IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

A.224/83

BETWEEN NEW ZEALAND LAW SOCIETY a body constituted under the provisions of the Law Practitioners Act 1955 and having its office at Wellington

Plaintiff

A N D AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED a duly incorporated company having its registered office at Wellington and carrying on business there as Bankers

Defendant

Hearing 29, 30 August 1984

Counsel S C Ennor for plaintiff
W M Wilson and P R Castle for defendant

Judgment 21 September 1984

JUDGMENT OF DAVISON C.J.

This case raises for decision the liability to the true owner of a collecting bank which receives third party cheques marked "Not Negotiable A/C Payee Only" and credits them to a solicitor customer's trust account.

FACTS

Although the facts relating to this matter were substantially undisputed there were several areas of contest and I propose first to find the facts. They were these.

Mr Calkin was a solicitor practising in Palmerston North and operated his trust account through a branch of the defendant's bank at Rangitikei Street. The manager, Mr Campbell, believed Mr Calkin to be a person of integrity and entirely trustworthy. His trust account was never overdrawn - as, of course, it should not have been.

The Bank's Staff Instruction Manual in the section relating to "Cash and Telling" provided:

" If a cheque payable to the order of a third party is accepted for credit or collection on a customer's account the cheque must bear the endorsement of the payee.

If a cheque already bears a technically correct endorsement the duty of the Collecting Banker still applies to ensure that the true owner of the cheque is protected. "

" In order to ensure that adequate precautions are taken, each teller or part time teller is to keep a 'Third Party Cheque Refer Book'. Every cheque payable to a person other than the party for whom it is accepted, irrespective of whether it is an 'open' or 'crossed' cheque, is to be recorded in the book and each entry is to be initialled by the Manager or Accountant. Use Item 3512 - Memorandum Book - 8" x 5" - ruled to allow for the recording of the following information:

Date of cheque
Drawer
Drawee bank
Amount
Payee
Account to be credited
Brief details of enquiries
Reason for accepting cheque
Initials of Manager or Accountant. "

However, in the case of third party cheques lodged to the credit of solicitors' trust accounts, these were as a matter of practice exempted from the provisions of the Staff Instruction Manual relating to inquiring into the ownership of and recording of such cheques.

In December 1978 Broadlands Finance Ltd ("Broadlands") was approached by Mr Calkin, who was also a director of Tina Colliery Ltd and the solicitor for that company, to provide finance for the purchase of two second-hand trucks to transport coal from a mine operated by the company to a hospital in Palmerston North. The trucks were being purchased from Meyer Freightlines Ltd a company with which Mr Calkin was also involved. Two loans of $25,000 each were agreed to be made by Broadlands. The transactions were to be effected

by Broadlands acquiring ownership of the trucks and by Broadlands then selling the trucks to the company for $25,000 each on hire purchase terms. The hire purchase agreements were prepared by Mr McCarroll, the Palmerston North Branch Manager of Broadlands and given to Mr Calkin for completion. Mr Calkin later returned to Mr McCarroll the completed hire purchase agreements and produced registration certificates in respect of the two vehicles showing that their registration had been changed into the name of Tina Colliery Ltd on 21 December 1978.

[At this stage of the narrative there is a material conflict between certain of the evidence of events as given by Mr McCarroll at the hearing and the narration of events contained in a letter written by Broadlands' solicitor to the plaintiff on 24 January 1980 and also contained in the claim dated 10 March 1980 made by Broadlands against the plaintiff's Guarantee Fund. Having heard what Mr McCarroll said in evidence and given due consideration to it, I have resolved that conflict by accepting the statements as contained in the letter and in the claim. Such statements were made closer to the events to which they referred and resulted from discussions held personally by Mr McCarroll with Mr Grove, Broadlands' solicitor, for the purpose of making a claim against the Solicitors' Fidelity Guarantee Fund. I regard the evidence contained in the letter and in the claim as being more likely to be correct than the recollections of Mr McCarroll four and a half years further removed from the events in question.]

On that basis I find that prior to any money being paid over by Broadlands, Mr Calkin advised Mr McCarroll that the advances of $25,000 would be paid by him into his trust account and that through his trust account the trucks would be paid for so that they became the property of Broadlands and Tina Colliery Ltd for their respective rights and interests.

Mr McCarroll having received the completed hire purchase agreements then made out two cheques to "Tina Colliery Ltd" or order for $25,000 each and crossed them

"Not Negotiable A/C Payee Only". He then delivered the cheques to Mr Calkin because, as he said, he was a director of the company and he had made application for the advances.

Mr Calkin issued a trust account receipt for $50,000 to the credit of "Mid Island Transport Ltd" being "advance on two trucks". It will be noted that the advance was made by Broadlands not to Mid Island Transport Ltd but to Tina Colliery Ltd and further, the purchase of the trucks was being made from Meyer Freightlines Ltd not from Mid Island Transport Ltd. Be that as it may, the two cheques were then presented to the defendant for lodgment to the credit of Mr Calkin's trust account.

No inquiry was made by the bank as to Mr Calkin's right to the two cheques and they were credited to his trust account. The moneys never found their way to Tina Colliery Ltd.

It was subsequently discovered that Mr Calkin's dealings were fraudulent. The two trucks concerned were owned by Australian Guarantee Corporation which had sold them on hire purchase to Mid Island Transport Ltd which had not paid for them. Meyer Freightlines Ltd did not own the trucks and the registration certificates produced to Mr McCarroll showing Tina Colliery Ltd as the owner on 21 December 1978 were false. The guarantees endorsed on the hire purchase agreements were forgeries. Mr Calkin was personally interested in Tina Colliery Ltd., Mid Island Transport Ltd., and Meyer Freightlines Ltd.

The sum of $50,000 paid over by Broadlands was lost as a result of the theft by Mr Calkin within the meaning of s 89 of the Law Practitioners Act 1955 (now s 169 of the Law Practitioners Act 1982). Broadlands made a claim against the Solicitors' Fidelity Guarantee Fund and the claim was compromised by the plaintiff which took an assignment from Broadlands of all Broadlands rights against the defendant with respect to the two cheques made payable to Tina Colliery Ltd.

THE PROCEEDINGS

The plaintiff now claims against the defendant, alleging that the defendant converted the two Broadlands cheques by receiving the cheques and the moneys payable thereon other than to the credit of Tina Colliery Ltd.

The defendant denies that it converted the two cheques and pleads in the alternative that the cheques were received and collected in good faith and without negligence and that it is therefore entitled to the protection afforded by s 5 of the Cheques Act 1960.

DECISION

Let me first deal with two matters simply to dispose of them.

First It was acknowledged by counsel that no question of the good faith of the defendant as referred to in s 5 of the Cheque Act 1960 arises.

Second Counsel for the defendant accepted that the onus rested on him to establish that the defendant was not negligent in terms of s 5 of the Cheques Act 1960. This is clearly so. The defendant pleads the benefit of the statute - the onus is on it to prove it is entitled to it. Souchette Ltd v London County Westminster and Parr's Bank (1920) 36 TLR 395; Francis & Taylor Ltd v Commercial Bank of Australia Ltd [1932] NZLR 1028, 1032. See also: Marfani & Co Ltd v Midland Bank Ltd [1968] 2 All ER 573, 578.

I turn to consider the liability of the defendant apart from the statute and then to deal with the statutory defence.

COMMON LAW LIABILITY

At common law a banker who wrongfully interferes with cheques or other instruments contrary to the interests of the true owner is liable for conversion of these cheques or other instruments. As Diplock L.J. (as he then was) said

in Marfani & Co Ltd v Midland Bank Ltd (ante):

> " If the customer is not entitled to the cheque which he delivers to his banker for collection, the banker, however, innocent and careful he might have been, would at common law be liable to tbe true owner of the cheque for the amount of which he receives payment, either as damages for conversion or under the cognate cause of action, based historically on assumpsit, for money had and received. "

THE TRUE OWNER

> " The true owner of a cheque must be the party with an unassailable title to it whether in possession of it or not, for the reason that a cheque is a negotiable instrument. That party may not be the holder or last transferee; where forgery enters into the matter the true owner must be someone prior to the forgery, but if it is only a question of defective title, even though the transfer may have been affected by fraud, the transferee or holder may yet be the true owner. At the time the cheque is issued either the drawer or the payee is the true owner, the payee if he has not come by the cheque fraudulently and the drawer if the payee has been fraudulent. "
> See Paget's Law of Banking (9th ed) p 198.

The two cheques were obtained from Broadlands by fraud on the part of Mr Calkin acting in his capacity either as a director of Tina Colliery Ltd or as solicitor of Tina Colliery Ltd or both. Tina Colliery Ltd. the payee, did not therefore have a better title than Broadlands which had a prior unassailable title to the cheques and must be considered to have been the true owner.

The defendant received the two cheques of which Broadlands was the true owner and if, contrary to the interests of the true owner, it credited them, or rather the proceeds of them, to the trust account of Mr Calkin, it converted those cheques. The defendant, however, denies any such conversion but says that if there was a conversion that Broadlands suffered no loss.

NO CONVERSION?

On behalf of the defendant, Mr Wilson submitted that there was no conversion of the cheques because the defendant did not deal with them contrary to the interests of the true owner - Broadlands. It is, he said, implicit in the concept of conversion that an action taken with the consent of the true owner cannot constitute a conversion. If the defendant did convert the cheques then it did so at the point of time when it accepted the lodgment of them and collected the proceeds to the credit of the trust account of Mr Calkin. Accordingly, said Mr Wilson, whether or not there was a conversion depends on whether the cheques were so lodged to the trust account with the consent of Broadlands.

I have already found that Mr Calkin advised Mr McCarroll before the cheques were made out that the two advances of $25,000 each would be paid into his trust account. It is on that evidence that Mr Wilson relied for his submission that Broadlands consented to such course. But there are other factors to be considered. Mr McCarroll gave evidence that he made out the cheques to Tina Colliery Ltd and gave them to Mr Calkin because he was a director of that company and had made application for the advances. If he had intended the cheques to be paid into Mr Calkin's trust account, he said, he would have made them out " R.A.Calkin - on a/c Tina Colliery Ltd". In support of that contention, Mr McCarroll produced in evidence a cheque made out only a short time earlier to "R.A.Calkin a/c Meyer Freightlines Ltd".

That evidence coupled with the fact that Mr McCarroll, even in the face of Mr Calkin's statement that the advances would be paid by him into his trust account, made out the cheques simply to Tina Colliery Ltd. is sufficient to prevent me drawing the inference that Mr McCarroll on behalf of Broadlands consented to the two cheques being lodged to the credit of Mr Calkin's trust account. I do not find that he so consented. Whatever may have been Mr Calkin's intention, I am not satisfied that Mr McCarroll by his actions evidenced his concurrence with that course.

NO LOSS?

Next Mr Wilson submitted that even if the defendant did convert the two cheques, no loss resulted to Broadlands.

It is accepted that in conversion a claimant can only recover to the extent of its loss and such loss in the case of conversion of a cheque is usually the full value of that cheque: see Morison v London County and Westminster Bank Ltd [1914] 3 KB 356, 365.

Mr Wilson's argument that Broadlands suffered no loss resulting from the defendant's alleged conversion was based on two propositions:

First: that any loss suffered was as a consequence of how the funds were dealt with once they were within that trust account and not simply as a consequence of their being credited to that account. A cheque payable to Tina Colliery Ltd when placed in the trust account should have been received to the credit of Tina Colliery Ltd and to have been held in trust on its account. It was not, it was said, the alleged act of conversion by the defendant which created the loss but Mr Calkin' s misappropriation of the funds in his hands when he credited the cheques not to Tina Colliery Ltd but to Mid Island Transport Ltd.

Second: Broadlands position would have been exactly the same whether the cheques were lodged directly to Mr Calkin's trust account or were paid into Tina Colliery Ltd's account and cheques drawn on that company's account paid into Mr Calkin's trust account.

I am afraid I cannot agree with those arguments. The lodgment of the cheques to the credit of Mr Calkin's trust account provided the opportunity for Mr Calkin to dispose of the funds to his own benefit. One can not be satisfied that if the cheques had been lodged to the credit of Tina Colliery Ltd in its own account the same result would have occurred. The loss which Broadlands is claimed to have suffered arises from the fact that its two cheques found their way not to Tina Colliery Ltd from whom it could have claimed the funds but to Mr Calkin against whom any such claim was

fruitless because of his financial position. It is true that the cheques were handed to Mr Calkin by Mr McCarroll. But they were handed to him, as Mr McCarroll said, because he was a director of the company (Tina Colliery Ltd). Had the defendant not converted the cheques by crediting them to Mr Calkin's trust account and had instead dealt with them so that they were credited to the account of Tina Colliery Ltd then Broadlands would have been able to hold Tina Colliery Ltd liable for the amount of the funds received. By reason of the defendant's conversion, Broadlands has no claim against the company and has no ability to recover the moneys from Mr Calkin and has therefore suffered loss.

In so far as Mr Wilson suggested that the position would have been the same if the moneys were paid into Tina Colliery Ltd account and new cheques drawn on that account and paid into Mr Calkin's trust account, I disagree. If the funds had gone to Tina Colliery Ltd then, first, one does not know whether a cheque would have been drawn in favour of Mr Calkin's trust account. Such is pure speculation. Second, if the cheques had been paid to the credit of Tina Colliery Ltd account then Broadlands could have claimed against the company.

NEGLIGENCE

The substantial issue in this case is the plea by the defendant that it is entitled to the protection afforded by s 5 of the Cheques Act 1960.

Section 5(1) provides:

> " 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 any such instrument receives payment thereof for himself -
>
> and the customer has no title, or a defective title, to the instrument, the banker shall not incur any liability to the true owner of the instrument by reason only of having received payment thereof. "

The Bank's good faith is not in question - the issue is negligence.

What has been regarded as the classic test for determining negligence on the part of a bank was stated by Lord Dunedin in Taxation Commissioners v English, Scottish and Australian Bank Ltd [1920] A.C.683. The test is whether the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so out of the ordinary course that it might have aroused doubts in the bankers' mind and caused them to make inquiry.

That test was adopted in New Zealand by Kennedy J. in Francis & Taylor Ltd v Commercial Bank of Australia Ltd [1932] NZLR 1028, who said at p 1033:

> " The guidance given by the judgment just referred to helps to a determination of the question whether inquiry should be made, and it was admitted by counsel for the bank that, in this case, the bank was put upon inquiry. "

More recently in Marfani & Co Ltd v Midland Bank Ltd (ante) Diplock L.J. said at p 579:

> " Granted good faith in the banker (the other condition of the immunity) the usual matter with respect to which the banker must take reasonable care is to satisfy himself that his own customer's title to the cheque delivered to him for collection is not defective, i.e., that no other person is the true owner of it. Where the customer is in possession of the cheque at the time of delivery for collection, and appears on the face of it to be the 'holder', i.e., the payee or indorsee or the bearer, the banker is, in my view, entitled to assume that the customer is the owner of the cheque unless there are facts which are known, or ought to be known, to the banker which would cause a reasonable banker to suspect that the customer is not the true owner. "

And a little later:

> " What the court has to do is to look at all the circumstances at the time of the acts complained of, and to ask itself were

> those circumstances such as would cause a reasonable banker possessed of such information about his customer as a reasonable banker would possess, to suspect that his customer was not the true owner of the cheque. "

There are in the Reports numerous cases illustrating circumstances where a banker has been held to be negligent or a banker has been held to be not negligent but the issue to be determined is one of fact in each case.

Cases decided years ago in other countries do not necessarily provide useful guidance as to the duty of a careful banker in New Zealand at the present day or at the time of the events with which this case is concerned. As Diplock L.J. said in Marfani's case (p 579):

> " What facts ought to be known to the banker, i.e., what inquiries he should make, and what facts are sufficient to cause him reasonably to suspect that the customer is not the true owner, must depend on current banking practice, and change as that practice changes. Cases decided thirty years ago, when the use by the general public of banking facilities was much less widespread, may not be a reliable guide to what the duty of a careful banker, in relation to inquiries and as to facts which should give rise to suspicion, is today. "

Before considering the evidence in the present case it will be not unhelpful as background to look at the way in which Courts in previous cases have treated collection of "A/c Payee Only" cheques and how far failure to adhere strictly to internal Bank instructions has been regarded as evidence of a bank's negligence bearing in mind that the requirement of the statute that the bank should act "without negligence" means "without want of reasonable care in reference to the interests of the true owner" - Commercial Bank of Australia v Flannagan [1932] 47 C.L.R. 461, 467.

THE ACCOUNT PAYEE CHEQUE

The implication of an A/c Payee only cheque or the duty of a collecting banker are referred to in Paget's Law of Banking (9th ed) p 330 as follows:

> " As far as the collecting banker is concerned, disregard of the true owner's interests usually takes the form of ignoring (or perhaps not noticing) obvious indications that the customer for whom the banker is collecting may not be the true owner. It is not always easy to know who in certain circumstances the true owner may be. However, to ignore the signs is neither the easiest nor the wisest way out of any difficulty. Such signs, for instance, as the presence of 'a/c payee' on the cheque or the fact that the customer is paying into his personal account cheques by or in favour of his employers or principals should sound a warning."

In Universal Guarantee Pty Ltd v National Bank of Australasia Ltd [1965] 2 All ER 98, 102, Lord Upjohn said:

> " The words (A/c Payee only) merely operate as a warning to the collecting bank that if it pays the proceeds of the cheque to some other account it is put on inquiry and it may be in a difficulty in relying on any defence under s 88 of the Act in an action against it for conversion of the cheque. "

The use of the words "A/c Payee only" on a cheque presented for collection by a customer who is not the payee must raise in the mind of the collecting banker the title of the customer to that cheque. What inquiry the banker thereafter makes or does not make and how he deals with the cheque in the circumstances will be relevant when considering whether he has been negligent.

INTERNAL INSTRUCTIONS

The existence of Bank internal instructions is a factor - although not necessarily a decisive factor - to be taken into account in considering whether a Bank has been negligent.

In Savings Bank of South Australia v Wallman (1935) 52 CLR 688, 695, it was said:

> " The stringent rules which banks adopt for the guidance of their officers afford evidence of the kind of precaution which may be taken ... but it is unsafe and perhaps unfair to rely upon their rigour as a measure of the standard of prudence required by law. "

And in Motor Traders Corp. v Midland Bank [1937] 4 All ER 90 at p 94 Lord Goddard said:

> " The bank are not owing a duty as bankers to the plaintiffs except in so far as, under sect.82 of the Act, in order to escape a liability in conversion, they have to show that they have acted with due regard to the interests of the true owner of the cheque. But it is said, and said with great force, by Mr Willink, that, if he shows that the officers of the bank did not obey their own regulations, he goes a very long way to establishing a case of negligence. I think it cannot be taken always as a universal principle, because, if the facts showed that the bank cashier had taken every reasonable precaution to satisfy himself, and that he was satisfied with the information he had got, and that the conclusion which he had been able to draw from that information was such as would satisfy anyone that the bank might safely and properly take that cheque, I do not see how it can be said that, because he had not followed out to the letter the regulations of the bank, because he had not submitted it to the manager's attention directly, the bank would have been guilty of negligence. The bank could not have been guilty of negligence if their servant, whether the cashier or manager, had taken all reasonable precaution. "

THE FACTUAL SITUATION

Bearing in mind that the onus rests upon the defendant to establish that it acted without negligence, Mr Wilson submitted that the proper inferences to be drawn from the facts are that the Bank did so act without negligence so as to entitle it to the benefit of the protection afforded by s 5 of the Cheques Act 1960.

Mr Wilson submitted:

1. At the relevant time the Bank had no reason to doubt the integrity of Mr Calkin

On the evidence as I have already found there is no doubt that Mr Campbell, the Manager of the defendant bank at the material time, had no cause to regard Mr Calkin as otherwise than entirely trustworthy and a person of integrity. There was no reason for him to believe that as a solicitor Mr Calkin would deal in any way other than honestly and correctly with any cheque received by him. If a cheque to a third party payee was received into Mr Calkin's trust account, Mr Campbell would have had no cause to believe simply on the basis of that fact that it was made to a third party payee that Mr Calkin was not properly in possession of it and entitled to have it credited to his trust account.

2. Cheques lodged to solicitor's trust account

It was emphasized by Mr Wilson that the fact that the cheques were being credited to a solicitor's trust account was an important factor in the bank's case that it acted without negligence. It is in the very nature of such trust accounts he said that they operate as a receptacle for moneys belonging to other persons, and the moneys remain the property of such other persons even though credited to the trust account. Further, the trust accounts are subject to stringent audit in terms of the Solicitors Audit Regulations 1969.

3. Current bank practice re trust account

There was evidence given by Mr Campbell, who was at the time the manager of the defendant bank at Palmerston North, that it was quite general practice for third party cheques to be lodged to a solicitor's trust account. He was asked whether it was a matter of trusting solicitors or whether there was any individual appraisal of each before the practice applied. He replied that he believed there was an assessment of integrity and trustworthiness in each case.

Mr Boyt, the Senior Manager (Legal) at the Westpac Banking Corporation, also gave evidence. He said:

" The bank's requirements in re third party cheques is similar to ANZ. With respect to third party cheques made in professional people's trust accounts we would generally expect those people to deal in other people's money and unless we held or had notice of any impropriety or reasons to the contrary, those cheques would generally be accepted without referral to any higher authority.

Q. Is that the position in relation to A/c Payee Only cheques?

A. It would be.

Q. Would that be the position where both crossings appear on cheque?

A. It would.

Q. From your experience as branch manager are you able to say that it is common practice to adopt the practice you have just described in your own bank?

A. With respect to deposits to professional people's trust accounts, yes.

Q. From your experience in current position are you able to say that is common practice of Westpac?

A. I am.

Q. You talked of some impropriety or notice to the bank. What sort of impropriety do you have in mind?

A. In respect of solicitors trust accounts, inquiries by auditors of the trust accounts - obviously the Manager's observations in other dealings, and rumours that may suggest some need to look at certain transactions.

Q. Would you include in that cheques overdrawn?

A. Yes. "

Mr Grant, who until his retirement in 1980 was Central Regional Manager of the National Bank of New Zealand and who is currently Teaching Fellow in Banking Studies at Massey University and holder of other offices, gave evidence as follows:

" Q. In considering the position of ANZ Bank in this matter, of what if any significance is it in your opinion that the account in question was a solicitor's trust account?

A. Very significant. Several points here. First of all, the purpose of a solicitor's trust account is to handle moneys belonging to someone else. Secondly, these accounts are subject to solicitor's trust or regulations - whatever exact title. Thirdly, the receipts given by solicitors are printed by Law Society and bear its monogram. Fourthly, solicitors - the assumption about solicitors is that they are of integrity.

Q. In your experience is it usual or otherwise for third party cheques to be lodged to solicitor's trust account?

A. I cant quantify, but not unusual.

.....

Q. Did you hear Mr Campbell's evidence that in ANZ Bank in 1978 lodgments to solicitor's trust account were exempted from normal rule re third party cheques?

A. Yes.

Q. What was your reaction to hearing that evidence?

A. It didn't surprise me at all.

Q. Why was that?

A. I have seen transactions of that nature from 1940s to 1980.

Q. Is or is not the fact that payee of cheque lodged to solicitor's trust account - a payee other than the solicitor - is that of itself sufficient to require the bank to make further inquiry before accepting lodgment?

A. No, you would need something more than that - either something in that transaction or something previous which made you suspicious. "

4. Trust account operated normally - nothing suspicious in transaction

On the evidence there was nothing to indicate that Mr Calkin's trust account was operated other than properly.

There was nothing suspicious in the transaction. The two cheques were deposited along with others in the normal manner.

5. Bank's internal instructions

Although the Bank's internal instructions require that order cheques lodged to the credit of an account other than that of the payee indicated on the cheque require endorsement, and tellers should keep a "Third Party Cheque Refer Book" to record third party cheques and have each entry initialled by the Manager or Accountant, the failure to observe those instructions was due Mr Campbell said to the following circumstances:

> " Q. In your own participation of this practice did you ever consider the bank's duty to the drawer of the cheque?
>
> A. Yes, it is always paramount in one's mind instructions given by drawer of cheque, but when we are considering the cheque is to be deposited to an account of holder who is held in highest integrity, the practice has been - one's practice has been to exempt that particular client, in this case a solicitor trust account holder, from that requirement.
>
> .....
>
> Q. In exempting solicitors trust accounts from the Manual practice, was the extent of the practice taken into account or did it have any significance?
>
> A. I don't believe it was an overriding factor. It was the history and integrity assessed by the Manager at the time. "

Mr Wilson submitted that the failure to comply with the internal instructions was not, having regard to the practice of banks in relation to third party cheques lodged to solicitors trust accounts, evidence of negligence on the part of the defendant Bank.

Mr Ennor, whilst commenting (quite properly) that it was not for him to prove negligence, submitted that there were circumstances in this case from which evidence should be inferred and that the defendant Bank had not satisfied the onus resting upon it. He pointed out -

1. Calkin's name not on cheque

The cheque was made out to Tina Colliery Ltd and was endorsed "Not negotiable A/c payee only".

2. Bank took risk

In so far as the Bank assumed that Mr Calkin was entitled to bank the cheque into his trust account, it took a risk. The taking of such risk was a breach of duty to the drawer, the true owner.

3. What more could the drawer do?

Broadlands had done all it could to ensure that its cheques reached the intended payee Tina Colliery Ltd. What more could it have done? The Bank simply ignored the Broadlands instruction and did so at its peril.

4. Drawing of cheque

The cheque was not drawn in such a way as to indicate that it was to be paid into a solicitor's trust account.

CONCLUSION

In my judgment the success or otherwise of the Bank's plea that it acted without negligence depends almost entirely upon the view I take of the payment being made to the credit of a solicitor's trust account. If payment had been made to an account other than a solicitor's trust account then the Bank would have received a "Not negotiable A/c payee" cheque which should have put it on inquiry and in accordance with its internal instructions should have required entry in the"Third Party Cheque Refer Book" and

initialling by the Manager or Accountant. There was no evidence of any such inquiry, entry or initialling.

But the failure to make inquiry and to follow internal instructions was said to be because of a practice existing not only in the Bank but amongst Bankers in New Zealand generally that third party cheques were credited to solicitors' trust accounts as of course where no circumstances existed such as to cause bankers to have any disquiet about the integrity of the solicitors concerned.

Whether such a practice existed in New Zealand at the relevant time is a matter for the defendant to establish. The fact that such practice may not have existed in overseas countries or in an earlier age is not strictly material to the present case. It would no doubt be helpful to the defendant to be able to establish a more general practice of bankers, including bankers outside New Zealand, but there is no evidence before me to support it.

The standard to be sought is as Lord Dunedin said in Taxation Comrs v English, Scottish and Australian Bank Ltd (ante) at p 689 "the ordinary practice of bankers". Are they put upon inquiry by lodgment to a solicitor customer's trust account of a third party cheque or do they accept it in the case of a solicitor of integrity as a matter of course?

The evidence presented at the hearing was given by representatives of three of the four main trading banks in New Zealand - the ANZ Banking Corporation, Westpac Banking Corporation and the National Bank of New Zealand Limited. Evidence was not called for the Bank of New Zealand Limited because it was said that it was banker of the New Zealand Law Society. I am satisfied on the evidence that a practice as contended for by the defendant did at the relevant time exist in New Zealand. But that is not the end of the matter. Whilst the fact that a banker acted in accordance with a recognised practice may go a long way to establishing that the banker acted without negligence, it is not conclusive of that fact.

This was clearly demonstrated in Edward Wong Ltd v Johnson, Stokes & Master [1984] 1 A.C. 296, where the point in issue was whether a solicitor in Hong Kong who followed an established local conveyancing practice of paying over settlement moneys before receiving documents of title thus providing the opportunity for the vendor's solicitor to abscond with the purchase money, was negligent in so doing. The Privy Council held that in the circumstances he was. Lord Brightman delivering the opinion of the Council at p 306 said:

> " As already indicated, the prevalence of the Hong Kong style of completion is established beyond a peradventure. It is peculiarly well adapted to the conditions in Hong Kong. It has obvious advantages to both solicitors and their clients. Their Lordships intend to say nothing to discourage its continuance. However, in assessing whether the respondents fell short of the standard of care which they owed towards the appellants, three questions must be considered; first, does the practice, as operated by the respondents in the instant case, involve a foreseeable risk? If so, could that risk have been avoided? If so, were the respondents negligent in failing to take avoiding action?
>
> In the opinion of their Lordships, the risk of loss to the appellants by placing the money at the disposition of the vendors' solicitors unquestionably involved a foreseeable risk, the risk of an embezzlement by the recipient. Such a risk is usually remote, but is none the less foreseeable. "

What was the risk that the defendant took in the present case by collecting third party cheques to the credit of Mr Calkin's trust account? It was the risk that Mr Calkin would embezzle them. Was that a foreseeable risk?

Embezzlement by a solicitor was found to be a foreseeable risk in the Hong Kong case and the solicitor following the established conveyancing practice was negligent. The reasons why it was held to be so were primarily -

First The risk was foreseen by the profession itself which had appointed a sub-committee of the Law Society to consider whether changes should be made to the conveyancing practice. Certain suggestions which might give greater protection were made by that sub-committee.

Second The practice depended solely upon trust between solicitors.

Third The risk was one which could have been avoided.

The question must now be asked in relation to Mr Campbell, the defendant's manager: should he in the circumstances have foreseen the risk that Mr Calkin would embezzle the two cheques and was he negligent in collecting the two third party cheques to the credit of Mr Calkin's trust account?

The duty owed by Mr Campbell in collecting the cheques for his customer Mr Calkin was to the true owner of the cheques, Broadlands, not to convert its cheques. In considering whether Mr Campbell was in breach of that duty one should bear in mind what was said by Diplock L.J. in Marfani's case at p 580:

> " In all actions of the kind with which we are here concerned, the banker's customer has in fact turned out to be a fraudulent rogue, and attention is naturally concentrated on the duty of care which was owed by the banker to the person who has in fact turned out to be the true owner of the cheque. We are always able to be wise after the event, but the banker's duty fell to be performed before it, and the duty which he owed to the true owner ought not to be considered in isolation. At the relevant time the banker was entitled to take into consideration the interests of his customer who, be it remembered, would in all probability turn out to be honest, as most men are, and his own business interests, and to weigh these against the risk of loss or damage to the true owner of the cheque in the unlikely event that he should turn out not to be the customer himself. "

In the present case in deciding whether or not there was a foreseeable risk which could have resulted in a breach of duty on the part of Mr Campbell and the Bank, it is relevant to take into account:

1. The general practice of bankers in New Zealand to accept third party cheques for payment to solicitors' trust accounts.

2. The fact that payments to a solicitor's trust account should have been received by the solicitor to the credit of the person entitled - in this case Tina Colliery Ltd the payee of the cheques.

3. The fact that upon credit of payments into the trust account the moneys thereafter are held on behalf of the person entitled to be disposed of by the direction or on the instruction of such person.

4. That solicitors' trust accounts are strictly controlled and subject to the stringent audit requirements of the Solicitors' Audit Regulations 1969.

5. In considering the likelihood of loss - the existence of the Solicitors' Fidelity Guarantee Fund.

6. Mr Campbell's belief at the time of the personal integrity and honesty of Mr Calkin.

7. Mr Campbell's knowledge that Mr Calkin apart from being a solicitor was also a director of Tina Colliery Ltd.

Any payment of moneys to a solicitor's trust account may be said to present the possibility of embezzlement by the solicitor but the risk of any such embezzlement following the action of the defendant Bank in the present case was no greater than that faced by any person paying moneys into a solicitor's trust account.

If it is suggested that the risk could have been avoided then it appears to me that the only way in which it might be suggested that that could have been done was by the Bank inquiring of the payee Tina Colliery Ltd. or the drawer Broadlands whether it was in order for the cheques made out to it to be credited to Mr Calkin's trust account. If inquiries had been so made, who would they have been made to? Most likely to Mr Calkin himself as he was known by Mr Campbell to be a director. If to another officer of Tina Colliery Ltd. then would such an officer have disagreed with the actions of one of its directors who was also its solicitor and who had been directly involved in arranging the finance for Tina Colliery Ltd from Broadlands? The answer must surely be No.

So that even if Mr Campbell had made the further inquiries suggested above of Tina Colliery Ltd. would not the cheques still have been credited to Mr Calkin's trust account? If inquiry had been made of Broadlands and it had confirmed that Tina Colliery had legal title to the cheques, would Mr Campbell as a prudent banker have refused to allow Mr Calkin, a director of Tina Colliery Ltd. to pay the cheques into his solicitor's trust account knowing he was also the solicitor for Tina Colliery Limited? The answer again must be No.

The reason why Banks are usually required to make inquiries concerning the banking of third party cheques is to satisfy themselves that the persons depositing those cheques for collection have legal title to them because on the face of the matter such persons are lodging the property of others.

In my judgment the crediting of the two cheques to the trust account of Mr Calkin without making inquiry of Tina Colliery Ltd was not, in the circumstances of this case, taking a risk which should have been foreseen by a prudent banker - a risk that Mr Calkin was in possession of cheques to which Tina Colliery had title - without that company's authority. Mr Campbell had no reason to doubt

the honesty of Mr Calkin and where Mr Calkin was also a director of the payee of the cheque it would in my view be carrying the Bank's obligation too far to suggest that Mr Campbell should have made further inquiries. As matters transpired, the lodgment was dealt with by the teller in accordance with the Bank's usual practice in relation to solicitors' trust accounts, including Mr Calkin's, but even if the matter had been referred to Mr Campbell he would have approved the collection of the cheques without further inquiry. I adopt in this respect what was said by Diplock L.J. in Marfani's case at p 582 with the modifications necessary to apply to the present case:

> " It does not constitute any lack of reasonable care to refrain from making inquiries which it is improbable will lead to detection of the potential customer's dishonest purpose, if he is dishonest, and which are calculated to offend him and maybe drive away his custom if he is honest. "

I would say in the present case that it did not constitute lack of reasonable care to refrain from making inquiries in circumstances where it was improbable that they would have led to detection of Mr Calkin's dishonest purpose. There was no evidence of his dishonesty at that stage.

In the result, I am satisfied that the defendant has discharged the obligation resting upon it and has proved that it acted in the circumstances of this case without negligence. It is thus entitled to the benefit of s 5 of the Cheques Act 1960 and to be held to have incurred no liability to the true owner of the cheques - Broadbank. The plaintiff by its assignment has no greater rights to claim against the Bank than Broadbank had and its action must be dismissed. Costs reserved.

Solicitors for the plaintiff — Glaister Ennor & Kiff (Auckland)

Solicitors for the defendant — Bell Gully Buddle Weir (Wellington and Auckland)