139.

78. cf. pp.866-871 supra.

79. cf. pp.831-835 supra.

80. For a detailed account of the attitude of the Anglo-American legal systems in determining the impact of forged indorsements on the negotiable instrument as well as the rights and liabilities arising from its negotiation and acquisition see pp.235-237 supra.

81. For a detailed account of the attitude of the Continental Geneva legal systems in determining the impact of forged indorsements on the negotiable instrument as well as the rights and liabilities arising from its issuance and acquisition cf. pp.237-241 supra.

82. cf. Section 21 and 31 B.E.A. and the decision in Baxendale v Bennett (1878) 3 QB 525.

83. cf. Article 16 G.U.L.(Bills) and Articles 19-21 G.U.L.(Cheques).

84. Section 2 of the B.E.A. defines issuance as the first delivery of a bill or note, complete in form, to a person who takes it as a holder. The term holder in the context of negotiable instruments is the counterpart of proprietor. Thus, for a person to qualify as the holder of a document, its possessor should intend to transfer its property right to the former. If it was transferred for the purpose of safe custody or trust only, the transferee does not establish the holder status. Accordingly, he cannot effect a valid transfer of the property right of the document in question in favour of a third person.
cf. Smith v Prosser [1907] 2 KB 735.
Baxendale v Bennett (1878) 3 QB 525.

85. For an overview of the Argentinian Law on Bills of Exchange and its resemblance with the Geneva Conventions on the Uniform Law relating to Bills of Exchange Promissory Notes and Cheques - cf. Daniel E. Murray, Forged Bills of Exchange and Checks: A Comparison of the Anglo-American, European and Latin American Law, (1965), 82 Bank. L.J. 680.

86. cf. pp. 822-823 supra.

87. For a more detailed account of the manner through which the signatory on a negotiable instrument could provide against the misuse of his instrument - cf. pp.596-597, 601-603 supra.

88. The negotiable instrument which bears a valid signature is presumed to be a valuable property. The incorporation of such a signature vests the document in question with currency. The currency attribute of a negotiable instrument establishes an enforceable value in favour of the proprietor. It entitles him to enforce the incorporated promise against a liable party and it entitles him to demand the payment of the monetary obligation in his favour. For a more detailed analysis of the enforceable value of negotiable instruments - cf. pp.603-604 supra.

89. For a more detailed analysis of the value derivable from the exercise of care in the safe custody and negotiation of negotiable instruments cf. pp.604-605 supra.

90. For a detailed account of the attitude of the English legal system in determining the instances whereby the proprietor of a negotiable instrument could be held liable for the loss resulting from the forgery of his signature and/or the theft of his instrument cf. pp.398-415 supra.

91. cf. The decision in Alcock v Smith [1892] 1 Ch 238.
Embiricos v Anglo-Austrian Bank [1905] 1 KB 677.
United States v Guaranty Trust Company,
Supreme Court of the United States 1934, 293 US 340, 55 S.Ct 221, 79 L.Ed 415, 95 ALR 651.
For the facts of the foregoing cases and the decision of the courts cf. pp.871-876 supra.

92. cf. Cammell v Sewell (1860) 5H & N 728.

93. For the reading of Section 72(2) B.E.A. and its interpretation cf. p.847 supra.

94. For the application of the intention theory in determining the establishment of liability against the signatory on a negotiable instrument in the English legal system -
cf. the decision in Smith v Prosser [1907] 2 KB 735.
For the facts of the case under consideration and the relevant passage of the judgement of the court cf. pp.761-762 supra.

95. cf. Edgerly v Busch, 81 NY 199 (1880).

96. cf. Bailey, Conflict of Laws, (1963), 80 Banking L.J. 411.
John Hancock Mut. Life Ins. v Fidelity Baltimore Nat. Bank, (1957), 212 M d 506.
Edgerly v Busch, 81 NY 199 (1880).

97. cf. W. Morris, Some Conflict of Laws Problems Relating to Negotiable Instruments, (1964), 66 West Virginia L. Rev., p.93.

98. cf. Beale, Jurisdiction over Title of Absent Owner in a Chattel, 1927, Harv. L. Rev., 805.
Comment, What law governs the defences to a Negotiable Instrument in the Hands of a Bona Fide Holder for Value, (1951), Yale L. J., p.809.
Weissman v Banque de Bruxelles, 254 NY 488, 173 NE 385, (1930).

99. See in general Beale, Jurisdiction over Title of Absent Owner in a Chattel, (1927), 40 Harv. L. Rev. 805.

100. Article 9 of the Convention on the Settlement of Some Problems on the Conflict of Laws relating to Cheques is the counterpart of Article 10 of the Convention on the Settlement of Some Problems on the Conflict of Laws relating to Bills of Exchange and Promissory Notes. The wording of the former article is identical to that of Article 10 of the Convention on Bills of Exchange and Promissory Notes.

101. cf. pp.866-871 supra.

102. For a brief account of the attitude of the North American legal system in determining the proper law in instances of the surreptitious removal of negotiable instruments cf. pp.887-889 supra.

103. For a detailed analysis as to how the objective of value maximisation could be approached cf. pp.112-138 supra.

104. For a more detailed account of the argument that the allocation to the person to whom a negotiable instrument is offered for a valuable exchange, of the duty to invest cost and time is economically inefficient, cf. pp.332-339 and 606-610 supra.

105. cf. Authority cited in n.92 above.

106. cf. pp.882-883 supra.

107. cf. pp.883-885 supra.

108. cf. Sections 21, 29, 31 and 72(2) B.E.A.

109. cf. pp.351-359 and 614-624 supra.

110. cf. Article 10 of the Convention on the Settlement of Some Problems on the Conflict of Laws Relating to Bills of Exchange and Promissory Notes. For the reading of the above article see p.890 above.

111. For a brief account of the attitude of the Continental Geneva legal systems in determining the significance of actual delivery by the signatory in establishing liability on the negotiable instrument see pp.137-141 supra.

112. For a detailed account of the argument that the signatory from whom a negotiable instrument was stolen, is in the best position to provide against the occurrence of loss, cf. pp.601-605 supra.

113. cf. pp.603-605, 624-626 supra.

CHAPTER TEN

CONCLUSION

I. The legal device of negotiable instruments is of wide ambit. It embraces documents of title as well as money documents.[1] The scope of this thesis has been restricted to examining a limited variety of negotiable instruments. The term has been interpreted narrowly so as to denote what is widely known as commercial paper. The most common forms of such documents are the bill of exchange, promissory note and cheque.[2]

Negotiable instruments, in the sense under examination, are a form of obligation. Their creation is a direct result of a pre-existing transaction. The parties to this transaction agree to discharge their respective monetary obligations by issuing, indorsing, guaranteeing or accepting a negotiable instrument. By virtue of such an act, the party in question promises or undertakes to pay the holder of the issued, indorsed, guaranteed or accepted instrument, the credit incorporated in it.

Due to the risk inherent in the transmission of money as cash, the commercial community became persuaded that in order to promote trade, especially in the international sphere, it would be expedient to replace cash with a more reliable and efficient medium of exchange. Negotiable instruments, in the strict sense, were chosen to serve this need of the commercial community.

In order to facilitate the intended function of negotiable instruments, they had to be vested with some of the characteristics of chattels. To this end, the general mercantile custom rendered the documents in question freely transferable. Their negotiation could be effected by either delivery or by indorsement and delivery. They remained transferable as such, until their proprietors negatived or restricted their negotiation.

More significantly, for the purpose of facilitating their function as a substitute for money, the general mercantile custom intertwines the property right of negotiable instruments and the promises and undertakings incorporated in them. That is to say that the general mercantile custom considered that the transfer of the property right of a negotiable instrument incorporates the transfer of the promise or undertaking contained in it. Thus, if the property right of a negotiable instrument is transferred to a named person, such as Billy Barnes, the said person establishes in his favour the promises and undertaking incorporated in the acquired document. He may demand the enforcement of the incorporated credit from the principal debtor, such as the acceptor. In instances of the latter's failure, the acquirer, such as Billy Barnes, may raise the liability of the secondarily liable parties, such as the drawer and the indorsor.

From the foregoing, it may be seen that the transfer of a negotiable instrument establishes against the transferor, liability on the instrument in favour of the

transferee. In the absence of the latter's laches, the transferor would not be discharged of liability unless and until the ultimate transferee i.e. holder, obtains monetary satisfaction. However, the payment of the incorporated credit to the holder does not discharge the liability of the immediate transferor only. Rather, its effect is to discharge all related promises and undertakings. That is to say that the payment of the incorporated credit in favour of the holder discharges all the obligors on the negotiable instrument. Ultimately, the said payment discharges the negotiable instrument as a whole.[3]

Since the creation of a negotiable instrument and the engagement on it is a direct result of a pre-existing transaction, the discharge of the former and the engagement assumed under it is presumed to possess a retroactive effect. That is to say, that the discharge of the negotiable instrument or the engagements assumed under it discharges the pre-existing transaction giving rise to it, as well as the underlying obligation arising from such a transaction. Thus, in instances where the negotiable instrument is paid in favour of its holder, the relationship arising from the independent transaction will be extinguished. The parties to such a transaction will return to their status ante as if no relationship had ever existed between them.

II. However, the negotiable instrument transaction does not always run smoothly. Its performance is vulnerable

to the risk of being disrupted. A major incident whereby the performance of the negotiable instrument would be disrupted is when the property of such a document is divested from its original true owner and fraudulently transferred to a bona fide third party or fraudulently cashed with the drawee.[4] It is submitted that the above mentioned risk occurs as a direct consequence of the intervention of a person who is not intended to possess an enforceable title in the negotiable instrument. Thus he could either be a total stranger, an employee, an agent or a trustee of the original true owner.[5] The person in question causes the risk under consideration to occur by firstly, intercepting or stealing the negotiable instrument, secondly, by forging the signature of the original true owner and thirdly, by re-indorsing the intercepted or stolen document to a bona fide third party or to the drawee.

The signature, the forgery of which could give rise to the risk of disrupting the performance of the negotiable instrument transaction, is that which is capable of transferring the property right to the negotiable instrument. The signatures which fall within the above mentioned category are - the signature of the maker or drawer of the negotiable instrument and the signature of the payee or indorsee. The engagement arising from the placing of the maker's or drawer's signature is known as the making, drawing or issuance. The engagement arising from the placing of the payee's or

indorsee's signature is technically known as the indorsement.

The disruption arising from the theft, interception or misuse of a negotiable instrument, and the forgery of the signature of the maker, drawer, payee or indorsee is threefold. One the one hand, the fraudulent act of stealing or intercepting the negotiable instrument interferes with the proprietor's property right to the negotiable instrument. It dispossesses the said person of his property. On the other hand, the act of forging the signature of the proprietor or the intended payee or indorsee purports to vest the property right to the stolen or intercepted document in favour of the thief, the dishonest employee, agent or trustee. Accordingly, it enables the fraudulent person to transfer the property right to the document in question in favour of a bona fide third party, or it enables him to cash the said document with the drawee. Finally, by forging the signature of the proprietor or the payee or indorsee and by re-indorsing the stolen or intercepted instrument to a bona fide third party, the fraudulent person purports to establish a contractual relationship between himself and, eventually, between the bona fide third party and the signatory or purported signatory. The fraudulent person purports to establish that he, as well as his transferee, satisfies the holder status. He purports to indicate that the promise or undertaking incorporated or purported to be incorporated in the negotiable instrument runs in his favour, as well as in favour of his intended

transferee. Ultimately, by forging the signature of the proprietor or the payee or indorsee and by re-indorsing the stolen or intercepted instrument in favour of a bona fide third party, the fraudulent person purports to establish liability against the signatory or purported signatory.

Once the performance of the negotiable instrument transaction is disrupted, the reasonable expectations of either of the competing parties would be disturbed. Since the form of disruption arises from the theft of the negotiable instrument and the forgery of a potential signature gives rise to a situation of competing interests in the property right to the negotiable instrument, the party whose reasonable expectations would be disturbed, is the person against whom the property right in conflict is established. Thus, if the property right to the negotiable instrument is established in favour of the original true owner i.e. the person from whom the document in question was stolen and whose signature was forged, the party whose reasonable expectation would be disturbed is the bona fide third party acquirer or the drawee payor. He would either be denied the right of enforcing the credit incorporated in the acquired or presented instrument against the original true owner or any prior signatory, including the initial maker, or he would be held accountable to the original true owner or any prior signatory for the proceeds of the acquired or paid instrument. He would either have to revert, repay or recredit the receipted or erroneously paid proceeds to the

original true owner or the initial maker. The disturbance in the reasonable expectations arising from the instance under consideration is illustrated in divesting the acquired or paid instrument of any practical value. The establishment of the property right in favour of the original true owner necessarily divests the bona fide third party acquirer and the drawee payor of all rights and privileges.

By comparison, if the allocation of the property right rule is established in favour of bona fide third party acquirer or the drawee payor, the party whose reasonable expectations would be disturbed is the original true owner i.e. the person from whom the document was stolen or intercepted and whose signature was forged. He would be denied the rights arising from his ownership of the negotiable instrument. In particular, he would be denied the right of enforcing the credit incorporated in the negotiable instrument against a prior signatory or the drawee. He would be denied the right of demanding a fresh payment or a recredit of the paid proceeds from the original true owner. He would be denied the right of claiming the surrender of the instrument or its proceeds from the bona fide third party acquirer. Furthermore, he might be held liable on the negotiable instrument to the bona fide third party acquirer.[6]

From the foregoing, it could be concluded that the disturbance arising from allocating the property right rule in favour of the bona fide third party acquirer or the drawee payor is illustrated in either dispossessing

the original true owner from his ownership or in establishing liability against him for a promise or undertaking in favour of a third party to whom he had not intended to establish such a promise or undertaking. The direct result of the above mentioned application is to allocate the loss to the original true owner. In instances where he is dispossessed of the ownership of the negotiable instrument he would be denied the right of enforcing its incorporated credit. In instances where he is held liable on the negotiable instrument he would be made subject to double payment, one based on the negotiable instrument in favour of the acquirer, whilst the second is based on the underlying obligation in favour of his creditor to whom he intended to transfer the negotiable instrument in the first place.[7]

III. It is submitted that the determination of the person to whose favour the property right of a negotiable instrument should be established in situations of conflicting entitlements is a matter of legal art. The determination that X - rather than Y - is the holder of the document, the property of which is in conflict, is but a mere consequence of the operation of the risk allocation rule, in the legal system in question. The law in the said legal system determines its risk allocation rule in a manner compatible with its policy. In forming its policy, the legal system takes into account a number of considerations. The considerations which are taken into account in formulating the policy of the legal system are

those which satisfy in an efficient manner, the interest of the legal institution, the interest of the commercial community and the interest of commerce in general. The objective of satisfying the interest of commerce in general involves the observance of the rules of economic efficiency. This is because the rules of economic efficiency optimise the function of the market in the sense that it maximises value.[8]

Once the paramount considerations are determined, the law, in situations of conflicting entitlements, decides the interest, the protection of which satisfies most efficiently the underlying considerations. By determining the superior interest, the law formulates its risk allocation rule. It establishes liability i.e. allocates the risk in question to the competing party whose interest is less compatible with the paramount considerations.

In the context of negotiable instruments, the paramount considerations are six in number. They are:

1) the promotion of the institution of negotiable instruments,

2) the satisfaction of the reasonable expectations of the commercial community involved in such an institution,

3) the fixing of a predictable, certain and uniform rule,

4) the simplification and expedition of the enforcement of the negotiable instrument,

5) the provision against the occurrence of loss, and

6) the allocation of loss to the party best able to provide against it.[9]

The significance of promoting the institution of negotiable instruments arises from the need to devise an instrument which is capable of fulfilling the function of cash money but avoids the hazard involved in the transmission of such an instrument. The invention of such a document would meet the interest of commerce in that it would facilitate the finance of commercial transactions, especially in the international sphere. It is submitted that the institution of negotiable instruments is in the position to fulfil most efficiently the above mentioned function. This is due to the wide scope of the instances where it could be involved as a finance instrument and due to the fact that its application satisfies the reasonable expectations, as well as the economic interest, of the involved parties.[10]

The promotion of the institution of negotiable instruments is approached when some of the characteristics of money are attributed to such documents, in particular when the transferability of the various forms of negotiable instrument is facilitated when such documents are allowed to flow in the stream of commerce independent from the transactions underlying their creation and when the transactions arising from the dealing in them are vested with finality. By attributing to negotiable instruments the foregoing characteristics, such documents would be readily marketable. Ultimately, the commercial community would be encouraged to take up such instruments. This is due to the fact that the duty of care allocable to the commercial community would be set at the standard

where no economic detriment would result. The members of the said community would be discharged from the duty of investigating extraneous elements. Their duty of care would be limited to examining the four corners of the offered or presented instrument. Such an approach satisfies the reasonable expectations of the members of the commercial community. They would be protected in their bona fide reliance on the prima facie regularity of the offered or presented instrument.[11]

The significance of fixing a predictable, certain and uniform rule is that it eliminates or minimises court settlement. Once court settlement is eliminated or minimised, wealth would be maximised. The allocation of liability would be determined with expedience and simplicity. The cost and time that would have been involved in court settlement would be invested in channels where an enforceable value could be obtained.

The fixing of a predictable, certain and uniform rule would eliminate or minimise court settlement because the person whom the rule in question indicated as the liable party would abide by the said rule. He would enforce the liability allocated to him in favour of the person in whose favour the rule operates. In normal circumstances, the person against whom the rule operates would not endeavour to delay or challenge the rule in question. His behaviour as such would result in an added cost to him. He would end up bearing the expenses of court settlement and he might end up paying accumulated interest on the principal obligation.

The securing of a predictable, certain and uniform rule is approached by automatically indicating a single party to whom risk is allocated. By such an approach, the competing parties involved in the situation of conflicting entitlements would not have to resort to court settlement to determine the liable party and ultimately enforce his liability. By reference to the automatic risk allocation rule, they can exercise their right of recourse against the person to whom the rule in question allocates liability and demand from him the enforcement of his liability.[12]

The significance of the provision against the occurrence of loss is to protect the interest of the public at large as well as to protect the interest of commerce. It protects the wealth of the community in that it operates in investing the wealth in appropriate channels. It operates to invest the wealth of the community in channels where an optimum value could be obtained.

The provision against the occurrence of loss is approached by allocating to each of the competing parties the duty to exercise care. By such an approach, each of the said parties would be compelled to optimise his standard of care. This he does so as to discharge himself from liability. In instances where each of the competing parties was made to optimise his standard of care, the rate of loss occurrence would be minimised, especially in situations where the occurrence of loss is the direct result of the intervention of a fraudulent

person. In such an instance, the fraudulent person would find the perpetration of fraud onerous and ultimately, he would find the causing of loss to a bona fide third party onerous. Once the rate of loss occurrence is eliminated or minimised, wealth would be protected. The expenses that would have been involved to repair the resulting damage would be invested to generate an enforceable value.

The significance of allocating the loss to the person who is in the best position to provide against it is that it satisfies the notion of fairness and justice, as well as the notion of economic efficiency. It results in allocating the loss in question to the person who is most at fault. It determines the standard of care by reference to the person's capability to conform with it. Ultimately, it allocates the duty of care, the compliance with which would provide against the loss in question, to the person who would suffer the least hardship.[13] The allocation of loss in the above sense is compatible with market values. It results in allocating the duty of investing cost and time in a manner which would generate a practical enforceable value. It enables the person who would sustain an undue hardship from the exercise of care to invest his wealth in channels which would generate the optimum value.[14]

The determination of the party who is in the best position to provide against the occurrence of loss is a matter dependent upon a number of factors. They are as follows.

(a) The party's capability to avoid the occurrence of risk.

The determination of the party's capability to avoid the occurrence of risk depends on two elements. Firstly, it depends on the party's capability to introduce devices which render the perpetration of fraud ineffective, impossible or onerous. Secondly, it depends on the party's capability to shop for information, the significance of which is to reveal the existence of fraud. The party who is in the position to engage in such activities is presumed to be in the best position to avoid the occurrence of risk.

(b) The party's capability to provide for insurance.

The determination of the party's capability to provide for insurance depends on the appreciation of the frequency of the occurrence of risk, its gravity and the capability to avoid its occurrence. It is submitted that the capability of the party to purchase insurance and his capability to spread the cost of insurance is not a justifiable consideration in determining the party's capability to provide for insurance. Its application could give rise to moral hazard and ultimately, it could result in a misallocation of wealth.[15] However, its application is of value in determining the party's capability to provide for insurance in instances where it is read in conjunction with other considerations, such as the party's capability to avoid the occurrence of risk and his capability to derive a practical enforceable value in purchasing insurance.

(c) The party's capability to derive an enforceable value from the avoidance of risk and the provision for insurance.

The determination of the party's capability to derive a practical enforceable value from the investment of cost and time arising in the course of avoiding the occurrence of loss or that arising in the course of providing for insurance depends on his status in the market and the status of the activity in which he engages.[16] In instances where the investment of cost and time generates a profit in favour of the party in question or his business, or in instances where the said party is in the position to absorb the evolving cost and time, the allocation to him of the duty to take the necessary precautions to avoid the occurrence of loss, and the allocation to him of the duty to provide for insurance, would be economically valid. The investment of cost and time would either result in wealth maximisation to him or it would not result in an undue hardship to him.

(d) The party's capability to foresee the occurrence of risk.

The determination of the party's capability to foresee the occurrence of risk depends on the nature of the legal engagement. If the engagement in question is of the type which could be manipulated with relative ease and utilised to mislead a bona fide third party in his dealings, the person involved in such an engagement is presumed to possess reasonable foresight as to the occurrence of risk. An example of the engagement which could be manipulated

with relative ease is that incorporated in the negotiable instrument. This is because the document in which such an engagement is incorporated is by nature, freely marketable. Its four corners, or the circumstances surrounding its negotiation, do not raise suspicion as to its regularity. Accordingly, the person to whom such a document is offered, or the person to whom it is presented for payment, may be defrauded as to its genuineness. Ultimately, the person in question may be induced to take up a worthless document.

IV. Since this work is concerned with allocating the loss arising from the theft, interception or misuse of a negotiable instrument and the forgery of a potential signature, the determination of the party who is in the best position to provide against the occurrence of the said loss depends on the category of the forged signature and the setting in which the situation of conflicting entitlements arises. The type of involved signature and the setting in which the risk arises determines the nature of the negotiable instrument, the property right to which is in conflict, and the parties who are involved in the situation of conflicting entitlements. Such considerations are submitted to be of significance in determining the standard of the required care and ultimately, they are of significance in determining the party to whom the risk ought to be allocated.

If the loss in question arises from the forgery of a negotiable instrument, the said loss, in instances of

dishonour, should be allocated to the bona fide third party acquirer i.e. the person to whom the fraudulent person negotiates the forged document. As between himself and the purported maker/drawer, i.e. the person whose signature was forged, the bona fide third party acquirer is presumed to be better situated to provide against the occurrence of loss. This is due to the fact that the care, the exercise of which would have avoided the occurrence of the loss in question, is less detrimental to the bona fide third party acquirer, than that which would have been allocated to the purported maker/drawer. On the one hand, the standard of care allocable to the bona fide third party acquirer does not involve more than the exercise of reasonable care, whilst the standard of care that would have to be allocated to the purported maker/drawer in order to provide against the occurrence of loss, involves a high standard of care. On the other hand, the investment of cost and time in the course of exercising care in the acquisition of a negotiable instrument is economically more valid than the investment of cost and time in the course of exercising care in the safe custody of such document.

At the time of acquiring a document for a valuable exchange, the said document purports to possess a practical value. By virtue of the signature incorporated in it, the offered document purports to possess currency. It purports to establish a contractual liability in favour of the third party to whom it is offered. By comparison, the document in its blank status is a worthless piece of

paper. It does not possess any value in favour of its proprietor. Ultimately, the investment of cost and time in its safe custody takes the form of a misallocation of wealth.

From the foregoing, it could be concluded that in instances of dishonour, the risk arising from the forgery of a negotiable instrument should be allocated to the bona fide third party acquirer. The forgery of the signature of the proprietor of a blank document should not establish liability against him. Accordingly, the bona fide third party acquirer should be denied the right of exercising recourse on the negotiable instrument against the purported maker/drawer.[17]

However, the above rule should not be enforced in an absolute term. In instances where it could be shown that the occurrence of loss has been facilitated by the purported maker/drawer's own misconduct, or that the exercise of care that could have prevented the occurrence of loss would not result in a misallocation of wealth to the said party, the loss in question should be reallocated to the purported maker/drawer. He should be held liable for the said loss to the bona fide third party acquirer. The latter should be entitled to exercise a right of recourse against the purported maker/drawer.

In the instance under consideration, the purported maker/drawer is presumed to be better situated to provide against the occurrence of loss. The standard of care allocable to him either would not involve more than the exercise of reasonable care, or would mean that the

investment of cost and time arising in the course of exercising a high standard of care generates a practical enforceable value to him. It results in enhancing his reliability in the market, it attracts credit in his favour and ultimately, it promotes his business. In such an instance, the original true owner would be afforded the opportunity to spread the incurred cost among his employees and the customers of his business.[18].

In the instance under consideration, the presumed liability of the bona fide third party acquirer should be diminished. This is because the allocation of liability to him is detrimental. It attributes to him the blame for causing the loss in situations where he could not have provided against it in an efficient manner. The allocation to him of the duty of exercising reasonable care requires him to invest cost and time in channels where no practical enforceable value could be obtained. If, in the instance under consideration, the resulting loss was to be allocated in whole or in part to the bona fide third party acquirer,it would be allocated inefficiently. The whole loss, or a portion of it, would be allocated to a relatively innocent party. The other competing party i.e. the purported maker or drawer would obtain a windfall from his own failure to exercise care. Accordingly, he would be encouraged to behave carelessly.

If the situation of loss occurrence arises from the payment of a forged instrument, the party to whom the said loss should be allocated is the drawee payor. Due to his status as a party with whom the negotiable instrument

rests for payment and due to his status as a party engaged in the banking business, he is presumed to be better situated to provide against the occurrence of loss. This he can approach by introducing measures - the function of which is to render the forgery of a negotiable instrument impossible or onerous - and by employing measures, the function of which is to detect the forgery should it occur, or by arranging for insurance. Although the compliance with the foregoing duties involves the investment of time and/or cost, their assumption is economically valid. They are either consistent with the business in which the drawee payor engages i.e. the banking business, or they generate a practical enforceable value in favour of the said business.[19]

The allocation of the loss arising from the payment of a forged instrument to the drawee payor satisfies in an efficient manner the considerations underlying the risk allocation rule in the context of negotiable instruments. It meets the reasonable expectations of the commercial community engaging in the issuance and acquisition of such instruments. It reasonably assures the members of the commercial community that their property is protected and the enforcement of their transaction is final. Such a consideration clothes the members of the commercial community with reasonable certainty. It enables them to pursue their commercial interests in a favourable manner. Once the members of the commercial community are protected in their reasonable expectations, they would be encouraged in issuing and acquiring negotiable instruments. In such

an instance, the free transferability of such documents would be facilitated, whereby the function of the institution of negotiable instruments as a finance device would be promoted.[20]

However, the allocation of the loss arising from the payment of a forged instrument to the drawee payor is not inconsistent with the reasonable expectations of such a person. Due to his status as a party with whom the payment of negotiable instruments rests and due to his status as a person engaged in the banking business, the drawee is presumed to appreciate the frequency of the occurrence of the forgery of negotiable instruments and he is presumed to appreciate the gravity of the evolving loss. Accordingly, the drawee is presumed to be in the position to determine the necessity to provide against such a risk. If he decides not to take the precautionary measures necessary to provide against the forgery of instruments, he is presumed to have consented to submit himself to the evolving loss. He is presumed to have considered that the bearing of the loss in question is less detrimental than the provision of measures, the function of which is to prevent the forgery of negotiable instruments from occurring.[21]

Finally, the allocation of the loss arising from the payment of a forged instrument to the drawee payor is not unduly favourable to the other competing parties, namely, the purported maker or drawer and the bona fide third party acquirer. In the absence of a clear case of negligence, neither of the said parties could properly be

blamed for the occurrence of the risk in question. None of them is in the position to provide against the forgery of an instrument, or the occurrence of loss in an efficient manner. The care which would provide against the forgery of instruments and ultimately, which would provide against the occurrence of loss, had it been allocated to them, would either result in an economic detriment to the party to whom it is intended to be allocated, or it would result in a detriment to the institution of negotiable instruments. The allocation of the risk of the forgery of instruments and the allocation of the loss arising from it to either the purported maker, drawer or the bona fide third party acquirer, would either result in a misallocation of wealth to the party to whom it is intended to be allocated, or it would prevent the institution of negotiable instruments from fulfilling its intended function. Such an application could deter the commercial community from engaging in the business of issuing or acquiring such documents. In the last analysis, the allocation of the risk of the forgery of negotiable instruments, to either the purported maker, drawer or the bona fide third party acquirer, could restrict the free marketability of negotiable instruments, whereby the finance-like nature of such documents could be disturbed.[22]

From the foregoing, it could be concluded that the risk of the forgery of negotiable instruments and the loss arising from it should be allocated to the drawee payor. The said person should not be entitled to charge to his

customer i.e. the purported maker or drawer, the face value of the forged instrument. The latter should be entitled to compel the drawee to recredit his account as if payment had not been made. Moreover, the drawee payor should not be entitled to claim from the bona fide third party acquirer the surrender of the erroneously paid proceeds. The bona fide acquirer recipient should be entitled to retain the erroneously paid proceeds. As between himself and the drawee payor, the bona fide acquirer recipient should be established the protected holder status.

The above rule should not be enforced in an absolute term. In instances where it could be shown that the forgery of the negotiable instrument or the occurrence of loss has been facilitated by the purported maker's or drawer's misconduct, or that it has been facilitated by the bona fide third party acquirer's misconduct, the drawee payor should be entitled by way of court settlement to reallocate a portion of the resulting loss to the negligent competing party. He should not be entitled to reallocate a portion of the resulting loss to the other competing party as a matter of right, because it could give rise to a situation of a misallocation of wealth. The competing party to whom the drawee payor allocates a portion of the resulting loss could be a totally or relatively innocent person. Ultimately, the said party could end up in bearing a portion of the loss which he had not caused or the occurrence of which he had not facilitated.[23]

On the other hand, the drawee payor should not be entitled to reallocate the whole loss to the negligent competing party. The loss arising from the payment of a forged instrument can not be blamed in whole on the negligent purported maker/drawer or the negligent bona fide third party acquirer. The drawee payor always bears a degree of blame for causing the loss in question to occur. Accordingly, he always should bear a portion of the loss resulting from his erroneous payment of a forged instrument. If he was entitled to reallocate the whole loss to the negligent purported maker/drawer or to the negligent bona fide third party acquirer, loss would be allocated inefficiently.[24]

V. In instances where the fraudulent practice vitiating the negotiable instrument takes the form of forging a potential indorsement, the resulting loss should be allocated to the original true owner i.e. the person from whom the instrument was stolen and whose signature was forged. This should be the rule where the loss in question arises in instances of payment as well as that arising in situations of non payment. The original true owner is always in the position to provide against the forgery of a potential indorsement and ultimately, he is presumed to be in the position to provide against the occurrence of loss. This is due to the fact that at the time of the theft or interception of the negotiable instrument, the document in question was under the control of its original true owner. By the exercise of a

reasonable control, the original true owner would be in the position of providing against his instrument coming into the hands of a dishonest person and ultimately, he would be in the position of providing against the situation where a bona fide third party would be misled in his acquisition or payment.

The manner through which the original true owner can practise an effective control on his negotiable instrument is illustrated in the exercise of care in the safe custody of his instruments, the exercise of care in the negotiation of such documents, the exercise of care in the selection of his employees, agents and trustees, to whom he assigns or entrusts the job of the safekeeping and negotiation of his instruments, and the exercise of care in supervising the job of the above mentioned persons.[25] Although the compliance with the foregoing duties involves the investment of cost and time, it generates a practical enforceable value in favour of the original true owner. It enhances his reliability in the market, it encourages the commercial community to advance credit in his favour and ultimately, it promotes his business. In such an instance, the original true owner would be afforded the opportunity to absorb the cost arising from his exercise of care. This could be approached by spreading the cost in question among the employees and the customers of the business.[26] Moreover, in instances where the original true owner considers the duty of exercising care unduly onerous, he is afforded the opportunity to safeguard his interest at a reasonable cost. This is illustrated in

the establishment in his favour of the power to negative or restrict the negotiability attribute of negotiable instruments. By introducing such measures, the original true owner is presumed to have confined the establishment of the property right to his instrument in favour of a limited category of parties. By such a measure, the original true owner is presumed to have alerted the third party to whom the instrument is offered or presented for payment of the risk which could arise from the act of acquisition or payment. That is to say that negativing or restricting the negotiability attribute of negotiable instruments increases the care allocable to the third party to whom the negotiable instrument is offered or presented for payment. It allocates to him the duty to investigate the title of the person offering or presenting the instrument for payment.[27]

In instances where the original true owner does not negative or restrict the negotiability attribute of his negotiable instrument it would be reasonable to allocate the loss resulting from the forgery of a potential indorsement to him. Due to the special nature of negotiable instruments, the original true owner ought to foresee the risk inherent in not exercising an effective control. He ought to foresee that a dishonest person might steal, intercept and misuse his document. Accordingly, the original true owner ought to foresee that the dishonest person might mislead a bona fide third party in acquiring or paying the stolen or intercepted instrument.

The allocation of the risk of the forgery of a potential indorsement and the allocation of the resulting loss to the original true owner is not unduly favourable to the bona fide third party acquirer or the drawee payor. In normal circumstances, the said parties are not in the position to provide against the risk and the loss under consideration. None of them could properly be blamed for causing or facilitating the risk of the forgery of the potential indorsement. The care which, had it been exercised, would have provided against the said risk, would either result in an economic detriment to the party to whom it is intended to be allocated, or it would result in a detriment to the institution of negotiable instruments. It would either result in a misallocation of wealth or it would disturb the favourable nature of negotiable instruments.

It is submitted that the foregoing considerations could deter the commercial community from engaging in the business of acquiring negotiable instruments. In such an instance, the free marketability of negotiable instruments would be restricted whilst the objective of promoting the institution of such documents would fail.[28]

From the foregoing, it could be concluded that the risk of the forgery of a potential indorsement and the loss arising from it should be allocated to the original true owner. He should be divested of the property right to his instrument and he should be denied the rights inherent in his ownership. In particular, the original true owner should be denied the right of enforcing the

promise or undertaking incorporated in his instrument, or that arising from the independent transaction giving rise to it. In instances where the theft or interception of his instrument occurs subsequent to the original true owner's placing of his signature, he should be held liable on it. The bona fide third party acquirer should be entitled to enforce the promise or undertaking arising from the placing of the signature, against the original true owner.

However, the above mentioned rule should not be enforced in an absolute form. In instances where the original true owner informs, in a timely manner, the other competing party of the theft or loss of his instrument, he should be entitled to assert his ownership to the said document and he should be entitled to assert the rights inherent in it. By informing the other competing party of the theft or loss of his instrument, the original true owner is presumed to have discharged his duty to provide against the occurrence of loss. He is presumed to have allocated the power to provide against the occurrence of loss exclusively to the other competing party. If the latter fails to behave in a manner compatible with the available information, the resulting loss should be allocated to him. In such an instance, the allocation to the informed competing party of the duty to exercise care, is not onerous. It is submitted that the compliance with such a duty does not involve the investment of undue cost and time. The care which, had it been complied with, would provide against the occurrence of loss, is

illustrated in the abstention from acquiring the offered instrument or the abstention from paying the presented instrument.[29]

Finally, in instances where the risk of the forgery of a potential indorsement and the occurrence of loss has been facilitated by the misconduct of the bona fide third party acquirer or the drawee payor, the original true owner should be entitled to reallocate a portion of the resulting loss to the negligent competing party. In such an instance, the negligent competing party is presumed to bear a portion of the blame for causing the loss. The original true owner should not, however, be entitled to discharge himself from liability by establishing the negligence of the other competing party. The former party is always presumed to bear a portion of the blame for causing the forgery of a potential indorsement and ultimately, he should always bear a portion of the blame for causing the occurrence of loss. This is due to the fact that the original true owner is always presumed to be in the position to provide against the risk and the loss under consideration. This is illustrated in his capability in exercising a high standard of care.

VI. In examining the attitude of the Anglo-American and the Continental Geneva legal systems, in allocating the risk of the forgery of instruments, it is submitted that none of the said legal systems allocates the risk in question in a manner compatible with the proposed risk allocation rule. Although, as a general rule they

allocate the risk of the forgery of instruments in an efficient manner, their incompatibility with the proposed risk allocation rule is illustrated in the detailed application of the existing rule.

In instances where the loss arises from the dishonour of the forged instrument, the English legal system almost always allocates the risk of the forgery of an instrument to the bona fide third party acquirer. The legal system under consideration allocates the risk in question, even if it could be shown that the purported maker or drawer was careless in the safe custody or the general running of his business.[30]

The theories underlying the English attitude are mainly based on a narrow conception of the elements of negligence. It limits the application of negligence as a cause of action in favour of the person who is in contractual privity with the careless person and whose injury is a direct and natural consequence of the latter's careless behaviour.[31]

It is submitted that the theories underlying the English attitude are outdated, misleading, inaccurate and unfair. Their application results in allocating the loss to a relatively innocent party. They result in attributing the blame for causing the loss to a person who is not in the position to provide against its occurrence in an economically efficient manner. Such an application is incompatible with the institution of negotiable instruments, nor is it compatible with economic efficiency. Their application could restrict negotiable

instruments from fulfilling their function as a finance device and they could result in moral hazard. They could encourage the proprietor of blank documents to behave carelessly. Such an application gives rise to a situation of misallocation of wealth and ultimately, it disturbs the interest of commerce.[32]

In relatively recent times, English law has recognised the inconveniences and hardships arising from the application of a narrow conception of negligence. In some areas of the law, the English legal system developed its conceptions so as to conform with the modern tendency.[33] However, the recent development has not yet been applied in the context of negotiable instruments. The theories underlying the concept of negligence, in the area under consideration, remain those enforced prior to the recent evolution.[34]

In instances where the risk arises from the payment of a forged instrument, the English legal system allocates the resulting loss in most cases, in favour of the careless purported maker or drawer and in favour of the indorsee.[35] As a general rule, the legal system under consideration excludes the initial payee from the protection inherent in the application of the negotiability concept. It does not establish in his favour the protected holder status. Accordingly, he is accountable to the drawee payor for the erroneously paid proceeds.[36] Apparently, the Continental Geneva legal systems also confine the protection inherent in the negotiability concept in favour of the indorsee. They

appear to hold the initial payee accountable to the drawee payor for the erroneously paid proceeds.[37]

Here also, the theories underlying the attitude of the English legal system is based on outdated, inaccurate and unfair concepts. As far as the concept of negligence is concerned, the legal system under consideration limits its application as a cause of action to instances where the loss resulting to the drawee payor is the proximate and natural consequence of the customer's i.e. the purported maker's/drawer's careless behaviour.[38] If the loss in question arises indirectly from the careless behaviour of the purported maker/drawer, the law conclusively presumes, in the absence of an express stipulation to the contrary, that the drawee has consented to bear the evolving loss.[39]

As far as the issue relates to confining the satisfaction of the holder status in favour of the indorsee, the English and the Continental Geneva legal systems are of the view that only the said person would sustain a detriment from the surrender of the erroneously paid proceeds to the drawee payor. Had the recipient been the initial payee, there would not be a negotiable instrument in the strict sense, upon which he can claim an enforceable interest and ultimately, there would not be a valuable security, the enforcement of which he would forego, by reason of surrendering the proceeds of the erroneous payment to the drawee.[40]

The inappropriateness and invalidity arising from the attitude of the English as well as the Continental Geneva

legal systems, are illustrated firstly, in interpreting potential concepts incompatible with modern tendency; secondly, in assigning to contract the duty to regulate matters inexpedient to the role of such an institution; and, thirdly, in excluding a significant form of damages from the category of recoverable damages.[41] The form of damage that ought to be taken into consideration in formulating the recoverable damages is that arising from the destruction of the element of certainty and finality. The resulting damage, in such an instance, is illustrated in the disruption of the commercial interest of the person in question. It causes him to forego the opportunity to satisfy his commercial interests in an economically efficient manner. Such damage could be caused to the indorsee as well as the initial payee in instances where he is made to surrender the erroneously paid proceeds to the drawee payor.[42]

The incompatibility arising from the narrow conception of negligence and the narrow definition of the person to whom the protected holder status should be established, is twofold. On the one hand, the loss resulting from the fraudulent misuse of a negotiable instrument could be allocated in its entirety to one competing party, in instances where the other competing party bears a portion of the blame, such as the case when the fraudulent practice has been facilitated by the careless behaviour of the purported maker or drawer. If the drawee payor was to bear on his own the loss resulting from his erroneous payment, the negligent purported

maker/drawer would be afforded a windfall from his careless behaviour. Ultimately, the said party would be encouraged to behave recklessly, whereby the rate of loss occurrence would be increased.[43] On the other hand, in instances where the category of protected party is confined to the indorsee, the objective of promoting the institution of negotiable instruments would be disturbed. This is due to the fact that the large majority of negotiable instruments are negotiated only once. If the acquirers of such documents were excluded from the protected holder status, the members of the commercial community would be discouraged from acquiring negotiable instruments. Accordingly, the free transferability of such documents would be restricted.

In instances where the Anglo-American and the Continental Geneva legal systems hold the purported maker or drawer liable in negligence, they establish against him liability for the resulting loss in full. Firstly, they entitle the drawee payor to charge his customer for the face value of the paid instrument. Secondly, they deny to the purported maker or drawer, the right of allocating a portion of the resulting loss to the drawee.[44] The legal systems under consideration discharge the drawee payor who has behaved with reasonable care, from the liability for the loss resulting from the payment of a forged instrument.

It is submitted that the foregoing rule is incompatible with the proposed risk allocation rule. On the one hand, it could result in allocating the evolving

loss to a totally or relatively innocent party. On the other hand, it would result in discharging a guilty party such as the drawee/payor from the liability for the loss, or a portion of it, in instances where the occurrence of such loss had been facilitated by his failure to exercise care.[45] In such an instance, the guilty party would be afforded a windfall, whereas the rule of discharging him from the liability for the loss which he had facilitated, would result in a misallocation of wealth to the other competing party.

In their current revision of Article 3 U.C.C., the American Law Institute and the National Conference of Commissioners on Uniform State Laws recognise the difficulty in allocating the loss arising from the erroneous payment of a forged instrument to the negligent purported maker/drawer. They partially remedied the difficulty in question by introducing the rule of divided liability. The scope of the rule of divided liability is that it apportions the liability arising from the misuse of a negotiable instrument between the competing parties on an equal basis. In instances where the misuse of the negotiable instrument takes the form of the forgery of the signature of the proprietor of the blank instruments, the rule of divided liability apportions the resulting loss between the drawee payor and the purported maker or drawer.[46]

Although the rule of divided liability operates as an improvement on the existing rule, in that it always establishes against the drawee payor, liability for the

loss resulting from the erroneous payment of a forged instrument, it is submitted its application does not offer a complete satisfaction. Like the existing rule it, firstly, could result in allocating a portion of the evolving loss to a relatively innocent party and secondly, it could result in a misallocation of wealth. The allocation of a portion of the resulting loss to a relatively or totally innocent party arises from the drawee payor's right to charge to the purported maker or drawer i.e. his customer, a portion of the face value of the erroneously paid proceeds. By comparison, the situation of misallocation of wealth arises from the possibility that the reallocated portion of the loss to the purported maker or drawer is not in fact attributable to him.[47]

A more satisfactory solution is that proposed in the report of the Review Committee on Banking Services. The Review Committee has recommended that the drawee bank should be entitled to recover a portion of the loss resulting from the erroneous payment of a forged instrument from the negligent customer i.e. the proprietor of the blank document whose signature was forged.[48] It could reasonably be inferred from the above recommendation that the drawee bank would firstly, have to enforce the liability of his customer for the resulting loss by way of court settlement and secondly, the degree of the customer's liability should be determined by the gravity of his negligence. Such a recommendation is submitted to be efficient. It allocates losses on an equitable basis

and it provides against the situation of misallocation of wealth.[49]

VII. In examining the attitude of the Anglo-American and the Continental Geneva legal systems in allocating the risk of the forgery of a potential indorsement, it is submitted that the attitude of the latter legal system is more compatible with the proposed risk allocation rule. As a general rule, they allocate the risk under consideration to the original true owner. They divest the said person of his ownership of the stolen or intercepted document. They deny him the right of enforcing the promise or undertaking arising from the negotiable instrument, or that arising from the underlying transaction. They establish the property right to the negotiable instrument and the rights inherent in it in favour of the bona fide third party acquirer. They establish a valid discharge in favour of the drawee who behaves in good faith and free from gross negligence. Finally, in instances where it could be shown that the loss resulting from the forgery of a potential indorsement has been facilitated by the misconduct of the bona fide third party acquirer or that of the drawee payor, the majority of the Continental Geneva legal systems apportion the loss in question between the original true owner and the negligent competing party.[50]

The allocation of the risk of the forgery of a potential indorsement, in the above manner, satisfies most efficiently the considerations underlying the risk

allocation rule in the context of negotiable instruments. It promotes the institution of negotiable instruments, it is compatible with the reasonable expectations of the competing parties. It allocates the evolving loss to the party who is better situated to provide against it and it provides against the occurrence of moral hazard. It motivates each of the competing parties to optimise his standard of care. Ultimately, it operates to invest cost and time in channels which would secure the enforcement of the optimum value.[51]

By comparison, the general rule underlying the allocation of the risk of the forgery of a potential indorsement as enforced in the Anglo-American legal systems is not compatible with the proposed risk allocation rule. It operates in favour of the original true owner. It preserves his property right to the stolen or intercepted document. It establishes in his favour the right of exercising the promise or undertaking arising from the negotiable instrument or that arising from the involved independent transaction. It enables the original true owner to demand a fresh payment from the drawee and it enable him to claim the surrender of the stolen or intercepted document or its proceeds from the bona fide third party acquirer. It denies to the latter the protected holder status, whilst it denies to the drawee payor a valid discharge.[52]

The allocation of the risk of the forgery of a potential indorsement in the above manner is incompatible with the promotion of the institution of negotiable

instruments, nor is it compatible with economic efficiency. Firstly, it results in allocating the duty to provide against the forgery of a potential indorsement and the duty of providing against the occurrence of risk, to the person who is not presumed to be in the position to comply with it in an efficient manner. It requires the said party to invest cost and time in channels that might not be profitable to him or it could cause him to forego the opportunity to manage his business in an economically favourable manner. In other words, the allocation of the duty to provide against the forgery of a potential indorsement to either the bona fide third party acquirer or the drawee payor could give rise to a situation of misallocation of wealth.[53]

Secondly, in instances where the allocation of the duty to provide against the forgery of a potential indorsement to either the bona fide third party acquirer or the drawee payor does not result, in the strict sense, in a misallocation of wealth, the time involved in such a duty conflicts with the special nature of negotiable instruments. It could prevent the document in question from being transmitted into money in a timely manner. It could prevent the said document from fulfilling its intended function as a finance device. Moreover, the time involved in the provision against the forgery of a potential indorsement could overlap with the maturity of the offered or presented instrument. Accordingly, it could disturb the commercial interest of the genuine acquirer or it could cause him to forego a valuable

security. Such results could deter the commercial community from engaging in the business of acquiring negotiable instruments; they would restrict the free transferability of negotiable instruments and finally, they would disturb the objective of promoting such documents.[54]

The incompatibility of the general rule underlying the application of the risk of the forgery of a potential indorsement, as enforced in the Anglo-American legal systems, is relaxed by the introduction of a number of exceptions. The function of the exemptions is to reallocate the risk under consideration in favour of the bona fide third party acquirer and the drawee payor. They operate to divest the property right to the stolen or intercepted document from its original true owner and vest it in the bona fide third party acquirer. They operate to divest the original true owner of the right of enforcing the promise or undertaking arising from the negotiable instrument or that arising from the underlying transaction. They operate to attribute to the original true owner the intention to transfer the property right of the stolen or intercepted instrument to its thief or finder. Finally, they attribute to the original true owner who placed his signature prior to the theft or interception of his document, a contractual promise or undertaking in favour of the acquirer.[55]

It is submitted that the exceptions to the general rule are more extensive in the North American legal system than is the case in the English legal system. The scope

of the exceptions in the North American legal system extends to situations of fictitious payees, the majority of the situations of impersonation, all situations of incomplete instruments and all situations of negligence.[56] The scope of the exceptions in the English legal system is restricted to those situations where the name of the fictitious payee is inserted by the nominal drawer, the situations where an incomplete instrument is delivered for the purpose of negotiation and the situations where the negligence of the original true owner is in the negotiation of the negotiable instrument.[57]

The extensiveness of the exceptions to the general rule is submitted to be of significance in determining the compatibility of the risk allocation rule with the proposed rule. Where the scope of the exceptions is enlarged, the ultimate risk allocation rule is presumed to conform with the proposed rule. By allocating the loss resulting from the forgery of a potential indorsement to the original true owner, the risk in question is presumed to be allocated in a manner compatible with the considerations underlying the risk allocation rule in the context of negotiable instruments. It is presumed to satisfy most efficiently the promotion of the institution of negotiable instruments and it is presumed to satisfy the notion of economic efficiency.[58]

Since the scope of the exceptions to the general rule is larger in the North American legal system than is the case in the English legal system, the ultimate rule underlying the allocation of the forgery of a potential

indorsement, as enforced in the North American legal system, is more compatible with the proposed risk allocation rule than that shaping the risk allocation rule in the English legal system. However, the ultimate risk allocation rule in the North American legal system does not fall squarely within the proposed risk allocation rule. There remain instances where the risk of the forgery of a potential indorsement would be allocated inefficiently. Examples of such an instance are:

(1) The exclusion of the delivery of a negotiable instrument in favour of an impostor as an agent of a fictitious principal, from the application of the rule underlying the situation of impersonation, and,

(2) the allocation of the duty to enforce the liability arising from the negligence of the original true owner to the bona fide third party and the drawee payor.

The difficulty arising from excluding the delivery of a negotiable instrument to an impostor from the application of the rule of impersonation, is that the resulting loss would not be allocated to the person who is presumed to be in the position to provide against it, namely, the original true owner. In such an instance the said person would be afforded a windfall. He would be discharged from the liability for the loss which he is presumed to have facilitated by his own conduct. Such a rule would encourage the original true owner to behave carelessly and ultimately it would increase the rate of loss occurrence.[59]

The difficulty arising from allocating the duty to enforce the liability evolving from the negligence of the original true owner as to the bona fide third party acquirer and the drawee payor, is that it establishes the resulting loss initially in favour of the negligent party. The initial allocation of losses in favour of negligent parties might operate as a windfall in favour of such a party. The injured party, due to his remoteness from the negligent party or due to the cost, time and trouble involved in the enforcement of liability might not be in the position to recoup the loss sustained by him from the negligent party. Accordingly, the loss in question might have to be borne by him. Such a result would allocate loss to a party who is not presumed to be in the position to provide against it. Ultimately, it could result in a misallocation of wealth.[60]

VIII. As far as the United Nations Commission on International Trade Laws Convention/draft Convention on International Negotiable Instruments, is concerned, it is submitted that the risk allocation rule incorporated in the said Convention/draft Convention is inefficient. This is due to the fact that the Convention/draft Convention does not offer a uniform interpretation of potential concepts which it introduces in formulating its risk allocation rule. It allocates such a duty to the forum before which the case arises.[61] Since the forum in question is cognisant with its own rules, it is presumed that the said forum would apply its own law in

interpreting the potential concepts. In the light of the existing inconsistent attitude of the law of the major legal systems, it is reasonably foreseeable that the Convention/draft Convention would be susceptible to a variant application. Such an attitude is inconvenient in commerce because it gives rise to uncertainty and it could result in allocating the loss in question in favour of a party who is in the best position to provide against it. That is to say that the Convention/draft Convention in its present version could give rise to moral hazard and ultimately, it could give rise to a situation of misallocation of wealth.[62]

The Convention/draft Convention's inefficiency is more apparent in the case of allocating the risk of the forgery of a potential indorsement. This is because it allocates the said risk to the immediate taker from the forger. It allocates to the said party the duty to compensate the original true owner for the loss that he would sustain as a result of the theft or interception of his document.[63] In fact, the Convention/draft Convention deems the immediate taker from the forger the guilty party for causing the forgery of a potential indorsement.

To state the obvious, the immediate taker from the forger can not properly be blamed for causing the forgery of a potential indorsement nor can he properly be blamed for causing the occurrence of loss. The said person is not presumed to be in the position to provide against the risk or the loss in question. In order for him to provide against the forgery of a potential indorsement,

the immediate taker from the forger would have to exercise care in a manner which would cause him undue hardship. It would require him to invest cost and time in channels where no practical enforceable value could be obtained.[64]

The inefficiency of the rule of the Convention/draft Convention in allocating the risk of the forgery of a potential indorsement is reinforced by the fact that the liability of the immediate taker from the forger for the loss resulting from the forgery of a potential indorsement is enforced off the instrument. The immediate taker from the forger can initially enforce the promise or undertaking arising from the negotiable instrument against a liable party who could well be the person from whom the instrument was stolen or intercepted i.e. the original true owner. If such an action proves to be detrimental to the party against whom the instrument is enforced, the said party by way of an independent action may enforce the liability of the immediate taker from the forger for the detriment caused to him.

Obviously, allocation of the liability against the immediate taker from the forger in the above manner represents a misallocation of wealth. It involves two separate causes of action in instances where the ultimate risk allocation rule could be approached by a single cause of action. The involvement of multiple causes of action increases transaction cost and consumes time. It is submitted that both cost and time are valuable assets in commerce. They should be utilised to generate the optimum value. Accordingly, they should not be invested

in law suits, the involvement in which could be avoided or minimised.

IX. Finally, the necessity to unify the rules regulating negotiable instruments is of significance especially in the context of the European Economic Community. Such a step would reduce the applicable rules into a single set of rules. The unification of the rules regulating negotiable instruments would coincide with the intention to introduce a single European market as well as with the desire to introduce a single European Currency. Once the rules regulating negotiable instruments are unified, the members of the European Commercial Community would be afforded reasonable certainty in their dealings. Accordingly, they would be afforded the opportunity to manage their interest in a commercially efficient manner. In order to promote the efficiency of the intended single market, the finance instrument involved in it should be efficient. Since negotiable instruments are a potential finance instrument, the rules regulating them are meant to be efficient. It is submitted that the rules regulating the issue of risk allocation forms a significant element in determining the efficiency of negotiable instruments. Thus, for the institution under consideration to fulfil its function in an efficient manner, the rules formulating the issue of risk allocation should be efficient.

CHAPTER TEN

BACK NOTES - (1.-64.)

1. For the definition of negotiable instruments and its variant implications see pp.36-37.

2. For the narrow definition of negotiable instruments and its variant forms see pp.37-40.

3. cf. pp. 47-48.

4. For an illustration of such an instance of disturbance see pp.84-86.

5. cf. pp.87-91.

6. cf. pp.91-99 and 205-223.

7. cf. pp.216-218.

8. cf. p.112.

9. For a detailed account concerning the significance of the considerations in question in determining the risk allocation problem in the context of negotiable instruments and for a detailed account of the efficient manner in achieving the said considerations see pp.100-138 and 171-175.

10. cf. pp.100-107.

11. cf. pp.107-109.

12. cf. pp.172-174.

13. cf. pp.111, 134-138, 175.

14. Ibid.

15. For a detailed account of the argument that the application of the insurance theory per se could result in a misallocation of wealth and for an illustration where the said theory could give rise to moral hazard see pp.162-165.

16. cf. pp. 134-138, 167-169,

17. cf. pp.362-364.

18. cf. pp.365-367.

19. cf. pp.340-342.

20. cf. pp.351-359.

21. cf. pp.346-351.

22. cf. pp.351-359.

23. cf. pp.369-370.

24. Ibid.

25. See pp.596-597.

26. See pp.602-605.

27. See p.616.

28. See pp.617-624.

29. See pp.648-649.

30. cf. The decisions in Bank of Ireland v Evans' Chartities Trustees (1855) 5HL Cas 389;
Swan v North British Australasian Co. (1863) 2 H & C 175;
Baxendale v Bennett (1878) 3 QB D.525;
Scholfield v Earl of Londesborough [1896] AC 514;
Tai Hing Cotton Mill Ltd. v Liu Chong Hing Bank Ltd. [1986] A.C.80.
For the facts of the cases and the decision of the courts see pp.399-404, 410-415, 430-433.

31. cf. pp.398-404, 410-415.

32. For a detailed account of the theories underlying the attitude of the English legal system in restricting the concept of negligence in the law of negotiable instruments and for a more detailed account of the invalidity of such theories see pp.415-436.

33. cf. The decision in Donoghue v Stevenson [1932] A.C.562;
Anns v Merton London Borough Council [1978] A.728;
Junior Books Ltd. v Veitchi [1982] 3 All E.R. 201.
For the facts of the above cases and the decision of the courts see pp.405-408.

34. The reinstatement of the pre Donoghue v Stevenson theory to the law of negotiable instruments is incorporated in the Privy Council decision in Tai Hing Cotton Mill Ltd. v Liu Chong Hing Bank Ltd. [1986] A.C.80. For the facts of this case and the decision of the Privy Council see pp.410-415.

35. cf. Authorities cited in n.31.
cf. Also the decisions in -
Price v Neal (1762) 3 Burr 1354.
Cocks v Masterman (1829) 9 B & C 902.
London and River Plate Bank v Bank of Liverpool [1896] 1 QB 7.
National Westminster Bank v Barclays Bank International and Ismail [1975] QB 654.

For the facts of the said cases and the decision of the courts see pp.261-270.

36. cf. pp.482-484.

37. cf. pp.271, 465-470.

38. cf. pp.502-505.

39. cf. The decision in Kepitigalla Rubber Estates Ltd. v National Bank of India Ltd. [1909] 2 KB 1010.
Tai Hing Cotton Mill Ltd. v Liu Chong Hing Bank Ltd. [1986] AC 80.
For the facts of the cases under consideration and the decision of the court see pp.495-502.

40. cf. pp.486-487.

41. cf. pp.478-482, 487-492.

42. cf. pp.470-478.

43. cf. pp.367-369.

44. cf. pp.462, 493-494, 521-522.

45. cf. pp.369-370.

46. cf. p.523.

47. cf. pp.523-525.

48. cf. p.514.

49. Ibid.

50. See pp.692-705.
However, not all legal systems falling within the Geneva umbrella conform squarely with the efficient risk allocation rule. Those legal systems which apply the amortization procedure are presumed to be less compatible with the proposed risk allocation rule. This is due to the fact that the enforcement of the amortization procedure prevents the avoidance of loss arising from the forgery of indorsements in an efficient manner and it restricts the free transferability of negotiable instruments cf. pp.698-701.

51. See pp.707-710.

52. See pp.682-692.

53. See pp.601-614.

54. See pp. 614-624, 705-706.

55. See pp.711-712.

56. See pp.712-783.

57. Ibid.

58. See pp.727-728 and 776.

59. See pp.733-736, 747-753.

60. See pp.781-783.

61. cf. pp.545-546.

62. cf. pp.546-550.

63. See pp.245-249 and 254-255.

64. See pp.606-610.

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