

NEGOTIABLE INSTRUMENTS: CHEQUES ACT OF 1957

A corollary to the desirability of codified commercial laws should be the continued adherence to an underlying principle of commercial law—that the rule exists to foster the usage to which it relates. As a commercial usage changes, effort should be exerted to bridge the gap between the codified rule and the changed usage.¹ The Cheques Act, 1957,² represents a major effort by the English Parliament to bring the codified law into step with the current usage of the bank check.

The Cheques Act amends the Bills of Exchange Act, 1882,³ and eliminates, in certain situations, the need for endorsement and inspection of indorsements by affording to banks protection from liability when collecting or paying an unindorsed or irregularly indorsed check. The paying bank is protected under the following provision:

1. (1) Where a banker in good faith and in the ordinary course of business pays a cheque drawn on him which is not indorsed or is irregularly indorsed, he does not, in doing so, incur any liability by reason only of the absence of, or irregularity in, indorsement, and he is deemed to have paid it in due course.

(2) Where a banker in good faith and in the ordinary course of business pays any such instrument as the following, namely,—

(a) a document issued by a customer of his which, a bill of exchange, is intended to enable a person to obtain payment from him of the sum mentioned in the document;

(b) a draft payable on demand drawn by him upon himself, whether payable at the head office or some other office of his bank;

he does not, in doing so, incur any liability by reason only of the absence of, or irregularity in, indorsement, and the payment discharges the instrument.

A similar provision protects the collecting bank:

4. (1) Where a banker, in good faith and without negligence—

(a) receives payment for a customer of an instrument to which this section applies; or

(b) having credited a customer's account with the amount of such an instrument, receives payment thereof for himself;

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

1. See Liberman, Opportunity and Challenge to Bring Commercial Laws in Step with Present Day Needs, 3 So. Texas L.J. 99 (1957-58); Note, 71 Harv. L. Rev. 1374, 1375 (1958).

2. Cheques Act, 1957, 5 & 6 Eliz. 2, c. 36.

3. Bills of Exchange Act, 1882, 45 & 46 Vict. 1, c. 61, (hereinafter referred to as BEA). The Negotiable Instruments Law will be referred to as NIL.

(2) This section applies to the following instruments, namely,—

(a) cheques;

(b) any document issued by a customer of a banker which, though not a bill of exchange, is intended to enable a person to obtain payment from that banker of the sum mentioned in the document;

(c) [Documents intended to enable payment from the Paymaster General or the Queen's and Lord Treasurer's Remembrancer]. . . .

(d) any draft payable on demand drawn by a banker upon himself, whether payable at the head office or some other office of his bank.

(3) A banker is not to be treated for the purpose of this section as having been negligent by reason only of his failure to concern himself with absence of, or irregularity in, indorsement of an instrument.

In addition the Act gives the collecting bank full rights formerly acquired only with an indorsed check:

2. A banker who gives value for, or has a lien on, a cheque payable to order which the holder delivers to him for collection without indorsing it, has such (if any) rights as he would have had if, upon delivery, the holder had indorsed it in blank.⁴

Although the provisions appear to deviate from the recommendation of a special parliamentary committee⁵ that change in the requirement of indorsement be limited to the situation where a payee deposits a check for collection,⁶ their ultimate effect will be in accordance with the committee's desires to increase convenience and reduce costs⁷ in

4. Another important provision of the Act declares the unindorsed check, that has been paid, to be evidence of receipt of payment by the payee. Other sections are administrative.

5. A special committee headed by Mr. A. A. Mocatta was appointed in 1955 to study the problem and make recommendations to Parliament. A report was presented to Parliament in November, 1956. Cheque Endorsement Committee, First Report, Cmd. No. 3 (1956).

6. Id. § 54. The Act appears to have at least two curious aspects when viewed with the committee's recommendations. Section 1 apparently frees paying banks from *any* concern with indorsements, but it is not clear whether § 4 places any duty on the collecting bank to check indorsements on instruments that have been negotiated. The committee recommended that indorsements continue in all situations except where the check is deposited by the payee, i.e., encashment of checks over the counter and deposit of checks by indorsees. Id. §§ 54-66. Secondly, the use of the word "holder" in § 2 is especially anomalous because the word "customer" is used in § 4 and the committee specifically recommended that "endorsement should continue to be required in all cases of encashment of cheques." Id. § 66. This was thought necessary by the committee to enable persons to hold unindorsed checks without special risk of loss. Id. § 65.

7. The committee found there was "an appreciable burden" on banks and "not inconsiderable amount of work to recipients of cheques" resulting from the requirement of indorsement on checks deposited for collection by payees. However, it admitted that reliable figurative estimates could not be made. Id. §§ 15-25.

the use of the check. Since the endorsement by the last holder of the check was required solely for the banks' protection from possible liability should payment be made to a thief or other unauthorized person,⁵ the problem was attacked from that angle. However, it is significant to note that the purpose of the Act is to aid both banks and their users, thus providing an example of a present day development in the law of negotiable instruments, a development that is entirely consistent with its original evolution.

Negotiable instruments were developed by the early merchants to satisfy the commercial need for a convenient and safe means for transferring and circulating funds when bulky gold bullion or coin was the medium of exchange and the trade routes were infested with pirates and highwaymen.⁹ The bill of exchange, an order for another to pay,¹⁰ the check, an order for a banker to pay¹¹ and the promissory note, the maker's promise to pay,¹² satisfied these needs. They were

It should be noted that while such a statute may increase convenience somewhat in the United States, it would not change the material position of the parties. Presently deposit agreements provide for the giving of tentative credit only, subject to final payment of the check. Also, it is the practice of the banks in the collection chain to guarantee all prior indorsements. See also Bank Collection Code § 2 (see Mo. Rev. Stat. § 402.030 (1949)), adopted by 19 states, which provides that the bank where an item is deposited is the "agent of the depositor for its collection and each subsequent collecting bank" is the "sub-agent of the depositor."

8. It is not clear why the indorsement on checks given to a bank as agent for collection and deposit is required. The committee found that although there were no specific statutory requirements, the practice became established in England in several ways. 1. Before the check collection system was developed the holder presented the check to the drawee bank and the bank desired to be in the position of a holder in due course on its own obligation should payment be made to a thief. 2. Section 60 of BEA required that payment be "in the ordinary course of business," and indorsement was "ordinary" at the time of its passage. Cheque Endorsement Committee, First Report, Cmd. No. 3, §§ 9-14 (1956).

The practice is also well established in the United States, probably for similar reasons. See Brady, *Bank Cheques* § 190 (2d ed. 1926); Liberman, *op. cit. supra* note 1, at 101 n.5.

9. See Holden, *History of Negotiable Instruments in English Law* 2 (1955); 8 Holdsworth, *History of English Law* 130 (1938); Story, *Promissory Notes* § 5 (7th ed. 1878); Story, *Bills of Exchange* § 11 (4th ed. 1860).

10. The bill of exchange was probably the first negotiable instrument. Jevons, *Money and the Mechanism of Exchange* 300 (1878); Story, *Promissory Notes* § 5 (7th ed. 1878).

11. The check is by definition a bill of exchange drawn on a banker and payable on demand. NIL § 185; BEA § 73. Prior to the existence of banks, English merchants placed bullion with goldsmiths and probably the earliest check was a letter from the merchant directing the goldsmith to give an amount of gold to a named person. Later the letter was phrased like a bill of exchange payable to another or his order. Holden, *op. cit. supra* note 9, at 206-15.

12. The Statute of Anne, 1704, 3 & 4 Anne 1, c. 9, made it clear that promissory notes were negotiable.

unconditional written orders or promises to pay a certain sum of money, at a specified time or on demand, to a named individual or to the bearer of the writing which could be negotiated or transferred¹³ free from any defenses a prior holder might have asserted. Because the instrument had those qualities it was a perfect representative of money¹⁴ if there was actually present ability to pay. As merchants gained confidence in the representative character of the writing, i.e., that it would certainly be honored with coin on presentment, the writing gained general acceptability in the commercial world as a store of values and medium of exchange and was circulated¹⁵ as money.¹⁶ Consequently promises representing future, as well as present, abilities to pay could be issued because the instruments would be circulated for a period of time before presentment.¹⁷ Thus, the negotiable instrument had another function, that of increasing the supply of money—the medium of exchange. Each function served to stimulate commerce by improving trade efficiency.

The idea that the negotiable instrument was to aid commerce, likewise, was central to the development of the law governing its use. Mercantile customs or usages adopted to regulate commercial dealings were the bases for the development of the law of negotiable instruments. At first negotiable instruments were enforced only by the merchants in special courts¹⁸ as a part of the Law Merchant, which consisted, among other things, of commercial customs.¹⁹ Then about the 17th century the English common law courts began to enforce negotiable instruments,²⁰ beginning the process of incorporating the

13. This is the present statutory definition of a negotiable instrument in both the United States and England. See NIL § 126; BEA § 3 (1).

14. There is no attempt here to distinguish between the technical meanings of "money," except to make it clear the meaning intended here is the one defined in note 16 infra. For technical definitions see, Halm, *Monetary Theory* 27 (representative money), 105 (standard money) (2d ed. 1946); Coulborn, *An Introduction to Money* 12 (legal tender) (1938).

15. Ogden, *Negotiable Instruments* § 2 (3rd ed. 1931); 8 Holdsworth, *op. cit. supra* note 9, at 169; cf. Jevons, *Money and the Mechanism of Exchange* 191 (1878).

16. It is generally agreed today that money can be defined as that which has general acceptability as a medium of exchange and a store of values. Stokes, *Money, Banking and the Financial System* 10 (1955); Coulborn, *op. cit. supra* note 14, at 3.

17. This function was not necessarily limited to negotiable credit instruments. Demand bank notes were the first paper currency. See 8 Holdsworth, *op. cit. supra* note 9, at 179; Waterman, *The Promissory Note as a Substitute for Money*, 14 *Minn. L. Rev.* 313, 321-30 (1930).

18. Bigelow, *Bills, Notes and Checks*, §§ 26-28 (3rd ed. 1928); Jones, *The Law Merchant: Some Reflections*, 1956 *Wash.U.L.Q.* 397, 415.

19. Ogden, *op. cit. supra* note 15, at § 3.

20. While there may have been earlier common law decisions, the first reported

law merchant into the common law, which was complete by the 18th century.²¹ But significantly the commercial needs were not subordinated to legal technicalities because the common law courts enforced the negotiable instrument as a custom, sometimes using a jury of merchants as advisors on the customs.²² Therefore, throughout the periods of development the rules of negotiable instruments were devised and automatically adjusted to current commercial needs by constant reference to current customs of merchants.

The law of negotiable instruments continued to mature as part of the common law during the 19th century.²³ However, further development was stymied by the original codification of the law of negotiable instruments in the Bills of Exchange Act, 1882,²⁴ the English model for the Negotiable Instruments Law²⁵ in the American states. Although the intent was to aid trade through uniformity and certainty,²⁶ one of the most important effects of codification was the relative petrification of the rules as of the time of the codification. There have been only minor changes in the codes since their original enactment,²⁷ despite the fact that commercial usages of the instruments have radically changed in the last half century.

Since these codifications one of the most important changes in commercial practices is the decrease in actual negotiations of those instruments coming within the general definition of a negotiable instrument. The general definition makes no reference to the intent of the parties as to negotiable character, but rather subjects all instruments possessing specific physical characteristics²⁸ to the provisions of the law.²⁹ As a result, many instruments not in fact negotiated or expected to be negotiated at the time of making are subjected to the rules of negotiable instruments.

case seems to be *Martin v. Boure*, Cro. Jac. 6, 79 Eng. Rep. 6 (Ex. 1602). 2 Street, Foundations of Legal Liability 347 (1906).

21. Britton, Bills and Notes § 2, at 14 (1943).

22. Bigelow, *op. cit. supra* note 18, § 32 n.2; Ogden, *op. cit. supra* note 15, at § 4.

23. Britton, Bills and Notes § 2, at 14 (1943). In the United States the development during this period was largely statutory. Beutel, The Development of State Statutes on Negotiable Paper Prior to the Negotiable Instruments Law, 40 Colum. L. Rev. 836 (1940).

24. See note 3 *supra*.

25. Brannan, Negotiable Instruments Law 74 (7th ed., Beutel 1948); Britton, Bills and Notes § 3, at 17 (1943).

26. Britton, Bills and Notes § 3, at 19 (1943).

27. Holden, *op. cit. supra* note 9, at 243.

28. NIL § 1; BEA § 3.

29. The exclusionary aspect of this definition should also be noted. See Jones, Finance Companies as Holders in Due Course of Commercial Paper, 1958 Wash. U.L.Q. 177, 195.

This is especially true of notes and checks. While the negotiable quality of the promissory note is still important to the creation of many of such instruments, a great many are created solely to evidence a loan or debt. Most short-term notes fall in this category, for there is no ready market for them. Other notes, whose negotiability is supposedly essential to the granting of the loan because of possible marketing, are not in fact transferred. This applies to both long- and short-term notes held by banks,³⁰ consumer finance institutions,³¹ and retail stores³² which frequently find commercial advantages³³ in borrowing on the strength of their customers' notes, rather than discounting, when cash is necessary for operations. Thus, here also the note is serving primarily as evidence of a debt. In contrast to the note, the bill of exchange still serves its traditional purpose. The drawer fully expects it to be used as a form of currency, i.e., to be transferred from hand to hand until presented for payment. However, the bill of exchange has lost its original importance. For example, in England from 1925 to 1952 the revenue on bills of exchange dropped by half.³⁴

Correspondingly, the number of bank checks in circulation during the same period doubled.³⁵ The bank check is, therefore, the most frequently used form of negotiable instrument today,³⁶ and although it is fully negotiable, only a few of the checks drawn are in fact negotiated. The drawer of a check uses it to discharge a single obligation and, probably, expects it will be placed in banking channels by the payee for collection, and does not expect the check will be circulated.

In recent years it has been estimated that of the 650 million order checks drawn annually in England 97 per cent are not negotiated, but are simply deposited for collection into the payees' accounts.³⁷ There is evidence that the American situation may not be very different from the one in England, except perhaps for a greater percentage of payroll checks many of which are not deposited by the payee. A recent survey indicates that 80 per cent of American families have at least one checking account and that most families meet their regular ex-

30. See note 44 *infra*.

31. See Kent, *Money and Banking* 289, 724 (3d ed. 1956).

32. See *id.* at 729.

33. There are several advantages: 1. Maintenance of the business relationship between the maker and the payee for goodwill purposes. 2. Convenience in calculating for one note rather than for a whole series. 3. Ability to utilize short-term loans.

34. Holden, *op. cit. supra* note 9, at 301.

35. *Ibid.*

36. It is estimated that 90 per cent of internal financial transactions are by check in the United States and England. Britton, *Bills and Notes* § 1, at 1 (1943); Holden, *op. cit. supra* note 9, at 306.

37. Page, *Indorsement of Cheques*, 4 *Bus. L. Rev.* 87 (1957).

penses with checks.³⁸ For instance, 68 per cent pay the rent or mortgage payments with a check; 57 per cent, the utility bills; 58 per cent, the telephone bills.³⁹ Undoubtedly those checks are written to satisfy an obligation with the expectation they will be deposited for collection, not negotiated. At the other end of the transaction this expectation is usually fulfilled. Businesses will probably deposit for collection all checks received, and pay their obligations with their own checks, because good bookkeeping suggests this as a good procedure for recordation and proof of payment. It would appear from this that the most attractive quality of the check is its convenience in paying and recording payment of obligations rather than its negotiability,⁴⁰ i.e., the ability to transfer the instrument for value free from defenses which might have been exerted against the preceding holder.

At least two reasons for the shift in the commercial usage of notes and checks can be suggested. First, the development of the banking system has fulfilled the commercial needs originally satisfied by the negotiable instrument. The banking system provides a convenient and efficient means for transferring funds between distant points by means of the rapid long-distance collection of bank checks, bank drafts, notes and bills of exchange⁴¹ without actual negotiation (except in form)⁴² of the instruments or without the use of any instrument whatsoever.⁴³ In addition, the banking system provides a method for increasing the money supply through the expansion of bank credit: as business needs for currency or bank credits are reflected in loans by banks, banks in turn may borrow from the federal reserve

38. Survey conducted by J. Walter Thompson Co. for the American Bankers Ass'n, reported in *Banking*, June 1956, p. 34.

39. *Ibid.* Other interesting facts uncovered by the survey are that the wife more often pays the principal family bills and that a college educated wife is twice as likely to pay with check as a wife with only a grade school education.

40. Upon deposit of a check with indorsement the form of negotiation, i.e., indorsement and delivery, has been completed; however, generally the bank does not at that time become the owner of the check and may withdraw the tentative credit given the depositor when the check is returned uncollected. See Brady, *Bank Checks* § 290 (2d ed. 1926).

41. Federal reserve banks give immediate tentative credit to collecting banks on checks. However, when bills of exchange, drafts and notes are sent for collection, credits are not given until actual payment is received. Burgess, *The Reserve Banks and the Money Market* 101 (rev. ed. 1946).

42. See note 40 *supra*.

43. Wire transfer of funds has become quite common. Steffen, *Commercial and Investment Paper* 24 (1954); and see Harfield, *Elements of Foreign Exchange Practice*, 64 *Harv. L. Rev.* 436, 441 (1951).

Modern technology has made it feasible to distribute payrolls by direct wire communication with the employees' banks. Also teletype communication between major banks enables businesses with far-flung activities to maintain central control over its funds. *Business Week*, July 12, 1958, pp. 121-22.

banks.⁴⁴ A second reason for the shift in the commercial usage of negotiable instruments is the increased realization that "money" is a mere idea—that the instrument representing a claim on legal tender is just as useful as the legal tender itself, if it is accepted in exchange for goods.⁴⁵ Thus, bank deposit credits are accepted as stores of values⁴⁶ and the check, a claim on bank credits, is accepted as a means of payment. It would seem that both factors, the banking system and the realization that money is an idea, are interdependently responsible for the percentage decline in transfers of negotiable instruments.

The Cheques Act, by eliminating the need for indorsement and inspection of indorsements on checks, significantly recognizes the fact that the rules of negotiable instruments are not fully consistent with the present use of the bank check. Indorsement by a depositor for collection in reality serves no purpose. No protection against theft and forgery is afforded since banks maintain other records to trace the tentative deposit credits to the correct deposit account should the check fail collection, making necessary the withdrawal of the tentative credit.⁴⁷ Likewise, the checking of indorsements when the payee is the depositor is a fruitless motion. The payee's ownership of the check appears on its face. Banks should not be held negligent in determination of ownership merely because there is no indorsement.⁴⁸ Probably, when checks were frequently negotiated the indorsement by depositors and the checking of indorsements by banks were not excessively burdensome; however, today considerable convenience and saving may result from the elimination of these requirements.⁴⁹

Although the Cheques Act is significant for its recognition of the inconvenience and waste resulting from the changed use of the check, its importance is of a much wider scope. Its importance lies in the fact that it is a legislative consideration of a negotiable instrument that is not negotiated—an instrument that is totally unrecognized by

44. Federal reserve banks issue reserve bank credits and currency (Federal Reserve Notes) upon discount of "eligible" commercial paper or pledge of adequate collateral, in the form of notes, bills, etc., with a bank's note. The requirement that commercial obligations be discounted or pledged gives credit money automatic elasticity with the needs of business. Thomas, *Our Modern Banking and Monetary System* 281-90 (1942); Burgess, *op. cit. supra* note 41, at 43, 71-83; Kent, *op. cit. supra* note 31, at 110-14; Stokes, *op. cit. supra* note 16, at 387.

45. The most important characteristic of money is its general acceptability. Coulborn, *op. cit. supra* note 14, at 29; cf. Jevons, *op. cit. supra* note 15, at 78.

46. See Kent, *op. cit. supra* note 31, at 5; Stokes, *op. cit. supra* note 16, at 10.

47. The Cheque Endorsement Committee considered the indorsement on encashed checks especially necessary to evidence the recipient of cash should there be a dispute. Cheque Endorsement Committee, *First Report*, Cmd No. 3, § 63 (1956).

48. See note 8 *supra*.

49. See note 7 *supra*.

the Negotiable Instruments Law. It will be recalled that the negotiable instrument and its customs or rules were developed to satisfy the commercial need for a form of "money."⁵⁰ The atmosphere of the development certainly was most concerned with the quality of free negotiability, the quality that fulfilled the needs of the time. Likewise, the expectation of free negotiability is reflected in the codification of those rules;⁵¹ the provisions for presentment,⁵² protest,⁵³ notice of dishonor⁵⁴ and warranties of indorsers⁵⁵ all assume the instrument will be transferred or negotiated before collection. In articulating the definition of a negotiable instrument the codifiers of the law of negotiable instruments included what at that time was probably an insignificant number of instruments that were in fact not negotiated; although possibly their intent was to subject to the code only those instruments that were in fact negotiated.⁵⁶ If this is true, the Cheques Act, 1957, by taking the bank check out of the operation of a provision of the Bills of Exchange Act, 1882, has merely more effectively carried out that intent.

In view of the above discussion, it is submitted that the major significance of the Cheques Act, 1957, lies in its consideration of the relationship between the law of negotiable instruments and the negotiable instrument that is in fact not negotiated. It is a step in a needed reconsideration⁵⁷ of the entire law of negotiable instruments as applied to instruments not negotiated—a reconsideration that should have as its basic premise an underlying principle of commercial law, that the rule of law exists for the benefit of the commercial usage to which it relates.⁵⁸

50. See notes 9-17 *supra* and text supported thereby.

51. See Jones, *supra* note 29, at 184.

52. NIL §§ 70-88, 143-51, 186.

53. NIL §§ 152-60.

54. NIL §§ 89-118.

55. NIL §§ 64-66.

56. This analysis has been suggested as a possible rationale of decisions denying financiers the position of holders in due course. See Jones, *supra* note 29, at 185.

57. Accord, *id.* at 191-96.

58. For additional proposals from English writers for the elimination of inconvenience and expense in indorsements, see Holden, Suggested Reform of the Law Relating to Cheques, 14 *Modern L. Rev.* 33 (1951) (new non-negotiable mandate); The Crossed Cheque: Its Legal Effect, 19-20 *Ir. Jur.* 47 (1953-54) (indemnity agreements between banks). See also Getting Rid of Endorsements, 103 *The Banker* 269 (1954); A Further Proposal by Mr. Papworth, 103 *The Banker* 357 (1954); Report of the Committee on Cheque Endorsement, 20 *Modern L. Rev.* 161 (1957).

For additional comment on the Cheques Act, 1957, see Page, Indorsement of Cheques, 4 *Bus. L. Rev.* 87 (1957); The Cheques Act of 1957, 107 *L.J.* 550 (1957); Note, 71 *Harv. L. Rev.* 1374 (1958).