[HIGH COURT OF AUSTRALIA.]

COMMERCIAL BANK OF AUSTRALIA LIMITED APPELLANT;
DEFENDANT,

AND

FLANNAGAN . . . . . RESPONDENT.
PLAINTIFF,

ON APPEAL FROM THE SUPREME COURT OF SOUTH AUSTRALIA.

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MELBOURNE, *Oct.* 7, 10, 11; *Nov.* 14.

Gavan Duffy C.J., Starke and Dixon JJ.

Banker and Customer—Collection and payment of cheque—Liability of banker for conversion—Whether payment of cheque received without negligence—Agent of drawer paying cheque into his own account—Bills of Exchange Act 1909 (*No.* 27 *of* 1909), *sec.* 88.

The respondent drew a cheque upon his banker in the form "Pay State tax or bearer." It was crossed generally and marked "not negotiable" The cheque was given to an agent of the drawer to pay the latter's income tax. The agent paid the cheque into his own account, though he had no authority so to do, and fraudulently disposed of the proceeds. The officer of the Bank who received the cheque for collection made an inquiry of the agent as to why he was paying the cheque into his own account and received the answer "Because it includes my fees for work done." He accepted this explanation without reference to the drawer. In an action by the drawer against the Bank for conversion of the cheque and the proceeds thereof,

Held, that the Bank had not discharged the onus of proof which rested upon it to show that in collecting the cheque it acted without negligence, and consequently that the Bank was not entitled to the protection afforded by sec. 88 of the *Bills of Exchange Act* 1909.

Decision of the Supreme Court of South Australia (Full Court): *Commercial Bank of Australia Ltd.* v. *Flannagan*, (1932) S.A.S.R. 82, affirmed.

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APPEAL from the Supreme Court of South Australia.

The plaintiff, Patrick Joseph Flannagan, sued the defendant, the Commercial Bank of Australia Ltd., for the conversion of a cheque drawn by the plaintiff for £435 9s. 9d., and, alternatively, claimed payment of such sum as money received by the defendant for the use of the plaintiff. The cheque was drawn by Flannagan upon the defendant in the following form: "Pay State tax or bearer the sum of four hundred and thirty-five pounds nine shillings and ninepence," and was crossed generally and marked "not negotiable." The cheque was forwarded to one Coffey, a taxation expert, who was acting on behalf of the plaintiff in the preparation and settlement of his income tax returns. The cheque was given to Coffey to pay the plaintiff's income tax, and he had no authority to pay it into his own account. Coffey, however, who was and had for some time been a customer of the defendant Bank, paid the cheque into his account current with that Bank, and the Bank collected or received payment of the amount of the cheque on Coffey's behalf and credited him in his account current with the amount so received. Coffey, in fact, fraudulently misappropriated the cheque and its proceeds. The plaintiff thereupon brought this action against the Bank in the Local Court of Adelaide seeking to make the Bank liable for the amount of the cheque so collected by it. The defendant relied substantially upon sec. 88 of the *Bills of Exchange Act* 1909, which provides:—"(1) When a banker in good faith and without negligence receives payment for a customer of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment. (2) A banker receives payment of a crossed cheque for a customer within the meaning of this section, notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof." Coffey was an old customer of the Bank and was believed by both parties to be a man of good character. The bank teller who received the cheque from Coffey said to him: "Why are you paying this cheque into your account? It is not payable to you." Coffey replied: "It is the only way to clear the cheque, because it has included my fees for work done." The teller

thereupon accepted the cheque. In fact the attorney of the owner of the cheque was in Adelaide and could have been communicated with by telephone, and there was time to make such inquiry before the cheque was collected. It also appeared that on many previous occasions Coffey had paid cheques drawn by clients for their taxes into his own account, and his actions had either been approved of by the clients on inquiry from them, or had not been questioned. A regulation of the Bank provided as follows:—"Managers are . . . instructed that where any crossed cheque or cheque marked 'not negotiable' bears on its face an indication of the purpose to which the drawer intended to apply it, it should not be credited to an account other than the account so indicated without inquiries as to the reason for it coming into other hands. Similarly, a 'not negotiable' cheque payable to other than the person depositing it should, as a rule, not be received if there is anything on the face of the cheque, or in connection with the circumstances of the case, which would suggest that the person lodging it has not a good title to it. This rule may, however, be relaxed in the case of clients of good character and repute." The plaintiff obtained judgment in his favour in the Local Court of Adelaide, and the defendant appealed to the Supreme Court of South Australia—*Murray* C.J. and *Richards* J. (*Piper* J. dissenting)—which upheld the decision of the Local Court. on the ground that the Bank had not established that it was free from negligence: *Commercial Bank of Australia Ltd.* v. *Flannagan* (1).

From that decision the Bank now appealed to the High Court.

Thomson K.C. (with him *S. H. Lewis*), for the appellant. The appellant is protected by sec. 88 of the *Bills of Exchange Act* 1909. There was no negligence on the part of the Bank in receiving and collecting the proceeds of this cheque, and the Bank acted in a reasonably prudent manner (*Commissioners of the State Savings Bank of Victoria* v. *Permewan, Wright & Co.* (2); *London Bank of Australia Ltd.* v. *Kendall* (3)). There was no duty imposed by law on the Bank to make any inquiry, but the bank official made an

(1) (1932) S.A.S.R. 87.
(2) (1914) 19 C.L.R. 457, at p. 483.
(3) (1920) 28 C.L.R. 401, at p. 414.

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inquiry on receiving the cheque because it was within the rule of the Bank that, where some purpose was indicated on the face of the cheque, the officer receiving it is required to make some inquiry. Coffey was a taxation expert and was so closely associated with the transaction that it was not unreasonable to pay the cheque into his account. Regard must be had to the course of business and the necessary subdivision of labour in the Bank. The words "Pay State tax" differ from "Pay Commissioner of Taxation." It was reasonable for the Bank to assume that Coffey, being a taxation expert, would pay the money into his own account and then pay it to the Commissioner of Taxation. The only other precaution which the Bank could have taken was to ring up the plaintiff or his attorney. The Court should have regard to the usual banking practice (*Commissioners of the State Savings Bank of Victoria* v. *Permewan, Wright & Co.* (1); *Commissioners of Taxation* v. *English, Scottish and Australian Bank* (2); *A. L. Underwood Ltd.* v. *Bank of Liverpool* (3); *Morison* v. *London County and Westminster Bank Ltd.* (4); *Lloyds Bank* v. *Chartered Bank of India, Australia and China* (5); *E. B. Savory & Co.* v. *Lloyds Bank* (6); *Midland Bank Ltd.* v. *Reckitt* (7); *Gippsland and Northern Co-operative Co.* v. *English, Scottish and Australian Bank Ltd.* (8)). *Permewan, Wright & Co.'s Case* (9) is distinguishable from the present case, as in that case the indorsements were equivalent to a direction to pay a named payee. The Bank could not have communicated with the plaintiff without the risk of casting some reflection upon Coffey's financial stability. [Counsel also referred to *Paget's Law of Banking*, 4th ed., pp. 256-258. and *Lloyds Bank* v. *Chartered Bank of India, Australia and China* (10).]

[STARKE J. referred to *Crumplin* v. *London Joint Stock Bank* (11).]

There must be something which shows that the transaction is markedly irregular. The appellant has to show that it was reasonably careful in arriving at the conclusion that the person paying

(1) (1914) 19 C.L.R., at pp. 478, 482, 483.
(2) (1920) A.C. 683, at pp. 688, 689.
(3) (1924) 1 K.B. 775.
(4) (1914) 3 K.B. 356, at pp. 368, 373.
(5) (1929) 1 K.B. 40.
(6) (1932) 2 K.B. 122.
(7) (1932) 48 T.L.R. 271.
(8) (1922) V.L.R. 670; 44 A.L.T. 34.
(9) (1914) 19 C.L.R. 457.
(10) (1929) 1 K.B., at pp. 56, 59, 60, 70, 72.
(11) (1913) 30 T.L.R. 99.

in the cheque had authority to pay it into the Bank. The question is: was it a reasonable belief on the facts that were known ? (See *Gippsland and Northern Co-operative Co.* v. *English, Scottish and Australian Bank* (1); *E. B. Savory & Co.* v. *Lloyds Bank* (2).)

[STARKE J. referred to *London and Montrose Shipbuilding and Repairing Co.* v. *Barclays Bank Ltd.* (3).]

If the appellant shows that according to ordinary banking practice the Bank was not negligent, that is sufficient to discharge the onus of proof. The indorsement on the cheque in question indicates that the payee is to get the cheque cashed and pay the taxes with the proceeds, but an indorsement such as "Pay taxes only" would restrict the subject matter.

Ligertwood K.C. (with him *Wright*), for the respondent. The question is whether the Bank did all that a reasonable banker should do to protect the owner of the cheque. Several cheques of other persons having reference to tax were paid into this account without any evidence of misappropriation, but as there was no connection of these cheques with the respondent they were inadmissible and, for aught that appeared, they may have been improperly paid in. The practice of paying tax to the Department by one cheque covering numerous assessments was an irregularity which should have awakened the Bank. The circumstances pointed to the reasonable possibility of the cheque being used in breach of the drawer's mandate. The appellant's instructions to its officers indicate the irregularity of accepting cheques such as the present without inquiry. The disclosure of the purpose for which the cheque is given is sufficient warning according to *Permewan, Wright & Co.'s Case* (4), and *Commissioners of Taxation* v. *English, Scottish and Australian Bank* (5). The appellant was negligent in not referring the matter to the drawer to ascertain whether Coffey had or had not authority to pay the cheque into his own account. There was no serious exercise of judgment on the appellant's part in making inquiries. On its face this cheque belonged to the

(1) (1922) V.L.R., 670; 44 A.L.T. 34.
(2) (1932) 2 K.B. 122.
(3) (1925) 31 Com. Cas. 67, at pp. 72, 73.
(4) (1914) 19 C.L.R. 457.
(5) (1920) A.C. 683.

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respondent and not to Coffey and this fact put the Bank upon its inquiry. The only way that the Bank could escape liability where a cheque such as this is presented by an agent of the owner is for it to have made full inquiries. The crossing "not negotiable" is a circumstance to be taken into consideration. [Counsel also referred to *Slingsby* v. *District Bank Ltd.* (1); *Lloyds Bank* v. *Chartered Bank of India, Australia and China* (2); *Mason* v. *Savings Bank of South Australia* (3); *Commissioners of Taxation* v. *English, Scottish and Australian Bank* (4).]

Thomson K.C., in reply. In all the circumstances of the case the Bank had not been negligent. If the Bank lives up to the standard of a prudent banker the statute gives it protection.

Cur. adv. vult.

NOV. 14. The following written judgments were delivered :—

GAVAN DUFFY C.J. AND STARKE J. A cheque was drawn by one Flannagan upon his banker in the following form : "Pay State tax or bearer the sum of four hundred and thirty-five pounds nine shillings and ninepence," and it was crossed generally and marked not negotiable. The cheque was forwarded to one Coffey, who was acting on behalf of Flannagan in the preparation and settlement of his income tax returns. The cheque was given to Coffey to pay Flannagan's income tax, and he had no authority to pay it into his own account. Coffey, however, who was and had for some time been a customer of the Commercial Bank of Australia Ltd., paid the cheque into his account current with that Bank, and the Bank collected or received payment of the amount of the cheque on Coffey's behalf, and credited him with the amount so received in his account current. Coffey, in truth, fraudulently misappropriated the cheque and its proceeds. The present respondent, Flannagan, brought an action in the Local Court of Adelaide seeking to make the Bank liable for the amount of the cheque so collected by it. He obtained a decision in his favour,

(1) (1932) 1 K.B. 544, at p. 556.
(2) (1929) 1 K.B., at pp. 60, 78, 79.
(3) (1925) S.A.S.R 198.
(4) (1920) A.C., at p. 688.

and the Bank appealed, without success, to the Supreme Court of South Australia. It now appeals to this Court.

The Bank relies upon the provisions of sec. 88 of the *Bills of Exchange Act* 1909: "Where a banker in good faith and without negligence receives payment for a customer of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment." The section has been the subject of many decisions. But it is not disputed, in the present case, that the Bank, in collecting the cheque for its customer, acted in good faith, and the only question for our consideration is: Did the Bank act without negligence? It is for the Bank to establish affirmatively that it did so act. The words "without negligence" do not mean without a breach of duty on the part of the Bank towards itself or towards the person who is its customer. The phrase means "without want of reasonable care in reference to the interests of the true owner" (*E. B. Savory & Co.* v. *Lloyds Bank* (1); *Commissioners of Taxation* v. *English, Scottish and Australian Bank* (2); *London and Montrose &c. Co.* v. *Barclays Bank Ltd.* (3)). Whether a banker in any given case has acted without negligence "is necessarily a question of fact . . . . It is . . . impossible to lay down rules or statements which will determine what is negligence and what is not. Each case must be determined on its own circumstances" (*Commissioners of Taxation* v. *English, Scottish and Australian Bank* (4)). "If there is in the appearance and details of the cheque, the nature of the persons dealing with it . . . anything unusual or suspicious, and suggesting the necessity for inquiry" in the interests of the true owner, then it is for the Bank to exercise due care for the protection of those interests (*London and Montrose &c. Co.* v. *Barclays Bank Ltd.* (5)).

In the present case, the cheque is drawn "Pay State tax or bearer." It is for a fairly large amount, and indicates on its face that it was drawn for the purpose of paying State tax. It is not in accordance with the ordinary course of business that a cheque so

(1) (1932) 2 K.B., at p. 130.
(2) (1920) A.C. 683.
(3) (1925) 31 Com. Cas. 67.
(4) (1920) A.C., at pp. 688, 689.
(5) (1925) 31 Com. Cas., at p. 73.

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drawn should be in the hands of, and used for the purposes of, a private individual. When Coffey paid this cheque into his own account at the Bank, the receiving officer noted that it was marked not negotiable and was made out to State tax, and rightly understood it to be for State income tax. A general instruction had been issued to officers of the Bank that where any crossed cheque, or cheque marked not negotiable, bore on its face an indication of the purpose to which the drawer intended to apply it, then the cheque should not be credited to an account other than the account so indicated, without inquiries as to the reason for its coming into other hands. Similarly, a "not negotiable" cheque payable to other than the person depositing it should not, as a rule, be received if there were anything on the cheque or in connection with the circumstances of the case which would suggest that the person lodging it had not a good title to it. But the instruction might be relaxed in the case of clients of good character and repute. As a matter of prudence, and of obedience no doubt to his general instructions, the receiving officer promptly challenged the cheque. He said to Coffey: "Why are you paying this cheque into your account? It is not payable to you." Coffey replied: "It is the only way to clear the cheque, because it includes my fees for work done." Coffey's statement that he was paying into his own private account a cheque drawn for a sum of money intended, in great part, to pay income tax due to the State, cannot be regarded as disclosing a transaction in the ordinary course of business; though a similar cheque had been collected by the Bank for Coffey after an identical explanation some months previously, and no complaint had come from the drawer. The statement, moreover, was not true. The receiving officer took the cheque on the faith of Coffey's statement, without making any further inquiry, and the Bank collected it on Coffey's account.

Both the Special Magistrate and the majority of the learned Judges of the Supreme Court thought the Bank lacking in care and caution in these circumstances; and we agree with them. The risk was apparent. Experience has shown that there is a grave risk of misappropriation if managers, agents or servants pay other people's money into their own private accounts. But the Bank, through its officers, took the risk. It accepted Coffey's statement, and assumed

his authority to pay the cheque into his account without the slightest inquiry, though he was the person against whom the true owner required protection. If it were too delicate a matter to make inquiries from the drawer of the cheque, the Bank might have declined the responsibility of collecting it unless Coffey produced some satisfactory authority or consent from the drawer to the cheque passing into his private account, or it might have procured an alteration of the cheque, as was insisted upon by another Bank on another occasion. The Bank has not affirmatively established that it acted without negligence in the circumstances of the case, and the appeal should, therefore, be dismissed.

DIXON J. I agree. The explanation which Coffey gave to the teller in answer to the question why, although the cheque was not payable to him, he was paying it into his own account, disclosed that the greater part at least of the proceeds of the cheque should be applied in discharging his client's liability to the Commissioner of Taxation of South Australia. The form in which the cheque was drawn was consistent with the hypothesis that it was a reimbursement to him of State tax which he had paid out of his own moneys on behalf of his client. The explanation excluded this hypothesis and made it clear that the words "State tax" after the word "Pay" had been written in reference to an undischarged liability to the Commissioner. In these circumstances Coffey's title to obtain payment of the cheque rested entirely upon the correctness of his assertion that his fees were included in the amount for which it was drawn. If this statement was wrong, it was almost certain that the property in the cheque remained in the drawer. Thus the identity was clearly established of the possible true owner for the protection of whose interests the Bank was bound to take reasonable care. The nature of the danger, whether great or small, to which his interests were exposed was not in doubt. The question, one of fact, is whether the failure to take further precautions, by inquiry or otherwise, for the protection of the drawer amounted in these circumstances to a want of proper care for the interests of a possible true owner. The fate of those interests was allowed to depend entirely upon the honesty and veracity of the Bank's customer.

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But, although he was in fact thoroughly dishonest, he was at that time unsuspected. Why, it is asked, should not the Bank content itself with an unqualified acceptance of his explanation? He was an old customer, well enough regarded. There was nothing inherently absurd in his statement. His occupation was that of a taxpayer's representative. He drew many cheques upon his account, which although payable to a number, bore upon them when presented for payment unmistakable evidence that they had been given in payment of taxes. Did not this show that it was his practice to pay his clients' taxes with his cheque, placing their cheques to his own credit? More than two months before, he had paid in a crossed cheque marked "not negotiable" drawn by the plaintiff's attorney "Pay tax Federal or Bearer." He had given the same explanation why he did so and no complaint had since been made in respect of the transaction. Cheques of other drawers, more or less in the same form, had been paid in and as yet no trouble had arisen. His account was active and suggested a substantial business. Did not all these circumstances justify a reliance upon the account of the cheque given by Coffey? Such a view of the situation is open to the criticism that it supposes a close acquaintance with the dealings of Coffey, but not too close. For a close watch of the operations upon his account would have suggested reason to doubt the honesty of his dealings in respect of taxation moneys. But, in any case, these contentions are answered by the character of the danger which care must be taken to avert and by the nature of the banking transaction itself. In the first place, the circumstances made it evident that if Coffey were a dishonest agent he might, by means of the Bank, act in fraud of his principal if it collected the cheque. In the second place, it cannot be in the ordinary course of business for a cheque, so drawn and marked as that in question, to include the fees of a taxation agent. To rely exclusively upon the agent's own explanation of his use of such a cheque is to encounter the risk, not to exercise care to avoid it.

Appeal dismissed with costs.

Solicitors for the appellant, *Varley, Evan, Thomson & Buttrose.*

Solicitors for the respondent, *Baker, McEwin, Ligertwood & Millhouse.*

H. D. W.