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TYREE, A.L. Electronic funds transfer in N.Z.



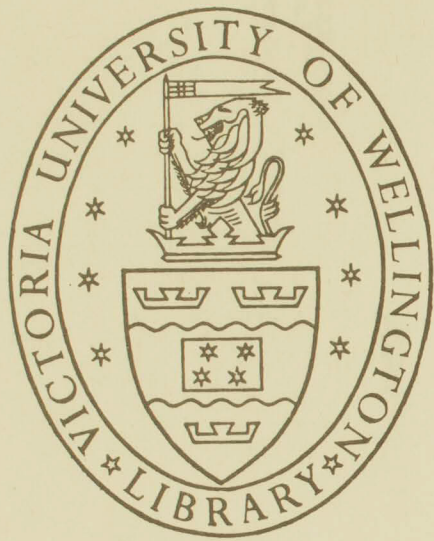


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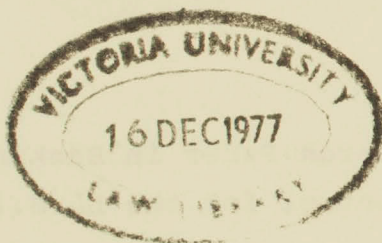
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1. For an interesting popular discussion, see Hendrickson, "The Cashless Society," New York, 1973.

Part I : Introduction

A Introduction

The expression "Electronic Funds Transfer Systems" (EFTS) relates to a variety of bookkeeping and paper handling operations which have been more or less automated using large scale digital computers. The phenomenal growth in popularity of the cheque as a means of effecting payment has been made possible by, and in turn has been the cause of, the automation of the cheque handling process. As this automation has progressed, it has become clear that the costs of handling the paper involved in the cheque system are both large and avoidable. Schemes have been devised which would theoretically allow the replacement of all paper by electrical impulses and magnetic records.

Whether this "cashless society" is desirable or not is an interesting question, ¹ but not one which will be discussed in this paper. The concern here is a narrower one; cheques are a class of bills of exchange and the law of such bills has been worked out by the courts, the legis-
^{use?}lation, and commercial practice over a period of several centuries. To what extent is this developed body of law applicable to the new forms of payment? When may such law be applied to resolve problems of EFTS and where does such application assist or inhibit the development of such systems?

1. For an interesting popular discussion, see Hendrickson, *The Cashless Society*, New York, 1972.

B EFTS in New Zealand

New Zealand is, perhaps surprisingly, one of the early leaders in the development of EFTS. ² The Bank of New Zealand commenced electronic data processing operations in 1966 in the two main North Island centres. The National Bank followed soon afterward and, following joint discussions, it was decided to use joint computer facilities. In late 1967, discussions were held with the other three trading banks on the feasibility of all banks using joint facilities. The outcome was that by November of 1969 every branch of the five banks had been converted to computer processing at central facilities.

A company was incorporated under the Companies Act 1955. This company, Databank Systems Ltd, has share capital owned by the five trading banks in approximate proportion to the size of the banks. Databank functions essentially as a clearing house and bookkeeper for the banks. There is an exemption clause in the agreement between Databank and each of the trading banks which specifically exempts Databank from any liability for failure to provide any of the services under the agreement.

The New Zealand scheme thus preceded the much heralded California Automated Clearing House by a full three years. ³ There are several reasons for this. One, and the most obvious,

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2. The historical material is derived from Databank Systems Ltd publications.
 3. For an account of the structure of the California Automated Clearing House Association, see Homrighausen, "One Large step towards Less-Check The California Automated Clearing House System", 28 Bus Law 1143.

is that there are only five banks in New Zealand. These banks serve a population of only three million, which would have made the cost of "going it alone" prohibitive. In addition to the high costs of computerisation, there is the further very important factor that this high cost is almost entirely in foreign exchange. In a country where the balance of payments is a problem never far from the public mind, this provided a powerful incentive to avoid unnecessary duplication. In addition, there was considerable pressure on the cheque clearing system. New Zealanders are among the most prolific cheque issuers in the world : in 1972 they wrote over 70 cheques per capita and the number of cheques was growing at the rate of ten percent per year.

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the computer to order certain types of transactions. This has led to a large measure of consumer resistance in some areas. Studies have shown that bank customers have rejected some services in favour of retaining cheques, even though the new services require less time than writing a cheque and even though the transaction is effected more cheaply by the new system than by means of a cheque. While some of this may be attributed solely to familiarity with the cheque system, surveys have found that there are more substantial reasons for the resistance. Consumers feel that they do not have the same direct control over their personal finances. They consider that they have lost the

1. See, for example, which "The Technology in Search of a Market", Margaret L. King, 14.

C EFTS Overseas

Development overseas, particularly in the United States, has also been rapid. In 1968, representatives of ten California banks formed the Special Committee on Paperless Entries (SCOPE) to discuss the establishment of an automated clearing house system. As mentioned above, the Californian Automated Clearing House Association began operations in late 1972.

The American development, perhaps characteristically, tended to elaborate on the technological possibilities of EFTS. For example, using the Bell Touch-Tone Telephone System, it is possible in some areas to communicate directly with the computer to order certain types of transactions. This has led to a large measure of consumer resistance in some areas. ⁴ Studies have shown that bank customers have rejected some services in favour of retaining cheques, even though the new services require less time than writing a cheque and even though the transaction is effected more cheaply by the new system than by means of a cheque. While some of this may be attributed solely to familiarity with the cheque system, surveys have found that there are more substantial reasons for the resistance. Consumers feel that they do not have the same direct control over their personal finances. They consider that they have lost the

4. See, for example, Schuck, "EFT : A Technology in Search of a Market", 35 Maryland L. Rev. 74.

security of a cancelled cheque as proof that payment has been made. They worry that they may no longer stop payment in the event of an unsatisfactory consumer transaction; they do not trust the security of computer held accounts.

Legislation has been introduced in thirty two of the American States to regulate the development of EFTS. ⁵ These laws are generally concerned with questions such as whether a remote terminal is a branch bank and whether EFTS facilities must be shared with other institutions to prevent unfair competition. ⁶

Again in the United States, the National Commission on Electronic Funds Transfer recently released its interim report. ⁷ This report emphasises the problems of privacy, consumer interests, and the apportionment of liability in the event of unauthorised use of the customer's account.

5. Computerworld, August 1, 1977, p.10.

6. There has been litigation on the question of whether a terminal is a branch bank and whether the operator of such a terminal is a banker; *State ex rel. Meyer v. American Community Stores*, 228 N.W. 2d 299; *Independent Bankers Association of America v. Smith* 534 F. 2d 921 (1976).

7. Report in Computerworld, February 28, 1977, p 1.

D The Scope of this Paper

In this paper, the existing and proposed EFTS in New Zealand will be described. An attempt will then be made to identify and examine some of the major legal problems which might be expected to arise from the operation of the system.

There are two extremely important issues which will not be discussed in this paper : privacy of customers transactions and accounts and the closely related problem of assuring that these records cannot be assessed by unauthorised people or agencies.

The privacy question is simply too broad to deal with here; its importance must not, however, be ignored or underestimated. ⁸ The American National Commission on EFTS came to the view that the privacy issue was their most important and difficult problem, even though it was given low priority at the outset. An appendix is included which shows just how offensive, and informative, a total record of all transactions can be.

Security of computer files is too technical to be dealt with here. ⁹ Recent studies have shown that the range of frauds perpetrated by unauthorised access to computer files is wider than was imagined. The short truth of the matter is that no security system is secure :

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8. For observations on both the privacy and the security issues, see Parker, *Crime by Computer*, New York, 1976.
 9. For a non-technical discussion which indicates the frightening scope of the problem, see Nycman, "Security for Electronic Funds Transfer Systems", 37 Pitt. L. Rev. 709. See also "Computers Raped by Telephone" NYT (Magazine) September 8, 1974, p.33.

wires may be tapped, operators bribed, codes may be broken (particularly by those who have access, legitimate or otherwise, to a computer). Security is a difficult issue and one with no apparent total solution.

Part II : The Databank System

A The Cheque System

The Databank Cheque system is based upon a Magnetic Ink Character Recognition (MICR) concept. Thus, the vast majority of the Databank work is the efficient processing of paper. Documents such as cheques and deposit slips are pre-encoded with the customer's account number. These documents are referred to as "MICR documents" or "MICR paper".

MICR paper must have additional information encoded upon it when received by a branch bank. For example, a cheque when deposited at the collecting bank of the payee contains MICR information concerning the account of the payor and identification of the drawee branch, but no information relating to the collecting bank or to the amount of the cheque. Such additional information is encoded upon the cheque in MICR figures either at the branch bank or at a regional "proofing" centre.

The only sorting required of the branch bank is into "credit" and "debit" bundles. In the example just mentioned, a deposit of a cheque by a customer, the cheque would be in the "debit" bundle. There would be a corresponding piece of MICR paper representing the deposit slip included in the "credit" bundle.

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Each bundle of documents is accompanied by a "batch ticket" which is a MICR document prepared by the branch. The batch ticket contains information describing the contents of the bundle. These batch tickets are used by the computer as control documents to cross-reference accounts and to provide an "audit trail".

These debit and credit bundles, together with their batch tickets, are taken by courier to the nearest Databank centre for processing. These centres convert the information on MICR paper into electronic forms and transmit the information via data transmission equipment to the main processing computer. There are two of these larger computers, one in Auckland and one in Wellington. If a MICR document relating to an account within the "jurisdiction" of, say, the Northern computer is entered by a bank in the Southern area, the document is physically transported to its proper home and processed the next day. A proposed data transmission link between the two computers will eliminate even this delay.

The information from the MICR documents is processed by the computer overnight. Accounts are altered at this time.¹ The computers prepare reports for the branch banks which are ready to be delivered to them the following morning. During this second day, the MICR documents are "fine sorted" by machine into batches according to their branch destin-

1. Accounts are thus credited and debited very early in the process. This has raised some concern with the question of the right of banks to later reverse the accounts upon dishonour of a cheque. These problems are discussed in Part III.

ation; for example, cheques would be placed in batches according to the branch upon which they are drawn. On the third day, these MICR documents are physically transported to the appropriate branches. ²

The actual coding and processing in the Databank system has several unique features, the most important being the use of a single basic code number for each customer with varying suffixes used to identify the individual accounts of that customer. This permits the system to cross reference all accounts held by a given customer.

The one basic customer number also permits the keeping of a Customer Master File. ³ This file contains the customer's name and address, occupation, and details of all the customer's accounts. The account details, in addition to balance, include information concerning the activity of each account, high and low figures of each account since the last review, warning codes to identify bad or stopped accounts, various particulars relating to overdraft facilities, e.g. securities held, limits, and interest rates. The Customer Master File also contains any details of stopped cheques and a host of statistical information concerning account activity for bank fee purposes.

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2. Banks claim the right to dishonour until closing time on this third day.
 3. In view of the commitment of Databank to the concept of a "cashless" society, the contents of this file are of extreme importance in any discussion of privacy. The example given in Appendix I shows that such a file may potentially be far more of an invasion of privacy than the much discussed Wanganui files.

The one basic customer number approach, together with the fact that all branches within the system, also allows all of the MICR paper to be processed in a single job stream; there is no particular order in which MICR paper must be processed by the system. There is no preliminary sorting, save for the initial branch division into credit and debit bundles. ⁴

The basic Databank MICR processing function has undoubtedly improved the cheque as a basic method of payment in New Zealand society. ⁵ Even so, the growth in the use of cheques threatens to overwhelm the existing systems, thus returning to the days when cheques required five days or more to clear, or, alternatively, resulting in an increase in the cost of the cheque system to unacceptable levels.

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4. The practical importance of this is very great : the sorting process is very slow in comparison with any other process in the entire system. Preliminary sorting would re-introduce considerable "float" into the system.
 5. New Zealander's are prolific cheque writers. Recent figures show that the number of transactions debited to trading bank customer's accounts totalled more than 154 million.

B The Elimination of MICR Paper

A prime goal of the Databank system is to introduce services which will stem the growth of the use of MICR paper. From the Databank point of view, such paper is useful only as a means of entering data into the system.⁶ As a means of data entry, it is relatively slow, cumbersome, and expensive. Databank offers several services which do not depend upon MICR paper for data input. These services, and proposed services, will be described in this section. The legal framework of these systems and the possible legal problems raised by the substitution of these systems for the cheque system will be discussed in part III of this paper.

The simplest and most obvious possibility is the use of direct electronic data processing (EDP) entry into the system. Instead of encoding information in magnetic ink on paper, this system encodes the information directly onto magnetic tape for use by the computer.⁷ In conjunction with the money transfer services, to be described, this may result in the elimination of a large amount of MICR paper when the originator has access to EDP equipment.

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6. As negotiable instruments, the paper is of considerable importance in other ways. Certain of the issues raised by the elimination of paper are discussed in Part III.
 7. The need for paper handling in the cheque system seems inevitable because of the requirement for presentation in s.45 of the Bills of Exchange Act 1908. The "truncation" of the cheque system would assist in the solution of the paper handling problem, but would need to be carefully examined for other effects.

Government departments are making great use of direct EDP entry in the payment of salaries.

The concept of a money transfer system (MTS) as envisaged by the Databank system is a broad one; it may be best explained by a consideration of one aspect of the cheque system.

If a MICR cheque is considered as a record of a transaction, then it is (for the computer) an incomplete record since the MICR field contains no information concerning the payee or his account; that information is obtained from the MICR deposit slip. Thus, in the MICR cheque system, a payment record (cheque) does not provide a direct means of communication between the account of the debtor and that of the creditor. Additional information is required to satisfactorily complete account settlement.

The Databank concept of a MTS is that each transaction record in a general MTS should contain, in machine readable form, at least the names and account information of both parties and sufficient information to completely settle the transaction accounts between the parties. Thus, for example, the transaction record might contain the number of an insurance policy in the case of a premium payment, or some identification of the commodity being settled. Such information then appears on each customer's monthly statement of account.

Such a general MTS could, of course, be implemented by a system based on MICR paper. The Bank Giro system in England is an example of such a payments system. The main advantage, from the Databank point of view, is that such systems may be conveniently implemented without the use of MICR documents.

Current Databank MTS services are an automatic payments system and a Direct Credit system. In the near future a limited Direct Debit system will be introduced, as will an extended Direct Credit scheme to be known as a Monthly Accounts scheme. Further in the future, and most radical of all, is the point of sale terminal (POS) which could conceivably eliminate not only MICR documents, but cash as well. ⁸ Each of these will be described briefly here, legal problems and issues being deferred until Part III.

The Automatic Payments system and the Direct Credit system may, for the purposes of this paper, be viewed as automated versions of standing orders and a version of a trader's credit system. EDP input to the system is encouraged in the case of the Direct Credit system, particularly when used to pay wages, salaries, pensions or dividends. The customer provides the particulars of each payee's account; these accounts are credited at the

8. And, it should be added, elevate the privacy question to one of top priority : see note 3 *supra*.

appropriate date and the customer's account is debited. The transactions do not depend upon MICR paper.

The banks claim the right to reverse these credit transactions, at least for a limited period of time. The legal nature of the transactions and the validity of the banks' claim will be examined in part III.

The Direct Debit system is, in a sense, the converse of the Direct Credit system. By prior arrangement between the creditor and the debtor, the creditor submits the details of the payment, including the account particulars of both parties, through his, the creditors, bank for payment. The scheme is seen as useful for periodical payments, particularly when the creditor is large enough to have access to EDP for input, such as, for example, gas and power payments, subscription fees for clubs and magazines, and the like.

The Direct Debit system is not yet in operation. The banks consider that there is a great deal of consumer resistance to the idea, and, consequently, that the scheme is of limited appeal. 9 When introduced, each account could be debited only up to a pre-authorized upper limit, a necessary restriction to overcome consumer resistance but an administrative nuisance in times of rapidly increasing costs, since the authorized upper limit

9. The Direct Debit system will probably be operational next year.

would soon be inadequate to cover the payment and new authorisation would need to be sought.

The obvious possibility for abuse of a Direct Debit system is minimised by offering the scheme only to selected customers, by the pre-authorized upper limit, and, possibly, by requiring an indemnity as is done by the banks in the Giro system.

The point-of-sale system (POS), also called a "money key" system, extends the concept of the electronic transfer of funds right down to the retail level. Bank customers would hold cards, similar in appearance to ordinary credit cards; these cards are intended to identify the customer and would probably be imprinted with a magnetic strip containing his account details.

The retail outlet would have a terminal which was linked directly to the Databank central computers. At the time of a purchase, the retailer would enter details such as price, description of the transaction, date, etc. The customer inserts his card and the account of the retailer is credited with the amount of the transaction. The account of the customer is debited simultaneously.

Facilities would be provided for holding the transactions in suspense, either through the retailer's own credit facility or through some other pre-arranged credit source.

The problems associated with unauthorised use of the card are obvious; various devices are proposed to guard against

such a possibility. The terminals already in use in the United States require, in addition to the insertion of the customer's card, that the customer enter his personal identification number (PIN). The PIN is a secret number allotted to the customer; entry of the PIN is by means of a keyboard, the "PIN Pad", on the customer's side of the terminal. No transaction will occur unless the number entered on the PIN pad matches the number allocated to the customer whose card is being used.

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More sophisticated means of customer identification have been proposed; of these, the use of fingerprints or voiceprints probably await only technological advances which will allow the identification method to be machine cognisable. Until such time, the risks associated with the unauthorised use of such cards remain to be allocated among the parties either by operation of law or by agreement.

The risks of unauthorised card use may be reduced somewhat by programming the computer to check for unusual activity in relation to the use of the card.

The widespread use of POS terminals raises severe questions of policy on matters such as privacy and the rights of individuals to hold cards. These questions, while fascinating, are beyond the scope of this paper.

1. At least, the English system was originally of this type. The system is described in detail in *Banking and Finance* (1961) 1 Q.B. 747 in view of the desire of the banking system to eliminate the "float" (see para 2 supra) this may have changed.

Part III : Legal Problems and Issues

A The Clearing of Cheques

(1) The Databank in Operation

There are two fundamentally different systems which might be used in the electronic clearing of cheques. In the first, the cheques are processed through the computer but the transactions are held in suspense for a period of time. During this time the cheques are presented for payment; if the cheque is to be paid, no further action is necessary: the appropriate accounts are debited and credited at the end of the period. If the cheque is to be dishonoured, special instructions are dispatched to the computer and the accounts are never changed.

In the second system, the accounts are debited and credited at the first instance, prior to presentation for payment. In the event of dishonour, the accounts are "reversed", i.e., returned to their original position.

The English system is based upon the first model. ¹
The New Zealand Databank system is of the second type. There are two reasons for this. The public explanation offered by the banks is that such a system offers better customer service : since only a small number of cheques

1. At least, the English system was originally of this type. The system is described in *Burnett v. Westminster Bank* [1966] 1 Q.B. 742. In view of the desire of the banking system to eliminate the "float" (see note 3 *infra*) this may have changed.

are dishonoured, why should the majority of accounts be "penalised" by being held in suspension. ² The second reason is not as well advertised, but may be the more important : the "float" in the second type of system is virtually eminated. ³

The precise timing of the operation of the Databank system is relevant to the discussion of the issues arising. If the day of the cheques being paid into the collecting bank is designated as Day 1, then the system proceeds as follows : the accounts are debited and credited overnight. On Day 2 the cheques are "fine sorted" according to drawee branch. On Day 3 the cheques are delivered to the drawee bank. The drawee bank claims the right to dishonour the cheque at any time until closing of Day 3. In such a case, the accounts would be reversed the night between Day 3 and Day 4.

Three important issues relating to this system have caused concern to bankers. Firstly, and most important, may the claimed right of reversal be justified? Secondly, is the presentation for payment timely under the system? Thirdly, is the actual presentation for payment necessary; could the

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2. This explanation is not entirely convincing. It may be that the customer whose account is being debited would not really consider a delay to be a penalty. To take this point further, the electronic transfer of funds may not necessarily be beneficial for banking customers; see the interesting article by Schuck, "EFT: A Technology in Search of a Market" (1975) 35 Maryland L. Rev. 74.
 3. The "float" may be most easily illustrated in the case of a cheque which is paid out in cash over the counter of some branch other than the drawee bank. Until the accounts are adjusted, i.e., until the cheque clears, the banking system as a whole has lost the use of the sum, yet still "owes" the sum to the drawer of the cheque. It is also the "float" which permits the fraudulent practice of "kiting" cheques.

clearing scheme be safely "truncated"? Each of these will be discussed in turn.

(2) Reversal of Accounts

Concern has been expressed in banking circles that the doctrine in *Price v. Neal*,⁴ as extended by the decision of Matthew J. in *London and River Plate Bank v. Bank of Liverpool*⁵ may operate to deprive the banks of their claimed right of reversal.

The doctrine in *Price v. Neal* is a doctrine of finality. In its narrow form, it states that a drawer of a bill of exchange accepts or pays a forged bill at his own peril, assuming, of course, that the holder of the bill is an innocent party. In somewhat wider form, the doctrine is said to apply whenever there is a mistake of fact between the two parties.

With respect, the concern that the doctrine might apply to the Databank cheque clearing system seems to be premature. The *Price v. Neal* doctrine, no matter how widely stated, comes into operation only if payment has actually been made. To worry about *Price v. Neal* is to assume that the initial crediting and debiting of accounts amounts to payment of the cheque.

4. (1762) 3 Burr. 1354

5. [1896] 1 Q.B. 7.

While it is certainly true that payment may be completed by the medium of bookkeeping,⁶ it is by no means obvious that every such bookkeeping entry is a final payment. In spite of the decision in *Capital and Counties Bank v. Gordon*⁷ it may not now be argued that the mere crediting of the customer's account makes the bank a holder for value. Since *Gordon's* case, it has been held that before the banker can be treated as a holder for value, there must be evidence of a binding agreement that the customer is entitled to draw upon the amount which has been credited in advance of collection; the mere fact that he has been credited and allowed to draw as a matter of practice is not sufficient evidence.⁸

It will be argued below⁹ that payment is not made until a decision is made by the paying bank on Day 3. A drawee of a cheque, like that of any other bill of exchange, is not liable to pay on the bill until it has been presented for payment. An internal system of accounting which operates to change the accounts prior to the actual presentation should have no bearing on the legal position. The paying banker cannot be held liable prior to his decision to pay the cheque or until the right to refuse payment is lost through lapse of time. If this is correct, then the doctrine of *Price v. Neal* is irrelevant in this context.

6. *Eylis v. Ellis*

7. [1903] A.C. 240

8. *Re Farrow's Bank* [1923] 1 Ch. 41; *A L Underwood Ltd v. Barclays Bank* [1924] 3 K.B. 775.

9. See part III.

3. The Time of Presentment

Presentment of cheques, whether governed by section 45(2) or by section 74(b) of the Bills of Exchange Act 1908¹⁰ must be made within a reasonable time.

In determining what is a reasonable time regard shall be had to the nature of the instrument, the usage of trade and of bankers, and the facts of the particular case.¹¹ Chalmers says that this is a "new and less rigorous measure of reasonable time" than the old common law rules.¹²

However, presentment within the time prescribed by the common law rules would certainly be regarded as reasonable; and presentment in violation of those rules might be prima facie unreasonable. It is here that concern with the Databank operation has been expressed. Under the common law rules, a collecting bank, if in the same place as the paying bank, would be required to present the cheque for payment the following day, i.e. Day 2 in the scheme described at the beginning of this part.¹³ Actual presentment is not made until Day 3.

In view of the express instructions of the Act to have regard to banking custom, it is difficult to imagine

10. As to which, see the discussion in Paget, *The Law of Banking*.

11. s.74(b), Bills of Exchange Act, 1908.

12. Chalmers, "On Bills of Exchange", 13th Edition, p 252.

13. *Forman v. Bank of England* (1902) 18 T.L.R. 339; *Hamilton Finance Co Ltd v. Coverby Westray Walbaum and Tosette Ltd*, and *Portland Finance Co Ltd*, [1969] 1 Lloyds Rep 53.

that any court would hold that presentment is out of time. To do so would ve to impose an intolerable strain upon the cheque system of payments. There is authority for the proposition that Clearing-house rules will be given the effect of law is necessary : *Parr's Bank (Limited) v. Thomas Ashby and Co.* ¹⁴ There is additional evidence to show that the Databank procedure is reasonable. In the initial system, the cheques were fine-sorted the night between Day 1 and Day 2. The change in the system was forced by the sheer increase in volume of the cheques being processed. The current system is a creature of necessity. One would hope that a court would find it to be reasonable.

(4) Is Presentment Necessary?

Various schemes have been suggested for the "truncation" of the cheque clearing process. The aim of such schemes is to reduce or eliminate the handling and sorting of paper, already noted as being the "bottleneck" in the cheque sorting process. All such schemes depend upon a simple observation : the process of clearing and the decision to pay or to dishonour depends only upon the information on the cheque, and not at all upon the individual piece of paper which is the cheque.

This information could be transmitted directly from the collecting bank to the central computers. From there, the relevant information could be transmitted directly

14. (1898) 14 T.L.R. 563.

to the paying bank where the decision to pay or to dishonour could be made. All paper movements and all paper sorting would be eliminated.

Unfortunately, even though the individual piece of paper is not important for the process, ~~The~~ Bills of Exchange Act 1908, and, indeed, the entire commercial concept of negotiability, envisages the piece of paper as an important source of rights and duties.

In particular, the Act requires that the cheques be "presented" for payment. If it is not, certain rights are forfeited. With so much at stake, the banks would probably not change the system in the absence of an enabling amendment to the Bills of Exchange Act 1908. ¹⁵ This result is one of the more unfortunate side effects of the historical classification of cheques as a particular form of bills of exchange.

(5) Other Problems

Since additional coding needs to be added to the cheque, there is always the possibility of a mistake. In an American case, ¹⁶ the collecting bank "under-encoded" a cheque, i.e. the coded MICR figure was lower than the

15. It may be possible to argue that the electronic transmission of information described is "presentment" within the meaning of the Act, but the clear intention of the Act makes this a very artificial argument.

16. *Georgia Railroad Bank and Trust Co v. The First National Bank and Trust Co of Augusta* 229 S.E. 2d 501.

sum for which the cheque was written. The cheque was paid though an automated clearing house according to the encoded sum. The mistake came to light some time later when the depositor of the cheque unexpectedly found his account to be overdrawn. The paying bank resisted the claim for the additional sum. While it is difficult to imagine New Zealand banks litigating such an issue, there can be no doubt that the outcome would be in favour of the collecting bank, as was the decision in the American case. There also would seem to be no doubt that an action would lie to recover money paid on an over-encoded cheque under similar circumstances, although the right to recover may be lost under the usual circumstances. The paying bank might also have an action in negligence against the encoder of the cheque. Again, it is difficult to envisage circumstances in New Zealand where such disputes would be litigated.

In the case where the cheque is encoded by a Databank proofing centre, it should be noticed that clause 8 of the banks' agreement with Databank specifically exempts Databank from liability for failure to provide any of the services under the agreement. It is felt that this clause could be struck down by the court, but in the absence of a liquidation of one of the banks, it is difficult to see how this could arise in practice.

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B The Direct Credit System

(1) Legal Nature 17

In the Direct Credit System, the debtor issues instructions to his bank, either directly or via EDP input to the Databank computers, to transfer sums from his account to the account of the creditor. There have been no decided cases elaborating on the legal relationships of the parties involved. The procedure is conceptually similar to the Giro system operating in the U K, but there are no cases on that system either.

It is, nevertheless, clear that the relationships are governed by the law of contract and of agency. The contract between the banks and Databank has been mentioned already; its effect would seem to be to make Databank agents of the banks for certain purposes. Thus, direct EDP input to the Databank computers constitutes, as hinted above, directions to the debtor's bank.

The paying bank is thus given instructions to pay, instructions which place the paying banker under a duty which appears to be very similar to the duty of a paying banker in the case of a cheque. He is, thus, presumably under a duty to follow the terms of the mandate strictly, and would be liable to the customer for loss arising

17. I am indebted to Professor E P Ellinger for many of the observations and arguments of this section. They will appear, with considerably greater clarity, in the next edition of *Chitty on Contracts*.

from a failure to follow this mandate. The customer is under a duty similar to that of the drawer of a cheque. Interesting questions might arise concerning the preparation of EDP input, but they would be questions of fact and of the technical standard to be followed; they would pose no novel legal problems. For example, if a computer tape is prepared and handled in such a way that alteration by an employee is facilitated, there seems no reason to suppose that *MacMillan's* case¹⁸ would not apply to make the customer liable.

The banker to whom the funds are transferred, i.e., the creditor's banker, is called the recipient banker. The recipient banker must be the agent of the creditor. He is given authority to receive payment on behalf of the creditor via the Databank system.

Not always?

When the paying bank and the recipient bank are one and the same, the bank must be the agent of both debtor and creditor. This raises some fine points concerning the time at which the debtor's right of revocation of the mandate is lost. This problem, closely related to the bank's right to reverse the accounts, will be discussed presently.¹⁹

(2) An Assignment ?

Chorley²⁰ argues that the legal nature of the Giro

18. *London Joint Stock Bank v. MacMillan* [1918] A.C. 777.

19. Part C, below.

20. Chorley, *The Law of Banking*.

transaction is one of assignment of a debt. Because of the similarity of the Databank Direct Credit system, it may be supposed that the same argument would be made here. The argument is a natural one on a functional view of the transaction, a debtor D owes a debt to a creditor C. At the same time, a banker P (the paying banker) owes a debt to D. At the termination of the transaction, the recipient banker R owes a debt to C, but D does not. At a functional level, a debt appears to have been transferred; in our law, the means of transferring a debt are limited; ²¹ since the entire transaction occurs by the issuing of instructions, it is natural to attempt the conceptual analysis by resort to the law of assignment. Indeed, it may be difficult to distinguish factually an order to pay from an assignment of funds. ²²

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However, there are compelling arguments against considering either the Giro transaction or the Databank Direct Credit system as an assignment. Perhaps the most telling argument is that all of the parties to the transaction would be startled at the consequences of considering the Direct Credit to be an assignment. It would, for example, place the payee in a stronger position than if he were paid by cheque, for he could maintain an action directly against the paying banker. It would mean that the instructions to the paying banker would be irrevocable once the creditor

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21. Halsbury's, The Law of England, Article entitled Choses in Action, para 10.
22. Halsbury's, The Law of England, Article entitled Choses in Action, paras 38, 39.

had notice of such instructions, a result which is clearly not intended by the parties. It would mean that payment would not be completed until the payee received notice; in many cases that would presumably not be until he read his monthly statement.

analysis?

These results, clearly not contemplated by any of the parties to the transfer scheme, seem to conclusively show that a credit transfer is neither an equitable nor a statutory assignment of funds.

There is an additional argument against it being a statutory assignment. Section 126 of the Property Law Act 1952 has been held to be inapplicable to the assignment of part of a debt. ²³ Yet the transfer of the whole debt would be an extremely rare occurrence under the credit transfer system.

In truth, the law of assignments is not necessary to explain the credit transfer system. Much more in accord with the expectations of the parties is the simple agency model suggested above.

(3) Revocation and the Reversal of Accounts;
The Problem of Finality

As was noted above, the banks claim the right to dishonour a cheque and reverse the accounts up until about 40 hours after the accounts have originally been debited and credited. They further claim the right to reverse

23. *Williams v. Atlantic Assurance Co* [1933] K.B. 81, *Walter and Sullivan Ltd v. Murphy and Sons Ltd* [1955] 2 Q.B. 584.

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the accounts of a credit transfer for an unspecified period of time after the initial crediting and debiting accounts. Presumably the customer is considered to have the right of countermand at any time until the banks lose their right to reverse the accounts.

It is easy to be innocently led into circularities in considering these problems. ²⁴ However, it seems impossible to imagine a situation in which the bank's right to countermand payment should not be determined at the same time. It seems reasonable to call the time of this determination the time of final payment. Even further, there seems little reason not to follow every day terminology and merely call it the time of payment on the simple understanding that payment is not made until it is final. Note that we are really concerned with two similar but conceptually distinct problems. Firstly, when does a paying banker pay on a cheque. Secondly, when A, in order to pay B, gives instructions to his bank to effect such a payment, when is it completed. Also note that a payment may be "final" in the sense used above even though it is a conditional payment. When A hands B a cheque, payment is made at the time of the handing over, even though that payment is conditional upon the cheques being honoured.

24. For example, "If money transfer entries can be reversed, when are they paid?" "When the right to reverse such an entry is lost."

The question of finality of payment has been discussed in a series of shipping and banking cases which will be discussed below. Before discussing these cases, however, a few preliminary observations will be made.

Firstly, it is clear that payment may be made by the accounting procedure of crediting the creditor's account and debiting the debtor's account.²⁵ On the other hand, there is no authority for the proposition that mere debiting and crediting of accounts amounts to payment.

Secondly, the structure of the New Zealand system blurs the distinction between "in-house" and "out-house" payments, a distinction which has been sometimes seen as important in the English cases. The Databank procedure for clearing cheques and for making credit transfers is used in all cases. Particularly in the case of a credit transfer, this system resembles an "in-house" payment, even when the paying bank and the recipient bank are different.

Finally, it would appear that the case of *Rekstin v. Severo Sibersko Gosvdarstvennoe Akcionerno*²⁶ has been interpreted far too widely. Not only have the facts of the case been misunderstood, possibly because the headnote is somewhat misleading, but also certain distinguishing features of that very peculiar case have not received sufficient attention.

25. *Eyles v. Ellis* (1827) 4 Bing. 112.

26. [1933] 1 K.B. 47.

The most recent case concerned with the payment question is *Momm v. Barclays Bank International Ltd.* ²⁷

In that case, Kerr J. reviewed and interpreted most of the cases on payment. The judgment of Kerr J. will be outlined in the following paragraphs, and the facts of each case will be explained as they arise for discussion.

The facts of that case were as follows : The plaintiffs were a German banking partnership. They entered into a contract with another German bank, Herstatt, which provided, inter alia, that Herstatt transfer to the plaintiff's account at the defendant's bank some £ 120,000 in sterling. The transfer was to be on the basis of "value June 26, 1974" which meant that the payment had to be made on that date. It happened that Herstatt also had an account with the defendant bank and intended to make the payment from that account, but that was not part of the contract between Herstatt and the plaintiff. Herstatt accordingly ordered the defendant to transfer the sum from Herstatt's account to the account of the plaintiff on June 26.

The defendants made this transfer on June 26 by altering the accounts, even though this placed Herstatt's account in an overdrawn position. The decision to do so was made by an appropriate officer of the defendant bank. The accounts were thus processed by the defendant bank's computer that night. The next morning, the defendant bank

27. [1976] 3 All E.R. 588.

became aware that Herstatt had ceased trading. Upon receipt of this information, they informed the plaintiff, in response to an inquiry, that the transfer had not been made, "due to the present position of Herstatt's accounts", and they took steps which resulted in the computer reversing the accounts. The plaintiffs then sued, claiming a wrongful debiting of their account of the amount in question; the defendants, relying on *Rekstin*,²⁸ claimed by way of defence that the transfer would only have been complete upon the plaintiffs receiving notice of it, and that account entries do not constitute such notice.

Kerr J. thought that, as a matter of principle, when a credit transfer is to be effected by a bank on a given "value date", then the position at the end of the day must be certain, that the bank could not delay its decision to credit until the next day. That principle, which is merely an application of the general principle that the banker must follow his instructions strictly, does not settle the matter, for the question still remains as to whether the bank in fact followed the instructions, in which case the plaintiff would win, or whether the bank did not do so, in which case the plaintiff could have no claim against the bank.

28. [1933] 1 K.B. 47.

Kerr J. found for the plaintiff on the basis of the old case of *Eyles v. Ellis*.²⁹ He then went on to distinguish and explain *Rekstin*³⁰ reinforcing his view of that case by reference to recent Court of Appeal decisions in two shipping cases, *The Brimmes*³¹ and *Mardorf Peach and Co Ltd v. Attica Carriers Corporation of Liberia*.³² Each of these cases, together with the analysis of Kerr J. and comment upon that analysis, will be discussed in turn.

Eyles v. Ellis :³³ The plaintiff was a creditor of the defendant. Both parties kept accounts at the same bank. On a Friday, the defendant instructed the banker to transfer the sum owed to the account of the plaintiff. The banker did this by making the appropriate entry in his books, even though the defendant's account was then overdrawn. On that same day, the defendant wrote to the plaintiff to inform him that the transfer had been ordered, but the letter did not reach the plaintiff until Sunday.³⁴ Meanwhile, on the Saturday the banker had failed. The court found for the defendant, observing that the plaintiff could have drawn for the sum and the banker could not have refused his draft.

29. (1827) 4 Bing. 112

30. [1933] 1 K.B. 47.

31. [1975] Q.B. 929.

32. [1976] Q.B. 835. This case was reversed on appeal to the House of Lords : "The Laconia", *The Times*, February 7, 1977. However the principles relating to time of payment do not seem to have been altered by the House of Lords.

33. (1827) 4 Bing. 112.

34. Kerr J. observes, rightly it is submitted, that the sending of the letter cannot be notice. It is actual notice which is required.

Kerr J. observes that "the important feature of the case is that the payment was held to be complete when the payee's account was credited and before the payee had had any notice that this had happened." He held that, on the facts, *Eyles v. Ellis*³⁵ was indistinguishable from *Momm.*³⁶

It is not to be supposed that Kerr J. was suggesting the above statement to be the *ratio* of *Eyles v. Ellis*.³⁷ It is important to notice a further feature of the case : the judgment of the court, given by Best C.J., clearly assumed that the bank had been given explicit authority to receive the money on behalf of the plaintiff. That this was indeed the case is evidenced by the fact that the transfer in question was a result of a complaint by the plaintiff that an earlier transfer had not taken place as it was supposed to have.

Also note that Kerr J. refers only to the crediting of the payee's account. This, in itself, is, of course, not decisive of the time of payment, since it has long been the custom of banks to credit the account of a payee of a cheque upon deposit while reserving the right to debit the account if the cheque is dishonoured upon presentment to the paying bank. Such a practice was held to be valid

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35. (1827) 4 Bing. 112.
36. [1976] 3 All E.R. 588.
37. (1827) 4 Bing. 112.

in *A L Underwood Ltd v. Bank of Liverpool* 38 in spite
of earlier confusion caused by *Capital and Counties Bank Ltd v.*
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Kerr J. then had to deal with the claim of the defendant
bank, based on counsel's interpretation of *Rekstin* 40
that no transfer could be complete until notice was given
to the transferee.

Rekstin : 41 There were two defendants in *Rekstin*,
the first was a Russian trading organisation commonly
referred to as "Severo". The second was a bank at which
Severo had an account. The plaintiff was a judgment
creditor of Severo. Severo devised a scheme to protect
the contents of their bank account from a garnishee
order. Severo ordered the bank to transfer the contents
of their account to the account of the Russian Trade
Delegation, who had an account with the same bank. The
Trade Delegation had diplomatic immunity. The order was
made without the knowledge or consent of the Trade Delegation.
Upon receipt of the order, a clerk of the bank made the
necessary book entries to close the Severo account, and
prepared a "credit slip" which was preparatory to crediting
the Delegation's account with the same sum. Before such
a credit entry was made, however, the plaintiff served the

38. [1924] 1 K.B. 775.

39. [1903] A.C. 240.

40. (1827) 4 Bing. 112.

41. [1933] 1 K.B. 47.

bank with a garnishee order nisi in respect of the judgment against Severo.

The court held, inter alia, that the mandate from Severo to the bank to transfer the money to the account of the Trade Delegation was, in the circumstances, still revocable and was, in fact, revoked by operation of law upon receipt of the garnishee order nisi.

Counsel for Barclays in the *Momm*⁴² case attempted to define the ratio of the *Rekstin*⁴³ case in terms of notice, asserting that transfer is incomplete until actual notice is received by the transferee. He might be forgiven for supposing that this line of argument would be readily accepted, for that seems to have been the accepted interpretation ever since the court explained *Rekstin*⁴⁴ in those terms in *Continental Cauoutchouc and Gutta Percha Co v. Kleinwort Sons & Co.*⁴⁵

Kerr J., however, rejected this statement as the ratio of *Rekstin*⁴⁶ on the grounds that it is inconsistent with the decision in *Eyles v. Ellis*⁴⁷. He further observed that *Eyles v. Ellis* was not mentioned in either the *Rekstin* case or the *Continental Cauoutchouc*⁵⁰ case.

Kerr J. suggests that the basis of the *Rekstin*⁵¹ decision

42. [1976] 3 All E.R. 588.
43. [1933] 1 K.B. 47.
44. [1933] 1 K.B. 47.
45. (1904) 90 L.T. 474.
46. [1933] 1 K.B. 47.
47. (1827) 4 Bing. 112.
48. (1827) 4 Bing. 112.
49. [1933] 1 K.B. 47.
50. (1904) 90 L.T. 474.
51. [1933] 1 K.B. 47.

is one of two propositions. First, that there had been no final appropriation of the money to the credit of the Trade Delegation. Secondly, "...the fact that the Trade Delegation knew nothing of the proposed transfer, that there was no transaction between Severo and the delegation underlying it, and that the delegation had accordingly never assented to its account being credited with these moneys."

With respect, the first of these begs the question in that finality of the transaction is what the court had to decide in *Rekstin*.⁵² It is, on its own, wrong, or at least misleading, in that later cases, as observed by Kerr J. later on, clearly indicate that payment may be completed prior to the completion of internal accounting procedures when the bank has authority to receive the payment.⁵³

The second basis given by Kerr J. might be summarised by the proposition that the bank was not the agent of the Trade Delegation for the purposes of receiving this payment. As will be noted below, the House of Lords decision in *The Laconia*⁵⁴ shows that payment is not completed in such a situation.

Indeed, on a common sense approach, the bank in *Rekstin*⁵⁵

52. [1933] 1 K.B. 47.

53. In particular, the clerk had decided to act on the order. Payment would have been complete had the bank been authorised to receive the sum on behalf of the Trade Delegation.

54. The Times, February 7. 1977.

55. [1933] 1 K.B. 47.

was a complete stranger to the Trade Delegation insofar as this particular transfer was concerned. It is as though Severo had ordered a new account to be opened in the name of the Trade Delegation in some far off bank. That the Trade Delegation might have an account at the bank is clearly irrelevant.

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Kerr J. then discussed two shipping cases concerning time of payment. In both, the owners were purporting to exercise their right of withdrawal of the ship in default of prompt payment by the charterers. The first, *The Brimnes*, 56 is of direct relevance, being an "in-house" payment. The second, *Mardorf Peach & Co Ltd v. Attical Sea Carriers Corporation of Liberia*, 57 has since been reversed by the House of Lords; it seems, however, that much of the Court of Appeal's comments on time of payment remain good law. These cases may be summarised very briefly for the present purposes.

The Brimnes : 58 The contract called for the charterers to make monthly payments into the account of the owners at the Morgan Guaranty Trust Co of New York (MGT). Payments were effected in the following manner : The charterers would instruct their bank, Hambros, to make the payment; Hambros, who also had an account with MGT, would send a Telex message instructing MGT to make the appropriate transfer

56. [1975] Q.B. 929.
57. [1976] Q.B. 835.
58. [1975] Q.B. 929.

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occasion in question, the Telex message arrived at MGT at 4.53 am, New York time, but was not dealt with until approximately noon of that day. In the meantime, it was found by the court, the owners had exercised their right of withdrawal.

The court rejected arguments that payment had been made either at 4.53 am or at 9.00 am when MGT opened for business, for to do so would be to elevate Telex messages to the status of negotiable instruments. The Court held that payment had not been made at the time of the purported withdrawal.

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It was not necessary for the court to decide when payment had been made, but each of the Judges spoke to this point. Kerr J. notes that "all the members of the Court of Appeal clearly considered that payment was complete when MGT decided to credit the shipowner's account and acted on that decision." While that is correct, it is, with respect, a simplification. Each of the Judges considered that payment was complete when the creditor had credit available on which he could unconditionally draw : on the evidence that time was found to be that stated by Kerr J.

The Laconia: 59 Payment in this case was made by means of a bank "payment order". This was an "out-house" payment. The Court of Appeal held that payment was

59. The Times, February 7, 1977.

complete at the time when the receiving bank accepted the order and decided to act upon it, irrespective of the time which had to elapse before the bank's internal accounting processes had been completed.

The House of Lords reversed the Court of Appeal, observing that the bank was not authorised to receive the particular payment on behalf of the owners. The observations of the Court of Appeal on the time of payment, had the receipt of such payment been authorised, were not challenged, and would seem to remain valid.

Again, it should be noted that evidence of banking practice played an important role.

(4) Summary

In *Momm* 60 Kerr J. puts forth the principle that when a credit transfer is to be effected by a banker on a given "value date", then the position at the end of the day in fact and in law must be that this has either happened or not happened, but that the position cannot be left in the air. He then examines cases to establish the consistency of this proposition with the case law. He concludes that payment was actually completed when the bank manager "decided to accept Herstatt's instructions to credit the plaintiff's account and the

60. [1976] 3 All E.R. 588.

computer processes for so doing were set in motion."

The principle which emerges from the cases is that payment is complete when the appropriate person decides to act upon the payment order and (possibly) acts upon that decision. This principle is subject to the following observations :

- (i) The proposition is not strictly speaking the *ratio decidendi* of any of the decided cases : In *Momm*,⁶¹ all of the accounting procedures had been completed; in *The Brimnes*⁶² it was only necessary to decide that the mere receipt of the Telex order was not completed payment; *The Laconia*⁶³ was an "out-house" payment. However, the time of payment was carefully argued in each of the cases; an argument in favour of some other time of payment would need to be very persuasive to succeed.
- (ii) In each of the cases, bank practice was relevant but not always decisive. In *The Brimnes*,⁶⁴ for example, the evidence of the bank established that there actually was a time of "decision" on the Telex message and that such payments were not, as claimed by the charterers, the result of a "continuous processing". However, in *Momm*⁶⁵ itself, the bank attempted to show that it was banking practice to reverse accounts on occasions on

61. [1976] 3 All E.R. 588.

62. [1975] Q.B. 929.

63. The Times, February 7, 1977.

64. [1975] Q.B. 929.

65. [1976] 3 All E.R. 588.

the following day. Kerr J. may not have been entirely convinced of the practice, no actual instances of such a reversal could be produced, but toward the end of his judgment it is clear that he did not accept such a practice as valid in any case.

(iii) The rule only applies when the bank is authorised to receive payment on behalf of the payee. In this case of the money transfer services offered by Databank, this authority would probably be implied by the payee's giving to the payor the details of his account.

(iv) In each of the cases, the accounting procedure followed the time of decision. In New Zealand, the accounting procedure is the first step in the process. It will be shown below that this may be relevant in the case of credit transfers.

(v) The problem of obtaining evidence showing the exact time of payment is a difficult one under the above rule. Bankers might be advised to keep better records regarding the times of such "decisions". Each of the cases were "special" payments in that the matter did indeed come before an officer of the bank for consideration. In the vast majority of credit transfers this will not be the case. The accounts will be credited and debited, the payors account will cover the transfers, and the entire transaction will not, in fact, come to the explicit attention of any of the bank's employees. When,

in such a circumstance, is the "decision" made? There are only two possibilities : The time when the accounts are changed or the close of the business day. The latter seems preferable, since until that time the bank clearly has the right to give the transaction special consideration and to "decide" in the above sense.

(vi) The dicta are not clear concerning the need for actions upon the decision to pay. As a practical matter, it seems unlikely that proof of the decision could be made without pointing to some overt action, as the question is probably quite academic.

(5) Application to the Databank System

As mentioned above, the unique feature of the Databank system is that the accounting procedure precedes the decision to pay.

In the case of a credit transfer to be paid on a certain day, the accounts are credited and debited the night before. The computer compares the ordered transfer with the state of the payee's account and with his overdraft facilities, if any. If there are inadequate funds, the transaction is "flagged" for the attention of an officer of the paying bank. It might be argued that if the transaction is not flagged then it should be considered paid at the time of alteration of the accounts. This argument presupposes that the computer contains all of

the relevant information as to the decision for payment, i.e., that it is in fact the computer that makes the decision to pay. There is no good reason, either in fact or in policy, to accept this assumption.

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A better approach is to consider that transactions are complete at the time of human consideration of them or when business has closed for the day in the case where they are never actually considered. This approach accords reasonably well with bank practice, it also receives a certain support from dicta which argue that the speed or slowness of the bank's internal accounting procedure should not be the determining factor as to time of payment. There seems no good reason to deprive the banks of the right to decide on payments merely because they use an efficient accounting system, particularly when that accounting procedure accomplishes the desirable end of reducing the "float" and thereby inhibiting the "kiting" of cheques.

As applied to the New Zealand system, the rule as to time of payment is similar to the rule in the Uniform Commercial Code. There, an item is finally paid, when the payor bank completes the process of posting to the account of the person to be charged therewith. ⁶⁶

The Code defines the process of posting as the usual

66. Uniform Commercial Code, Art. 4, 213 (c).

procedure followed by a payor bank in determining to pay
an item and in recording the payment. ⁶⁷ Thus, under
the UCC, the internal procedure of the bank is relevant
to the terms of the payment and the time of payment
under the UCC rule would always be later than that of
the English rule when applied to the English system,
i.e. when the decision precedes the accounting. Banks
are, of course, under a duty to follow a reasonable
system of accounting.

(6) Failure to Credit and Late Credits

The failure to effect a direct credit is a breach of
contract on the part of the paying bank. Damages for
such a breach would presumably be similar to those awarded
for wrongful dishonour of a cheque, unless it may be
shown that failure to effect a direct credit is somehow
more or less damaging to the customer's credit than a
cheque dishonour. It might be argued that failure to
effect a standing order is not as damaging as a cheque
dishonour since it might be regarded more as an
"accident" or mere absent-mindedness on the part of an
account holder who has insufficient funds to meet a
standing order. On the other hand, whereas a cheque
may be dishonoured for reasons which do not damage the
customers credit, e.g. irregularity on the face of a

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67. Uniform Commercial Code, Art. 4, 109.

cheque or suspicion of the validity of the customer's signature. The range of reasons for which the bank might fail to credit are much more restrictive.

Nevertheless, it is submitted that the principles relating to the measure of damages are the same; in particular, the bank will be liable for damage to the credit of the customer.⁶⁸ This damage may be greater if the "dishonoured" transaction is a small one rather than a large one;⁶⁹ in the case where the customer is a businessman, it is likely that large damages may be awarded without proof of actual damage to the customer; others will probably need proof of special damage.⁷⁰

(7) Libel

The practice of banks of noting the reasons for dishonour of a cheque on the cheque itself has led to banks being sued in libel. Indeed, the quest for an innocuous phrase which is informative without being libelous is one of the more entertaining parts of the law of banking.⁷¹

In the case of a wrongful failure to credit, there is, or may be, no document. There is no "dishonour" in the same sense as in a cheque which is not paid; there is a

68. Since this is damage which flows directly and naturally from the breach of contract : *Hadley v. Baxendale* (1854) 9 Ex. 354.

69. *Marzetti v. Williams* (1830) 1 B. & Ad. 415

70. *Gibbons v. Westminster Bank Ltd* [1939] 2 K.B. 882.

71. Paget, *The Law of Banking*, 8th Ed., 309-312.

mere failure to carry out instructions.

It would appear that the bank is safe from libel actions in the case of direct credits. Although it is here submitted that that is indeed the case, an argument to the contrary should be noted. It has been suggested that the mere dishonour of a cheque, when no explanation at all appears on the face of the cheque, might amount to defamation.⁷² The argument against this is that there have been cases where words on a dishonoured cheque have been held to be non-defamatory;⁷³ how, it is asked, can a blank cheque be defamatory when one with writing is not. Yet, this is not entirely convincing, for the words may "draw the sting" of the dishonour.

Even if the dishonour of a cheque could be found defamatory in itself, the case for holding a failure to credit to be defamatory is weaker, being an omission rather than the more positive act of dishonour.

(8) The Action on the Cheque

When a cheque is dishonoured, the payee has a right of action on the cheque itself. There is no similar right for a payee of a direct credit when the credit is not made. Again, there is no "dishonour"; payment is simply

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72. *Allen v. London County and Westminster Bank* (1915) 31 T.L.R. 210.
73. *Flack v. London and South-Wales Bank Ltd* (1915) 31 T.L.R. 334, but compare with *Sterling v. Barclays Bank Ltd* (1930) *The Times*, July 18.

The Direct Debit System
not made. The payee is thus in a weaker position when accepting payment by direct credit rather than by cheque. However, the right of action on the cheque is a result of the historical identification of the cheque as a special form of a bill of exchange. There would appear strictl to be no good policy reason for extending this right to a system of payment based solely on mandate.

(9) Late Credits

What should be the liability of the bank in the case where a direct credit is made a day late, or, for that matter, a day early? There seems no reason why the bank should not be held strictly to its mandate, much as in the case of the mandate of a cheque. On the other hand, there would appear to be no policy reason for allowing damages against the bank unless actual damage can be proved in cases of minimal breach.

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condition; the creditor looks to the debtor for satisfaction of the original debt.

The Californian system has chosen the second solution.

It seems the preferable one from the point of view of the bank, allowing it to keep the creditor/debtor dispute at arm's length.

(10) Agency Aspects

There are two basic legal models which might govern the relationships among the parties in the absence of well

C The Direct Debit System

(1) Introduction

The basic danger in a direct debit system is clearly the possibility of the creditor abusing his right to draw upon the creditor's account. This abuse is not limited to the case of out and out fraud, but extends to the case where there is a dispute between buyer and seller, where the buyer wishes to withhold payment pending resolution of the dispute but the seller debits the account of the buyer.

These problems are, of course, governed by the contractual relationships among the parties. There seems to be only two basic solutions :

- (i) The account is left debited and the debtor must look to the creditor for recovery, or
- (ii) Upon the outbreak of a dispute, the bank returns the accounts to their original condition; the creditor looks to the debtor for satisfaction of the original debt.

The Californian system has chosen the second solution. It seems the preferable one from the point of view of the bank, allowing it to keep the creditor/debtor dispute at arms length.

(2) Agency Aspects

There are two basic legal models which might govern the relationships among the parties in the absence of well

defined contractual terms. The two models yield quite different consequences in the case where the creditor overdebits the account of the debtor.

In the first model, the bank is authorised by the debtor to pay certain of his debts. The contract between the creditor and the debtor contains a term, perhaps implied, whereby the creditor looks to the bank for payment of the debt. The bank is in the position of paymaster.

In the second model, the creditor is the agent of the debtor with authority to draw upon the debtor's account with the bank. In this model, the instructions to the bank to debit are seen as originating from the debtor via his agent, the creditor. The situation is analogous to that where an agent issues a cheque to himself as payee drawn on the principal's account.

The two models give rise to different liabilities in the case of an overdebit. If the first model is the correct one, the bank has exceeded its authority as paymaster. The debtor may look directly to the bank for restitution of the over-debited amount. In the second model, the bank has followed its instructions properly; it is the creditor who has exceeded his authority and it is to the creditor that the debtor must look to recover the over-debited amount.

Handwritten note:
The bank has exceeded its authority as paymaster.

There are several observations which suggest that the second model is preferable. Firstly, it fits the practice of existing systems better than the first model. In both the English Giro and the California automated clearing house system, the bank will place the accounts in their original position upon demand by the debtor.⁷⁴ Both systems require indemnities from creditors wishing to use the direct debit system;⁷⁵ there would be no need for such indemnities in the first model. Secondly, the second model avoids the fiction that the order to pay comes from the debtor.

In practice, the liabilities of each of the parties should be carefully defined by the contract to avoid disputes.

(3) Revocation

Revocation of the creditor's right to draw upon the account may clearly occur at any time prior to payment. Revocation is effected, in either of the legal models, by notice to the bank by the debtor.

(4) Procedural Safeguards

The direct debit system planned by the Databank system uses upper limits as a safeguard. Each direct debit order is compared against a pre-authorized limit; if the

74. Homrighausen, "One Large Step Toward Less-Check : The California Automated Clearing House System" 28 Bus. Law 1143.

75. Homrighausen, *supra*; Chorley, *The Law of Banking*.

limit is exceeded, the debit order is rejected. While this is undoubtedly a sensible procedure, in times of rapid inflation it may lead to an inordinate amount of administration work as it becomes necessary to obtain new authorisations for more realistic upper limits.

use of the card. In practice, this should be carefully spelled out in the contracts. However, as the interpretation of contracts often depends upon the nature of the relationship in the absence of the specific contractual terms, it is worth examining the legal framework of the point-of-sale system. The liability of the card-holder in negligence will then be briefly discussed.

(2) Agency Aspects

The apportionment of liabilities for the unauthorized use of the card must depend upon what is being authorized when the card is properly used. Again, two models present themselves for consideration.

First model is that the point-of-sale transaction is a direct credit. By use of the card and his personal identification number, the consumer is authorizing his bank to debit his account for the amount of the transaction. The retailer, by using a point-of-sale terminal for the transaction, authorized the bank to receive payment for his. Thus, in the event of an unauthorized use of the card, the bank is, in this model, acting without instruction from the customer and would be liable for the unauthorized debit to the customer's account.

D The Point of Sale System

(1) Introduction

The major problem to be considered here is the apportionment of liabilities in the event of unauthorised use of the card. In practice, this should be carefully spelled out in the contracts. However, as the interpretation of contracts often depends upon the nature of the relationship in the absence of the specific contractual terms, it is worth examining the legal framework of the point-of-sale system. The liability of the card-holder in negligence will then be briefly discussed.

(2) Agency Aspects

The apportionment of liabilities for the unauthorised use of the card must depend upon what is being authorised when the card is properly used. Again, two models present themselves for consideration.

The first model is that the point-of-sale transaction is a direct credit. By use of the card and his personal identification number, the consumer is authorising his bank to debit his account for the amount of the transaction. The retailer, by using a point-of-sale terminal for the transaction, authorises the bank to receive payment for him. Thus, in the event of an unauthorised use of the card, the bank is, in this model, acting without instruction from the customer and would be liable for the unauthorised debit to the customer's account.

The second model is that the point-of-sale transaction is a direct debit. If the direct debit is analysed as being a mandate from the customer to his bank to pay certain proper debts, then the result is the same as the first model. If, however, the direct debit is given the alternative interpretation, then the use of the point-of-sale card is an authorisation from the customer to the retailer. In this case, an unauthorised use of the point-of-sale card induces the retailer to act where no authority is present; it is the retailer who is then liable for the resulting loss.

but is the first model

It is submitted that the first model is more in accordance with the parties' intentions. Actual customer/bank contracts clearly contemplate that the bank will be primarily liable. The banks demand no indemnities from the retailer; indeed the major advantage of such systems, from the retailer's point of view, is that payment is assured at the time of the sale without the need to deal in cash or in cheques of doubtful validity. It may be that special rules as to account reversals should be legislated for point-of-sale transactions. The policy problem is to balance the interests of retailers on the one hand and consumers on the other. The issues involved are not too dissimilar to those which arise

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from the use of bank credit cards. 76

(3) Negligence

To what extent will the customer be liable for unauthorised use of his card, and personal identification number, which is caused by his negligence? The negligent loss of a cheque book has been held to impose no liability on the owner, since that negligence is too remote from the loss caused when the finder forges a cheque. There is a stronger case for imposing liability in the case of the point-of-sale card : The card/number system is self-contained in that all of the safeguards against unauthorised use are present when the combination falls into the wrong hands. There is no need for the thief to add his own signature or identifying mark.

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It is an intriguing question whether contributory negligence might be raised as a defence by claiming that the bank had failed to implement technical safeguards against the abuse of the system. The matter will not be explored here.

(4) Other Problems

The point-of-sale terminals bring to a sharp focus the

76. There have been many articles written on the subject. A good history of the problem may be found in Lester, "Unauthorised Use of Credit Cards and some Related Questions : What Problems Remain?" 62 Ky. L. J. 881.

twin issues of privacy and security. Widespread use of the terminals could easily permit the sort of surveillance illustrated in Appendix I.

Further, since these terminals communicate directly with the main computer, the dangers of wiretappings and unauthorised entry into the system are severe. In spite of many bland assurances from politicians, safeguards are by no means foolproof or even adequate.

Nationwide Database, 24 Computers and People 31.

DAILY SURVEILLANCE SHEET - CONFIDENTIAL - JULY 13, 1964.

SUBJECT : John G. Public, 4 Main Street, Anywhere, USA
Male, Age 40, Married, Electrical Engineer.

PURCHASES : Wall Street Journal, \$1.00; Breakfast, \$2.75;
Gasoline, \$5.00; Phone (111-1234), \$1.25; Phone (222-5678),
\$1.25; Lunch, \$4.00; Cocktail, \$1.50; Bank (cash withdrawal)
\$200.00; Dinner, \$125.67; Phone, (111-8765), \$1.25; Phone
(444-1111), \$1.00; Beer, \$12.50; Boston Globe, \$1.50.

COMPUTER ANALYSIS :

Own stock (90% probability).
heavy starch breakfast - probably overweight.
bought \$5.00 gasoline. Own W. So far this week subject
has bought \$25.00 worth of gasoline. Obviously doing
something besides driving 5 miles to work.
bought gasoline at 1.27 at gas station 6 miles from work.
subject probably late for work. Third such occurrence this
week.

PART IV : Appendix

The following example of a hypothetical "daily surveillance sheet" shows the degree of privacy invasion possible under a total EFT system. Although parts of the "surveillance" are somewhat artificial, it is nevertheless very disquieting. The example is from Van Tassel, "Daily Surveillance Sheet, 1987, From a Nationwide Databank", 24 Computers and People 31.

DAILY SURVEILLANCE SHEET - CONFIDENTIAL - JULY 13, 1984.

SUBJECT : John Q Public, 4 Home Street, Anywhere, USA.
Male, Age 40, Married, Electrical Engineer.

PURCHASES : Wall Street Journal, \$1.00; Breakfast, \$2.25; Gasoline, \$6.00; Phone (111-1234), \$.25; Phone (222-5678), \$.25; Lunch, \$4.00; Cocktail, \$1.50; Bank (cash withdrawal) \$200.00; Lingerie, \$135.67; Phone, (111-8769), \$.85; Phone (869-1111), \$.80; Bourbon, \$12.53; Boston Globe, \$.50.

COMPUTER ANALYSIS :

Owens stock (90% probability).
Heavy starch breakfast - probably overweight.
Bought \$6.00 gasoline. Owns VW. So far this week subject has bought \$25.00 worth of gasoline. Obviously doing something besides driving 9 miles to work.
Bought gasoline at 7.57 at gas station 6 miles from work. Subject probably late for work. Third such occurrence this week.

Phone no 111-1234 belongs to Joe Book. Book was arrested for illegal bookmaking in 1970, 1978 and 1982. No convictions.

Phone no 222-5678 belongs to expensive men's barber shop specialising in hair restoration.

Drinks during lunch.

Withdrew \$200 cash. Very unusual since all legal purchases can be made using Uniform Federal Funds Transfer Card. Cash usually used for illegal purposes.

Bought very expensive lingerie. Not his wife's size.

Phone no 111-8769 belongs to Jane Doe.

Phone no 869-1111. Reservation for Las Vegas (without wife).

Third trip in last three months to Las Vegas (without wife).

No job related firms in Las Vegas. Will scan file to see if anyone else has gone to Las Vegas at the same time and compare to subject's phone call numbers.

Purchased Bourbon. Third bottle this month. Either heavy drinker or much entertaining.

OVERALL ANALYSIS :

Subject left work at 4.00 pm since he purchased Bourbon 1 mile from his job at 4.10 pm. (opposite direction from his house).

Subject brought newspaper at 6.30 near his house. Unaccountable 2.5 hours.

Subject made three purchases today from young blondes. (Statistical 1 chance in 78) Probably has weakness for young blondes. (Jane Doe is a young blonde)

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Electronic funds
transfer in New Zea-
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Due

Borrower's Name

14/4

Guyton 1980

16-04-80

Gilby 1981

5/3/81

Rumours

22/12/82

J. O'Neil

-3 JUL 1986

16/6/86

H. P. de S.
dd 23/6/86

9861-255-81

CU L 89

18/3

J. Sear

20/03

N. H.

L.C.

