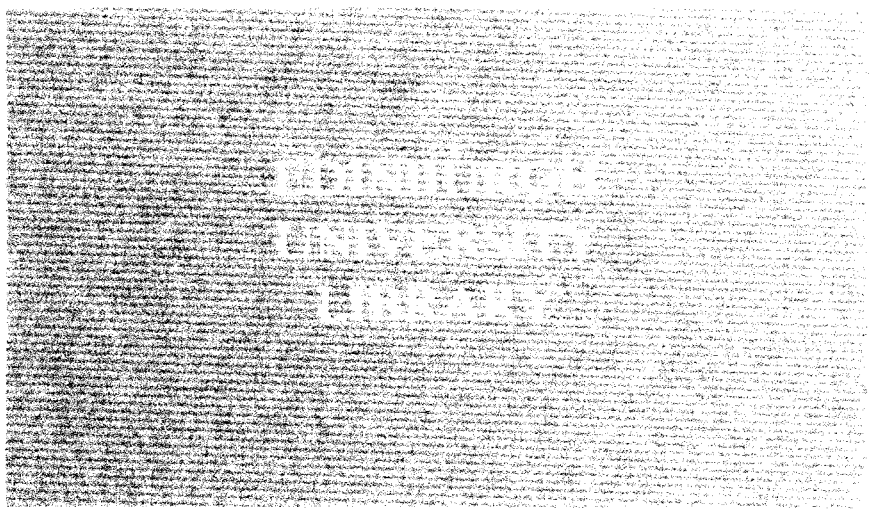


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THE LIABILITY OF BANKS IN ELECTRONIC FUND TRANSFER TRANSACTIONS:

A Study in the British and the United States Law

FAYYAD ALGUDAH

Ph.D.
THE UNIVERSITY OF EDINBURGH
1992



DEDICATION

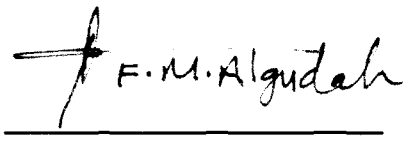
This thesis is dedicated to my parents;

the first tutors in my life.

DECLARATION

I hereby declare that unless otherwise mentioned by quotation or reference, this thesis has been entirely and solely composed by me. It has not been published or submitted to another degree.

Fayyad Algudah



October, 25th 1992.

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ABSTRACT

The liability of banks in electronic fund transfer (EFT) transactions is discussed in this thesis under the British and the United States law. The thesis covers banks' liability in electronic credit and debit transfers. It covers banks' liability in Electronic Fund Transfer at the Point Of Sale (EFTPOS), Automatic Teller Machines (ATM) and home and office banking. Liability of banks in credit card transactions and cheque truncation falls outside the scope of this thesis.

In the absence of British legislation in this area, an analogy is made with the traditional methods of payment. An attempt is also made to extract the applicable rules from the general principles of law and the banking practice. The discussion, under the United States law, relies on analysing the Electronic Fund Transfer Act of 1978 and Article 4A of the Uniform Commercial Code, which concern banks' liability in consumer and commercially based EFT transactions.

The thesis starts by analysing the legal nature of payment orders. In particular, whether a payment order is a negotiable instrument, a creation of trust funds, an assignation or merely a mandate from a customer to his bank. Chapter two discusses banks' liability for failure to make an EFT transaction. This encompasses banks' liability for complete failure to effect an EFT transaction and for improper implementation of such a transaction. Chapter three discusses the right to stop payment, completion of payment, irrevocability and banks' liability for failure to stop payment. Chapter four discusses banks' liability for erroneous EFT transactions. This includes allocation of losses resulting from errors in payment orders and errors committed by banks during the execution process of such orders. Chapter five discusses banks' liability for unauthorised EFT transactions. Issues such as authentication of payment orders, security measures adopted by banks and allocation of losses resulting from unauthorised transactions are discussed in this chapter. Chapter six discusses the recoverability of damages for banks' failure to implement customers' instructions properly. It discusses what measures of damages are applicable in certain situations such as banks' complete failure to make an EFT transaction, failure to transfer funds on time etc. The thesis is completed by summary and conclusion.

TABLE OF CONTENTS

Dedication. I
Declaration. II
Acknowledgement. III
Abstract. V
Table of Contents. VI
List of Cases XI

Introduction. 1

CHAPTER ONE
The Legal Nature of Payment Orders

1.1 A Search For Definition. . . . 11

1.2 The Payment Order v. Negotiable Instrument. . . . 17
1.2 [a] Under U.K Law. . . . 17
1.2 [b] Under U.S.A Law. . . . 20

1.3 The Payment Order v. Trust Fund. . . . 21
1.3 [a] Under U.K. Law. . . . 21
1.3 [b] Under U.S.A. Law. . . . 25

1.4 The Payment Order v. Assignation. . . . 30
1.4 [a] Under U.K. Law. . . . 31
1.4 [a] [i] Under Scots Law. . . . 31
1.4 [a] [i] [1] Credit Transfer Orders. . . . 32
1.4 [a] [i] [2] Debit Transfer Orders. . . . 33
1.4 [a] [ii] Under English Law. . . . 35
1.4 [a] [ii] [1] Statutory Assignment. . . . 36
1.4 [a] [ii] [2] Equitable Assignment. . . . 37
1.4 [b] Under U.S.A. Law. . . . 41

1.5 The Payment Order v. Mandate. . . . 48
1.5 [a] Under U.K. Law. . . . 48
1.5 [b] Under U.S.A. Law. . . . 58

CHAPTER TWO
Failure To Make An Electronic Fund Transfer Transaction

2.1 General. . . . 64

2.2 Duty to Repay Customers' Funds Generally. . . . 64
2.2 [a] Under U.K. Law. . . . 64
2.2 [b] Under U.S.A. Law. . . . 66

2.3 Duty to Make EFT Transactions. . . . 67
2.3.1 Electronic Credit Transfer Transactions. . . . 67
2.3.1 [a] Under U.K. Law. . . . 67
2.3.1 [b] Under U.S.A. Law. . . . 70
2.3.1 [b] [i] Common Law Rules. . . . 70
2.3.1 [b] [ii] Statutory Law Rules. . . . 71
2.3.1 [b] [ii] [1] Consemer-based Transactions. . . . 71
2.3.1 [b] [ii] [2] Commercially-based Transactions. . . . 71

2.3.2 EFTPOS & ATM Transactions. . . . 76
2.3.2 [a] Under U.K. Law. . . . 77
2.3.2 [b] Under U.S.A. Law. . . . 77

2.4 Scope of Banks' liability for Failure to Make an EFT. . . . 79
2.4.1 Electronic Credit Transfer Transactions. . . . 79
2.4.1 [a] Under U.K. Law. . . . 79
2.4.1 [a] [i] The Transferring Banks. . . . 79
2.4.1 [a] [ii] The Intermediary Banks. . . . 90
2.4.1 [a] [iii] The Payee's Banks. . . . 94

2.4.1 [b] Under U.S.A. Law. . . . 96
2.4.1 [b] [i] Common Law Rules. . . . 96
2.4.1 [b] [ii] Statutory Law Rules. . . . 106
2.4.1 [b] [ii] [1] Consumer-based Transactions. . . . 106
2.4.1 [b] [ii] [2] Commercially-based Transactions. . . . 108
i. The Receiving Banks. . . . 112
a- Liability for failure to accept a payment order contrary to an express agreement. . . . 112
b- Liability for noncompletion of the transfer. . . . 113
c- Liability for failure to execute properly. . . . 114
I. Proper Action. . . . 115
1. The amount term. . . . 115
2. The beneficiary term. . . . 115
3. The beneficiary's bank term. . . . 115
4. The intermediary bank term. . . . 116
i. Where the sender is a bank. . . . 117
ii. Where the sender is not a bank. . . . 118
5. The funds-transfer system term. . . . 120
6. The Manner of transmission term. . . . 121
II. Proper Time. . . . 123
1. The execution date term. . . . 123
2. The payment date term. . . . 125
ii. The Beneficiary's Banks. . . . 127
a- The obligation to pay the beneficiary. . . . 127
b- The obligation to notify the beneficiary. . . . 130
2.4.2 EFTPOS Transactions. . . . 131
2.4.2 [a] Under U.K. Law. . . . 131
2.4.2 [a] [i] The Purchaser's Banks. . . . 131
2.4.2 [a] [ii] The Retailer's Banks. . . . 132
2.4.2 [a] [ii] [1] Where the Retailer's Bank Guarantees Payment. . . . 132
2.4.2 [a] [ii] [2] Where the Retailer's Bank Only Collects Payment. . . . 133
2.4.2 [b] Under U.S.A. Law. . . . 133
2.4.2 [b] [i] The Purchaser's Banks. . . . 134
2.4.2 [b] [ii] The Retailer's Banks. . . . 136
2.4.3 ATM Transactions. . . . 136
2.4.3 [a] Under U.K. Law. . . . 136
2.4.3 [a] [i] Where an ATM is out of Service. . . . 137
2.4.3 [a] [ii] ATM's Wrongful Denial of Service. . . . 137
2.4.3 [b] Under U.S.A. Law. . . . 139

2.5 Special Case; Failure Caused by Malfunction. . . . 142
2.5 [a] Under U.K. Law. . . . 142
2.5 [b] Under U.S.A. Law. . . . 143

CHAPTER THREE
Failure To Stop An Electronic Fund Transfer Transaction

3.1 General. . . . 146

3.2 Finality of Payment. . . . 147
3.2.1 Electronic Credit Transfer Transactions. . . . 148
3.2.1 [a] Under U.K. Law. . . . 148
3.2.1 [a] [i] In-house Transfers. . . . 150
3.2.1 [a] [ii] Inter-bank Transfers. . . . 154
3.2.1 [a] [ii] [1] Credit Notification. . . . 155
3.2.1 [a] [ii] [2] Credit Instructions. . . . 158
3.2.1 [b] Under U.S.A. Law. . . . 164
3.2.1 [b] [i] The Rule under Article 4A. . . . 164
3.2.1 [b] [ii] The Rules under Specific Payment Systems. . . . 166
3.2.1 [b] [ii] [1] FedWire. . . . 167
3.2.1 [b] [ii] [2] CHIPS. . . . 168
3.2.2 EFTPOS Transactions. . . . 171
3.2.2 [a] On-Line EFTPOS Schemes. . . . 171
3.2.2 [b] Off-Line EFTPOS Schemes. . . . 172

3.3 The Scope of Banks' Liability for Failure to Stop an EFT. . . . 173

3.3.1 Electronic Credit Transfer Transactions. . . . 174
3.3.1 [a] Under U.K. Law. . . . 174
3.3.1 [b] Under U.S.A. Law. . . . 177
3.3.1 [b] [i] Common Law Rules. . . . 177
3.3.1 [b] [i] Statutory Law Rules. . . . 180
3.3.1 [b] [i] [1] Consumer-based Transactions. . . . 180
3.3.1 [b] [ii] [2] Commercially-based Transactions. . . . 186
i. Cancellation or Amendment Before Acceptance. . . . 187
ii. Cancellation and Amendment After Acceptance. . . . 189
3.3.2 EFTPOS Transactions. . . . 193
3.3.2 [a] Under U.K. Law 193
3.3.2 [b] Under U.S.A. Law. . . . 193

CHAPTER FOUR
Erroneous Electronic Fund Transfer Transactions

4.1 General. . . . 196

4.2 Electronic Credit Transfer Transactions. . . . 196
4.2.1 Erroneous Payment Orders. . . . 197
4.2.1 [a] Under U.K. Law. . . . 197
4.2.1 [b] Under U.S.A. Law. . . . 204
4.2.1 [b] [i] Consumer-based Transactions. . . . 204
4.2.1 [b] [ii] Commercially-based Transactions. . . . 204
4.2.2 Erroneous Execution of Payment Orders. . . . 211
4.2.2 [a] Under U.K. Law. . . . 211
4.2.2 [a] [i] Erroneous Amount. . . . 211
4.2.2 [a] [ii] Unintended Beneficiary. . . . 213
4.2.2 [a] [iii] Recoverability of Erroneous Payment from the Payee. . . . 216
4.2.2 [a] [iii] [1] Under the Scots Law. . . . 217
4.2.2 [a] [iii] [2] Under the English Law. . . . 219
4.2.2 [b] Under U.S.A. Law. . . . 225
4.2.2 [b] [i] Consumer-based Transactions. . . . 225
4.2.2 [b] [i] [1] Error Resolution Procedures. . . . 225
i. The Bank's Duty to Notify Consumers of Error Resolution Procedures. . . . 226
ii. The Consumer's Duty to Notify Errors. . . . 226
iii. Acts Constituting Errors. . . . 228
iv. The Investigation of the Alleged Error. . . . 228
v. The Implementation of the Investigation's Result. . . . 231
a- Existence of the Alleged Error. . . . 231
b- Absence of the Alleged Error. . . . 232
c- Existence of a Different Error. . . . 233
vi. Liability for Noncompliance with the Error Resolution Procedures. . . . 234
a- Failure to Disclose Error Resolution Provisions. . . . 234
b- *Mala fide* Noncompliance with the Investigation. . . . 234
c- *Bona fide* Noncompliance with the Investigation. . . . 235
4.2.2 [b] [i] [2] Post-Error Resolution Procedures. . . . 235
4.2.2 [b] [i] [3] Exceptions; Errors Caused by Act of God or Technical Malfunction. . . . 238
4.2.2 [b] [ii] Commercially-based Transactions. . . . 239
4.2.2 [b] [ii] [1] Erroneous Amount. . . . 239
4.2.2 [b] [ii] [2] Unintended Beneficiary. . . . 242
4.2.2 [b] [iii] Recoverability of Erroneous Payment Under the Law of Mistake and Restitution. . . . 247

4.3 EFTPOS Transactions. . . . 255
4.3.1 The Purchaser's Banks. . . . 255
4.3.1 [a] Under U.K. Law. . . . 256
4.3.1 [b] Under U.S.A. Law. . . . 258
4.3.2 The Retailer's Banks. . . . 259
4.3.2 [a] Under U.K. Law. . . . 260
4.3.2 [b] Under U.S.A. Law. . . . 261

4.4 ATM Transactions. . . . 261
4.4 [a] Under U.K. Law. . . . 261
4.4 [b] Under U.S.A. Law. . . . 262

CHAPTER FIVE
Unauthorised Electronic Fund Transfer Transactions

5.1 Authority in General. . . . 263

5.2 Definition of Unauthorised EFT 263

5.3 Authentication of Instructions. . . . 267

5.4 The Scope of Banks' Liability for Unauthorised Credit Transfer Transactions. . . . 270
5.4 [a] Under U.K. Law. . . . 271
5.4 [b] Under U.S.A. Law. . . . 283
5.4 [b] [i] Consumer-based Transactions. . . . 283
5.4 [b] [ii] Commercially-based Transactions. . . . 284
5.4 [b] [ii] [1] No Security Procedure is Used. . . . 284
5.4 [b] [ii] [2] The Use of Security Procedure. . . . 287
a- The Nature of the Security Procedure. . . . 289
b- Security Procedure's Requirements. . . . 291
1. The Commercial Reasonableness of the Security Procedure. . . . 292
2. The Acceptance of the Payment Order in Good Faith. . . . 298
3. The Bank's Compliance with the Security Procedure. . . . 299
4. Compliance with any Written Agreement or Instructions of the Customer Restricting Acceptance of Payment Orders. . . . 302
c- Special Case: Customer's Refusal of Commercially Reasonable Procedure. . . . 305
d- Unenforceability of Certain Verified Payment Orders. . . . 310
1. Express written agreement of the bank. . . . 310
2. Proof that the customer's "shop" was "clean". . . . 311
e- The Liability of the Receiving Bank to Refund Customers for Unauthorised and Unenforceable Payment Orders. . . . 314

5.5 The Scope of Banks' Liability for Unauthorised EFTPOS and ATMs Transactions. . . . 315
5.5.1 Security System in Use. . . . 315
5.5.2 Security and Authentication Concerns. . . . 316
5.5.2 [a] In the United Kingdom. . . . 316
5.5.2 [b] In the United States. . . . 317
5.5.3 Scope of Liability. . . . 319
5.5.3 [a] Under U.K. Law. . . . 320
5.5.3 [a] [i] Issue of Cards and PINs. . . . 320
5.5.3 [a] [ii] Security of Cards and PINs. . . . 321
5.5.3 [a] [iii] Notification of Lost or Stolen Cards and Unauthorised Transactions. . . . 322
5.5.3 [a] [iv] The Extent of Customers' Liability. . . . 322
5.5.3 [a] [v] Two Exceptions: Customer's Fraud and Gross Negligence. . . . 323
5.5.3 [a] [vi] The Burden of Proof. . . . 325
5.5.3 [b] Under U.S.A. Law. . . . 325
5.5.3 [b] [i] Unauthorised EFTPOS and ATM Transactions. . . . 325
5.5.3 [b] [ii] The Extent of Customers' Liability. . . . 327
1. Tiers of Liability. . . . 328
2. The Effect of Consumer's Negligence. . . . 329
3. Notice of Unauthorised Use. . . . 331
5.5.3 [b] [iii] The Burden of Proof. . . . 332

CHAPTER SIX
Damages

6.1 General. . . . 336

6.2 The Measure of Damages for Breach of Contractual Duty and its Applicability to EFT Transactions. . . . 337

6.3 The Measure of Damages for Breach of Delictual Duty and its Applicability to EFT Transactions. . . . 339

6.4 Damages Recoverable in Electronic Credit Transfer Transactions. . . . 341
6.4.1 Damages Recoverable from the Transferring Banks. . . . 341
6.4.1 [a] Under U.K. Law. . . . 342
6.4.1 [a] [i] Damages Recoverable For Breach of Contractual Obligation. . . . 342
6.4.1 [a] [i] [1] Direct Damages. . . . 343

6.4.1 [a] [i] [2] Consequential Damages. 346
6.4.1 [a] [i] [3] Recoverability of Interest as Damages. 352
6.4.1 [a] [i] [4] Recoverability of Currency Exchange Losses. 360
6.4.1 [a] [i] [5] The Trader Rule. 366
6.4.1 [a] [i] [6] The Soundness of the Applicability of Common Law Rules of Consequential Damages in EFT Transactions. 368
6.4.1 [a] [ii] Damages Recoverable for Breach of Delictual Obligation. 370
6.4.2 [a] [ii] [1] Banks' Negligent Performance of Services. 371
6.4.2 [a] [ii] [2] Banks' Negligent Misrepresentation. 372
6.4.1 [a] [iii] Reduction of Damages for Contributory Negligence. 378
6.4.1 [b] Under U.S.A. Law. 380
6.4.1 [b] [i] Damages Recoverable in Consumer-based Transactions. 381
6.4.1 [b] [i] [1] General. 381
6.4.1 [b] [ii] [2] The Measure of Damages Applicable for Banks' Failure to Properly Make or Stop an EFT. 382
a_ "All Damages Proximately Caused" 382
b- "Actual Damages Proved". 385
6.4.1 [b] [i] [3] The Measure of Damages for Specified Error Resolution Violations. 391
6.4.1 [b] [i] [4] The Measure of Damages Applicable for Bank's failure to Comply with EFTA's Provisions. 392
a- The General Rule. 392
b- The Scope of Recovery. 394
c- Exceptions and Defences. 402
i. Inadvertent Errors. 402
ii. Good Faith Conformity. 403
iii. Corrective Measures. 404
iv. Prescription. 405
6.4.1 [b] [ii] Damages Recoverable in Commercially-based Transactions. 406
6.4.1 [b] [ii] [1] The Measure of damages for the Receiving Bank's Failure to Execute. 406
a- Direct Damages. 406
b- Consequential Damages. 408
6.4.1 [b] [ii] [2] The Measure of Damages for the Receiving Bank's Improper Execution. 412
a- Direct Damages 413
b- Consequential Damages. 413
6.4.1 [b] [ii] [3] The Measure of Damages for Delayed Transfer. 414
a- Direct Damages. 415
b- Consequential Damages. 415
6.4.2 Damages Recoverable from Beneficiary's Banks. 416
6.4.2 [a] Under U.K. Law. 416
6.4.2 [b] Under U.S.A. Law. 418

6.5 Damages Recoverable in EFTPOS & ATM Transactions. 422
6.5 [a] Under U.K. Law. 422
6.5 [b] Under U.S.A. Law. 426

Summary and Conclusion 428
List of References 472
Selected Bibliography 486

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Abyaneh v. Merchants Bank, North 670 F. Supp. 1298 (M.D. Pa. 1987)
Accord, People ex rel. Resnick v. Curtis & Davis, Architects & Planners, Inc., 78 Ill.2d 381; 400 N.E.2d 918 (1980).
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INTRODUCTION

Payment is central to any commercial transaction. Thus, it is no surprise that payment law was the first part of the merchant law to be codified in the most important two commercial centres of the world. In the United Kingdom the law governing negotiable instruments was codified in the Bills of Exchange Act in 1882. In the United States of America, the Negotiable Instrument Law was promulgated by the National Conference of Commissioners on Uniform State Laws in 1896 and implemented by most major commercial states within a decade. The rapid development of technology introduced new electronic methods of payment. In the United States, for example, on an average business day more than one trillion dollars is transferred by wire in connection with a variety of commercial transactions.[1] If the importance of a certain method of payment is to be judged by the total amount effected via such a method, it is beyond doubt that electronic fund transfer (EFT) systems would be the most important method of payment.[2]

There is no consensus on a given definition of the term "electronic fund transfer". In the United Kingdom, the Review Committee Report defines EFT as "a funds transfer effected through the banking system by electronic techniques, with input and output methods being largely or completely in electronic form".[3] The American

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[1] The Prefatory note of Article 4A of the Uniform Commercial Code (U.C.C.). See also Miller & Davenport, Introduction to the Special Issue on the Uniform Commercial Code, [1991] 45 The Business Lawyer, 1389, 1391.

[2] See The Bank for International Settlements, Payment in Eleven Developed Countries, 1989, at 291, Table C: Relative Importance of Cashless Payment Instruments in the Payment Systems (there were 49.2 billion cheques issued in the United States, 9.1 billion credit cards transactions and only 84 million wire transfers. However, of the total dollar amount of funds transferred, wire transfers accounted for $281 trillion, while cheques and credit cards accounted for $55.9 trillion and $375 billion respectively). See for a statistical analysis of payment systems in the United Kingdom, Banking Service: Law and Practice Report by the Review Committee chaired by Prof. Jack R.B., (Cm 622), Appendix D. Hereinafter referred to as the Review Committee Report. No legislation has been passed in response to that Report. A non-binding code of banking practice entitled "Good Banking" has been issued by the British Bankers' Association, the Building Societies Association and Association for Payment Clearing Services. The Code was made effective from 16th of March 1991 and will be reviewed, at least, every two years. Banks may, however, observe higher standard of practice.

[3] The Review Committee Report, supra, at para. 9.02.

Electronic Fund Transfer Act of 1978 (EFTA) defines EFT as:[4]

> "any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but not limited to, point-of-sale transfers, automated teller machine transactions, direct deposits or withdrawals of funds, and transfers initiated by telephone."

It is a starting point for any work on EFT to define such a term, since the scope of the discussion will heavily depend on such a definition. No substantial departure is intended to be made from these common definitions. A slightly modified definition of an EFT transaction is formulated by this thesis. An EFT transaction, in this thesis, means "a funds transfer carried out through the banking system by electronic means pursuant to a payment order, regardless whether such funds transfer is originated by a non-electronic means". According to this definition, two extreme approaches are avoided. First, the expansive approach in which EFT is defined to mean a fund transfer in which one step, at least, in the transfer process is conducted by electronic means.[5] Second, the restrictive approach in which EFT is defined to mean a fund transfer originated and effected completely by electronic means. According to this definition, all the steps of the payment process including its initiation must be made by electronic means.[6] The definition adopted by this thesis stems from the nature of EFT transactions and banking practice both in the United Kingdom and the United States. The fact that a customer instructs his bank by filling

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[4] 15 U.S.C. § 1693a(6).

[5] See The UNCITRAL Legal Guide on Electronic Fund Transfers, A/CN.9/SER.B/1, prepared by the Secretariat of the United Nations Commissions on International Trade Law. United Nations Publications, New York 1987. Hereinafter referred to as UNCITRAL Legal Guide. It defines EFT, at para. 6, as "a funds transfer in which one or more of the steps in the process that were previously done by paper-based techniques are now done by electronic techniques."

[6] Although, the EFTA's definition requires that an EFT should not be "originated by check, draft, or similar paper instrument" but "initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape" no requirement that the other steps of the funds transfer should be undertaken by electronic means.

a paper-based form should not exclude the transaction from being an EFT transaction so long as the transaction is effected through the banking system by electronic means. Not all banks' customers originate their EFT transactions by electronic means. Indeed, in practice and especially on the consumer level, banks have their own standard payment forms which a customer must fill and sign in order to effect, for example, a credit transfer from his account. Since, the funds transfer reaches its last station by crediting the payee's account by the amount of the transfer, the mere delivery of such funds to the payee by means of a bank's draft or a cheque, for example, does not exclude such transaction from the ambit of the adopted definition.

Any fund transfer is initiated by a payment order. It is either a credit or a debit transfer. A credit transfer is often described "as one in which the funds are pushed from the transferor to the transferee".[7] The debit transfer is a transfer "in which the funds are pulled from the transferor to the transferee".[8] According to this definition, all credit and debit transfer transactions executed by banks through an electronic means are included. It does not matter whether such transaction is initiated by other means such as filling a paper-based standard form. Thus, transfer of funds through electronic clearing houses is within the scope of this definition.[9] Since the transfer of funds by home and office banking systems is usually carried out by electronic means, such as a computer-to-computer message or a telephone call, it is within the ambit of this definition. The well-known Girobank is also covered by this definition as a credit transfer. Debit transfers when carried out by electronic means through the banking

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[7] UNCITRAL Legal Guide, supra, at para. 8.

[8] Ibid, at para. 14.

[9] This includes in the United Kingdom, transfer of funds through The Bankers' Automated Clearing Services Ltd (BACS) and the Clearing House Automated Payment System (CHAPS). In the United States, the definition includes transfer of funds through Federal Reserve system's electronic communication network (FedWire) and the Clearing House Interbank Payments System (CHIPS).

system falls within the scope of this definition. The thesis concentrates mainly on Electronic Fund Transfer at the Point Of Sale (EFTPOS) as the commonly used electronic debit transfer. EFTPOS transactions are included in the definition of EFT transaction whether initiated by a combination of a debit card and a Personal Identification Number (PIN), or by a debit card and a signature on a sale slip. Transfer, deposit and withdrawal of funds by the use of Automated Teller Machines (ATMs) is also included.

Credit card transactions fall outside the scope of this definition. An important feature of credit card transactions is that a user is given access to a line of credit by the card issuer and no debit is made to his bank's current account. The user's obligation arising out of such transaction is usually discharged by another separate fund transfer to the card issuer. There is no instruction to a bank to transfer funds from the user's account to the payee's account, nor authorisation to the payee to debit the user's account. As such this transaction falls outside the scope of the definition of EFT transaction as adopted by this thesis. Another transaction which falls outside the scope of this definition is truncation of cheques and bills of exchange. Although the payment of a truncated cheque or bill of exchange is effected by some sort of electronic messages from the transferring (drawee) bank to the beneficiary's (depositary) bank, this is done pursuant to the deposit of a cheque or a bill of exchange and not a "payment order".[10] Both a truncated cheque and a bill of exchange are considered by the law as a cheque and a bill of exchange, with the effect that the law relevant to such instruments would continue to apply to such debit instructions with some potential consequences if the law is not modified to

[10] For what is meant by a "payment order", see chapter one.

accommodate such electronic processing.[11]

The aim of this thesis is to determine what is the scope of banks' liability in EFT transactions under the British and the United States law. This is done under separate sections because of the detailed regulation of EFT transactions under the United States law compared with a total lack of legislation in the United Kingdom. Thus, under the British law the object is to define what is the liability of banks in EFT transactions by extracting the applicable rules from a wide range of general principles of law and banking practice. Since the law in this area is in its infancy, a major problem is the lack of direct judicial authorities, in the case of British law, and a lack of judicial interpretation of some statutory terms in the case of American law. Moreover, the law relating to EFT transactions is not yet shaped. One view is that banks' liability for disclosure of confidential information is an issue of EFT. This is based on the fact that more information is captured about customers' financial dealings, which could be easily exchanged with other financial institutions for marketing purposes. However, taking into account that such a duty of the banks is already well-known in other banking transactions and not a direct consequence of this new method of payment, it is not discussed in this thesis. However, this should not obscure the fact that banks should take more precautions to protect their customers' privacy in EFT transactions. The general rules of banks' duty of confidentiality is applicable under EFT transactions.

The approach taken is that analysis of banks' liability should follow the process of the funds transfer from its initiation till its deviation or completion. The first chapter, however, discusses the legal nature of payment orders. The aim of this

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[11] The Legal Guide, supra, at para. 46.

chapter is to define the legal nature of the payment orders used to trigger the EFT transaction itself. In particular, an attempt is made to "fit them in", if possible, one of the already recognised concepts of law such as negotiable instruments, assignation, creation of trust funds or authorisation and mandates.

Tracing such payment orders starts in chapter two. Since no bank could be held liable unless it is bound to accept such payment orders, an analysis of whether banks are under a duty to accept such orders should be discussed before holding banks liable for failure to accept such orders. This, and whether banks under a duty to notify customer of their rejection of such orders if not under a duty to accept them, are discussed under chapter two. Where a bank is liable to carry out its customer's payment order, its liability for complete failure to effect such order is discussed. This includes banks' liability for failure to make an EFTPOS and ATM transaction. Moreover, since banks may fail to carry out EFT transactions properly as instructed, their liability for such failure is also discussed under chapter two. In general, chapter two attempts to investigate the scope of banks' liability for failure to make an EFT transaction, whether such failure is a complete failure to effect the transaction entirely or a mere deviation from the terms of its customer's instructions.

A person may change his mind and countermand or cancel a payment order given to his bank to make or effect an EFT transaction. If his bank honours such instruction, no problems as between the bank and its customer may arise. However, as the case in other traditional methods of payments, such as cheques, a bank may fail to respond properly to such instructions. Chapter three discusses whether bank's customers are entitled, at all, in the view of some instantaneous funds transfer, to this right. It also discusses relevant issues such as completion of payment and

irrevocability of funds transfer. Banks' liability for failure to respond to a properly given countermand instructions is discussed in this chapter.

Although a bank may carry out its customer's instructions to make an EFT transaction, it may do so erroneously. The occurrence of errors in banking transactions is certainly not uncommon. EFT transactions are no exception. Indeed, an error in a computer may have far reaching effects than it does in other traditional methods of payment. That is so because a computer's error is likely to propagate and thus affects more customers. Chapter four approaches the erroneous EFT transactions by looking at who causes the error in the transaction and at what stage of the transaction. An error could be found in the payment order when it is delivered to the bank. It may occur during the execution process of the funds transfer transaction. The chapter discusses the allocation of loss between the bank and its customer in such cases. It also discusses whether the party who bears such risk of loss is entitled to recover the erroneous payment from the payee or his bank under the common law and equity rules. It also investigates whether the law affords individual consumers any assistance in resolving such errors without forcing them, in practice, to give up their small claims because of the expenses of judicial litigation.

Chapter five deals with a long standing problem in banking transactions. It covers banks' liability for effecting an unauthorised EFT transaction. The main driving cause behind such unauthorised transactions is, as usual, fraud. The chapter investigates whether banks are liable to take extra security precautions in EFT transactions compared with those under other traditional payment systems. Whether the typical authentication methods in other payment systems are still workable in EFT transactions is also discussed. This includes an analysis of other alternative methods

of authentication introduced by the new technology and their susceptibility to old and new fraudulent schemes. However, where a fraud does occur, the allocation of loss resulting from such occurrence is also discussed.

Where a bank is found liable for breach of one or more of its duties under an EFT transaction, an aggrieved party may sue for damages. Chapter six attempts to decide what measure of damages is applicable in the different situations of banks' breach of their duties under an EFT transaction. This mainly includes bank's complete failure to make the EFT transaction in question, or its failure to make it properly as instructed. Where there is no statutory designation of a measure of damages, an attempt is made to apply the general principles of law to formulate a measure of damages in specific situations of banks' breach of their duties. The potential losses in certain breach of contract situations and the likelihood of their recoverability are also discussed.

A summary and a conclusion of these chapters complete this thesis. The summary and conclusion do not contain all my views and suggestions on the subject matter of the thesis. These can be found under the specific issues. It is an attempt to recollect the main ideas and issues discussed in more detail in the thesis. It deals mainly with the British law. One of the main points that the conclusion attempts to answer is whether the current law in the United Kingdom in EFT environment is satisfactory. Because of the absence of regulation in the United Kingdom in EFT transactions, the question whether regulation is needed is discussed.

The thesis does not purport to cover banks' liability under a specific payment card issued by commercial banks. These payment cards are issued according to terms and conditions of use which differ, to certain extent, from one bank to another. In

addition to the vast number of such cards and the different use of them, banks often issue new cards with different terms and conditions of use. However, where a specific payment card or EFT payment system is discussed, this is done by way of illustration.

The statutory distinction made under the American law between consumer and commercial credit transfer transactions is kept in the discussion of banks' liability through out the thesis. The scope of the analysis of the United States law in this thesis follows this distinction and thus is restricted to wholesale credit transfer under Article 4A of the Uniform Commercial Code and EFT transactions subject to EFTA. Thus, the law as regulated by local State laws is outside the scope of this work.[12] No such distinction is made under the British law. Banks' liability is discussed under separate headings according to the nature of the transaction in question. In particular, whether a transaction is credit transfer, EFTPOS, or an ATM. However, EFTPOS and ATM transactions are usually consumer-based transactions. Banks' liability under other debit transfer transactions is comparable with EFTPOS transactions. However, where there is no substantial difference between banks' liability under EFTPOS and ATM transactions, the discussion is combined under one heading. To avoid reiteration, the discussion of banks' liability under EFTPOS and ATM transactions in the United States law is restricted to the degree that it differs from that under credit transfer in consumer-based transactions. That is because, under EFTA the same rules of banks' liability are applicable to electronic credit transfer, EFTPOS and ATM transactions. Thus, since the discussion of liability of banks in credit transfer transactions in this thesis always precedes that in EFTPOS and ATM the rules discussed under the former

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[12] For a comprehensive coverage of State laws on EFT transactions, see Zimmer & Einhorn, The Law of Electronic Funds Transfer (1991), 2 vols., where there is a state-by-state coverage of these laws.

are, to the extent of practicability, applicable to the latter unless otherwise mentioned.

In this thesis, the person who initiates a credit transfer transaction is called the payer. His bank is called the transferring bank or the payer's bank. The person who is entitled to receive the payment is referred to as the payee or the beneficiary. His bank, thus, is the payee's bank or the beneficiary's bank. Any bank acts for these two banks in sending or receiving payment orders is called an intermediary bank. However, this rule is varied when discussing liability under Article 4A. Only in that case, the terminology used by this Article is followed. In debit transfer transactions, the person entitled to be paid is also called the payee or the beneficiary. His bank is thus called the payee's or the beneficiary's bank. The person who pays is called the payer, and thus his bank is the payer's bank. However, in EFTPOS transactions, the person who purchases goods or obtains services by the use of EFTPOS card is referred to as the purchaser although he is a payer. His bank, thus, is called the purchaser's bank. The person who sells goods or supplies services to the purchaser under an EFTPOS card scheme is called the retailer. His bank is referred to as the retailer's bank. In ATM transactions, the bank that issues a cash card to be used in ATMs is referred to as the card issuer or the customer's bank.

I have sought to state the law as it stands at the end of August 1992.

CHAPTER ONE

THE LEGAL NATURE OF PAYMENT ORDERS

1.1 A Search For Definition.

The Glossary of the UNCITRAL Legal Guide on Electronic Funds Transfers defines "funds transfer instruction" as:

> "message or that part of a message that contains the instruction and required details for a funds transfer. A funds transfer instruction may be further indicated to be a debit transfer instruction or a credit transfer instruction."

The Draft UNCITRAL Model Law on International Credit Transfers defines a "payment order" in Article 2(b) as:[1]

> "an unconditional instruction by a sender to a receiving bank to place at the disposal of a beneficiary a fixed or determinable amount of money if: (i) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and (ii) the instruction does not provide that payment is to be made at the request of the beneficiary. When an instruction is not a payment order because it is issued subject to a condition but the condition is subsequently satisfied and thereafter a bank that has received the instruction executes it, the instruction shall be treated as if it had been unconditional when it was issued."

There is no statutory definition of payment orders in the United Kingdom. The "Glossary of terms" attached to the Code of Good Banking does not offer any definition of payment orders. The prominent view of the legal literature on the point is that a "payment order" is an instruction or a mandate from a customer to his bank carried out within the agency law rules.[2] Two recent English cases have shed some

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[1] As reproduced in the Annex to the Report of the United Nations Commission on International Trade Law on its 24th Session, Vienna, June 1991, United Nations Document, A/CN.9/344.

[2] e.g., Arora A., Electronic Banking and the Law, at 49-53; Goode R.M. (ed.), Electronic Banking, The Legal Implications, at 34-37; Pennington, Hudson, and Mann, Commercial Banking Law, (1978), at 283-291; Ellinger, Modern Banking Law, at 363-374; Chitty on Contracts, (26th ed. 1989), at para. 2955; Ellinger, "The Giro System and Electronic Transfers of Funds", [1986] L.M.C.L.Q. 178, at 195; and Arora A., Recent Development in Money Transfer Methods [1980] L.M.C.L.Q. 416, at 418-423. *C.f.*, Chorley, Law of Banking (6th ed. 1974), at 268-269 (an assignment).

light on the point. In *Royal Products Ltd. v. Midland Bank Ltd.*,[3] the court considered the legal nature of payment order to make a credit transfer from one account to another. In that case, Webster J. said:[4]

> "In my judgment [money transfer orders] are to be regarded simply as an authority and instruction, from a customer to its bank, to transfer an amount standing to the credit of that customer with that bank to the credit of its account with another bank, that other bank being impliedly authorized by the customer to accept that credit by virtue of the fact that the customer has a current account with it, no consent to the receipt of the credit being expected from or required of that other bank, by virtue of the same fact. It is in other words, a banking operation, of a kind which is often carried out internally, that is to say, within the same bank or between two branches of the same bank and which, at least from the point of view of the customer, is no different in nature or quality when, as in the present case, it is carried out between different banks."

The nature of CHAPS payment order was considered by the Criminal Division of the Court of Appeal in *R v. King and Others*.[5] In that case, the question was whether a CHAPS order created a right to property and thus a valuable security, of which execution can be procured by deception contrary to § 20(2) of the Theft Act 1968. Reading the judgement of the court, Lord Lane said:[6]

> "The CHAPS order is certainly a document. Its effect is to direct the paying bank to debit the paying customer's account with £x (plus any charges) and to transfer the £x to the credit of the payee's account at another bank and to do so by means of an electronic device which would carry out the necessary operations as soon as the staff of the paying bank key the information contained in the document into the machine and then put the machine into operation."

A payment order is statutorily defined under the United States law. There are two principal EFT statutes in the United States. The Electronic Fund Transfer Act

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[3] [1981] 2 Lloyd's Rep. 194. See also *Scott v. Porcher* (1817) 34 L.T. 735; and *Morrel v. Wootten* (1852) 16 Beav. 197 (where it was held that an instruction to pay amounted to no more than a mandate to the mandatory which conferred no right or interest on the payee before payment).

[4] [1981] 2 Lloyd's Rep. 194, 198.

[5] [1991] 3 All E.R. 705.

[6] [1991] 3 All E.R. 705, 709.

(EFTA) of 1978,[7] and Article 4A of the Uniform Commercial Code.[8] No express definition of "payment orders" is offered by § 1693a of EFTA which deals with definition of terms used in the Act. The U.C.C.§ 4A-103(a)(1) defines a "payment order" in wholesale credit transfer as:

> "an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay or to cause another bank to pay a fixed or determinable amount of money to a beneficiary if: (i) the instruction does not state a condition to payment to the beneficiary other than time of payment, (ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and (iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, fund transfer system, or communication system for transmittal to the receiving bank."[9]

All the definitions mentioned above deals with a "payment order" in credit transfer transactions except the definition of the UNCITRAL Legal Guide. Thus the definition adopted by each of them reflected this fact. Since the scope of this thesis encompasses both types of EFT transactions, i.e. debit transfer as well as a credit transfer, any definition adopted by this thesis should reflect this fact. The restriction to the definition of payment orders in the above quoted definitions does not arise from the nature of payment orders as a term but from the scope of the transaction or transactions under consideration. A "payment order" in this thesis means:

> "an instruction transmitted, directly or indirectly, to a bank to make or to cause another bank to make a credit or a debit transfer of a fixed or determinable sum of money to a beneficiary which does not state a condition to payment to the beneficiary other than time of payment."

According to this definition, a payment order has the following material

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[7] 15 U.S.C. § 1693 et seq.

[8] U.C.C. § 4A is applicable to wholesale wire transfers only. This is known in banking circles to involve the movement of larg amounts of money between big commercial and financial entities such as banks in connection with commercial daily cash management activities. It is not applicable to consumer-based transactions. See U.C.C. §§ 4A-104(a) and 4A-108.

[9] For a graphical analysis of the payment order under Article 4A, see Fry P.B., A Primer on the Rules Governing Electronic Financial Services, ALI-ABA Course of Study, Basics of Computer Law, C601 ALA-ABA 135, WESTLAW, Database TP-ALL. See also for a discussion of the elements of a payment order under Article 4A, McKelvy T.E. (Note), Article 4A of the Uniform Commercial Code: Finality, Banks and Their Customers Know Where They Stand and Who Pays When a Wire Transfer Goes Awry [1991] 21 Memphis State University L. Rev. 351.

elements:

1. The language of the payment instructions must be imperative.[10] The use of the word "instruction" indicates such character. No particular form of words is necessary so long as it is imperative. Thus, "pay X", "credit X's account in Y bank", "debit my account No. (given an account number) for the benefit of X in his account No. (given an account number)"; or "transfer $X from my account No. (given an account number) to account No. (given an account number) in Y bank", satisfies this element.

2. The payment instructions must be for the payment or collection of a fixed or determinable amount of money. Such a payment order may require currency conversions on a future date to a domestic currency, but the sum must not be uncertain or subject to change.[11] One suggests that this condition can be construed by courts, both British and American, in the light of their interpretation of "a sum certain in money" requirement in the case of bills of exchange.[12] A sum is certain although it is to be paid with interest, or at an indicated rate of exchange, or rate to be ascertained in the future as directed.[13] An order by a person to his bank instructing an act to be done in addition to the payment or collection of money is not an EFT order.[14]

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[10] It was held in *Little v. Slackford* (1878) 173 E.R. 1120, that the sentence "please to let the bearer have £7 and place to my account and you will oblige your humble servant" was not an imperative language. However, the mere use of polite expressions by themselves such as "please" does not necessarily mean that the instructions are not an order. See in Scotland, *Provost of Airdrie v. French* (1915) 31 Sh.Ct.Rep. 189.

[11] Fry, P.B., Basic Concepts in Article 4A: Scope and definitions [1990] 45 The Business Lawyer, 1401, at 1408. Hereinafter cited as Fry, Basic Concepts.

[12] In U.K. see § 3(1) of Bills of Exchange Act 1882 (BEA 1882), "a sum certain in money". In U.S.A. see U.C.C. § 3-104(1)(b), "a sum certain in money". U.C.C. § 4A-103(1) which covers EFT payment orders, adopts the term "a fixed or determinable amount of money".

[13] See Prof. Wilson, The Scottish Law of Debt, (2nd ed. 1991), par.5-3. It was held in Scotland in *Lamberton v. Aiken* (1899) 2 F. 189, that a sum "together with any interest that may accrue thereon" is not certain.

[14] By analogy with § 3(2) of BEA 1882.

3. The payment instructions must not state any condition other than the time of payment.[15] It is not a requirement that payment should be on demand. A bank's customer is free to specify that payment to the beneficiary should be made on, or before, a specific date.[16] Thus, an instruction is not a payment order if it, for example, instructs the bank to pay only when the beneficiary, or some other person, performs a given obligation, or the bank receives certain documents, e.g., a bill of lading for specified goods. This requirement ensures that EFT transactions will not be confused with documentary credit transactions, or other transactions in which the main thrust is the underlying transaction as distinguished from payment.[17]

4. The payment instructions must be addressed to a bank.[18] An instruction to an individual debtor to pay a sum certain in money to a third party does not satisfy this condition.[19] Payment instructions can be transmitted to the bank directly or indirectly. The latter form is designed to contain such cases where payment orders are delivered to a bank's agent, an EFT system, or a communication system to be delivered to the bank concerned. The instructions may order the bank to make, or cause another bank to make, a credit or a debit transfer of funds. This includes paying

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[15] U.C.C. § 4A-103(a)(1)(i) provides that a payment order must not "state a condition to payment to the beneficiary other than time of payment". In the U.K., a bill of exchange is, *inter alia*, an "unconditional order".

[16] In the U.S.A. a bank's customer may specify an execution date in addition to a payment date of his payment order. See U.C.C. § 4A-301.

[17] Fry, "Basic Concepts", supra, p.1409. However, see 15 U.S.C. § 1693j (suspension of underlying obligations if the failure to make payment has resulted from a system malfunction).

[18] In the U.K., § 2 of BEA 1882 provides that "'banker' includes a body of persons whether incorporated or not who carry on the business of banking." This definition has not been altered by the Banking Act 1987. See Lord Denning M.R. in *United Dominions Trust v. Kirkwood* [1966] 2 Q.B. 431, 447 describing what constitutes banking business. See also The Laws of Scotland, Stair Memorial Encyclopedia (1988), vol.II, at para. 1129. For the purposes of EFT transactions, one suggests that the definition of "banker" in the Bills of Exchange Act, and the later judicial interpretation of this term should be adopted. That is because bills of exchange and EFT orders are methods for the payment of money. The Bank of England as a central bank is not included in the definition. See for the liability of Bank of England to depositors for its failure to supervise the conduct of commercial banks, Algudah F., Central Bank Liability to Depositors [1992] Journal of Business Law 481.

In the U.S.A., "Bank" is defined for the purpose of EFT transactions in U.C.C. § 4A-105(2) as to mean "a person engaged in the business of banking and includes a saving bank, saving and loan association, credit union, and trust company." For consumer transaction purposes, the EFTA uses the term "financial institution" rather than "bank". § 1693a(8) of EFTA defines "financial institution" as "a State or National bank, a State or Federal saving and loan associatio, a mutual saving bank, a State or Federal credit union, or any person who, directly or indirectly, holds an account belonging to a consumer".

[19] Neither, in the U.S.A., would a funds transfer through the Western Union system.

funds to other banks and collecting funds from other banks. If both the payer and the payee have accounts in one bank, the instructions need not go beyond ordering the bank to pay the payee. But, if the payee is to be paid in his account with another bank, the instructions are meant to cause another bank, i.e. not the transferring bank, to pay the payee. The last case covers the use of an intermediary bank where necessary.

5. It is not necessary that a payment order should be initiated by electronic means. Thus, an oral or a written instruction to a bank to transfer funds to a given payee is a payment order.[20] This is clear from the unqualified use of the word "instruction" in the definition. Banking practice indicates initiating EFT transactions by a non-electronic means is still substantial. Banks usually have a paper-based standard form to be filled by those customers who want to effect an electronic credit transfer, for example, unless they have special arrangments to give instructions by electronic means, such as in the case of home and office banking. Commenting on a paper-based CHAPS order, Lord Lane in *R v. King and Others* called it a "document".[21]

After defining what is meant by "payment order", the question that follows is, what is the legal nature of such order? Is there any concept of law whereby such order can be accommodated, or is it a completely new concept?

In this chapter, the legal nature of such order is analysed in the light of some legal concepts which are deemed to be close to such orders. Does a payment order

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[20] U.C.C. § 4A-103(a)(1) covers a "payment order" whether "transmitted orally, electronically, or in writing". However, it was said in the prefatory Note to Article 4A that "[i]n most cases, the payment order of each bank to the next bank in the chain is transmitted electronically , and often the payment order of [the originator] to its bank is transmitted electronically, but the means of transmission does not have any legal significance. A payment order may be transmitted by any means, and in some cases the payment order is transmitted by a slow means such as first class mail."

[21] [1991] 3 All E.R. 705, 709 (C.A.).

constitutes a negotiable instrument, an assignation[22] of chose in action, a creation of trust funds, or mere a mandate from a customer to his bank?

1.2 The Payment Order v. Negotiable Instrument.

1.2 [a] Under U.K Law.

It is argued that a payment order does not constitute a negotiable instrument for several reasons.[23] First, if an instrument is to be negotiable, it must be possible to pass title to the instrument and the rights embodied in it by delivery or by delivery and indorsement. The nature of the instrument must indicate that the payee can decide that such instrument can be paid to the order of a person other than himself. This means that he should be able to transfer the instrument in the appropriate manner. Any other construction of negotiability would render it meaningless.

However, the payee in EFT transactions is not entitled to transfer the payment order to the order of another payee by his sole will. Payment orders are not payable to order or to the bearer. Moreover, an EFT order that initiated by electronic means is intangible, and thus impossible to deliver to the bearer or to indorse it to the order of another payee. A negotiable instrument, however, is a piece of paper which passes from one hand to another either by endorsement or by delivery. It is in itself the subject of transfer or negotiation.

Secondly, a new type of negotiable instrument cannot be created by the mere will of the issuer, or the parties involved. The class of document to which an instrument belongs must have been recognised, either by statute or by mercantile custom, as negotiable. The parties cannot confer negotiability upon an instrument if

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[22] An "assignment" in England and U.S.A.

[23] Ellinger, Modern Banking Law, at 364-366; and Goode R.M. (ed.), Electronic Banking, The Legal Implications, at 34-35.

it lacks this quality.[24] Bills of exchange, promissory notes, and cheques are negotiable instruments by statute.[25] Certain other negotiable instruments are made negotiable by the custom of merchants, which are recognised by the courts. These, for example, include foreign and colonial bonds expressed to be transferrable by delivery,[26] scrip certificates which entitle the bearer to become holder of such bonds; and shares in a company.[27]

If a payment order were to be considered a negotiable instrument, it would not be by statute, simply because there is no British legislation concerning EFT. However, since the categories of negotiable instruments are never closed, it may be considerd as such by mercantile usage. Banking practice clearly indicates that no such characteristic is given to payment orders. Banks assume that they are conducting a service on behalf of their customers. Although, custom may be of recent origin,[28] it is not easy to establish a norm of mercantile custom. For any mercantile custom or usage to be recognised by courts, it must be notorious,[29] certain,[30] reasonable,[31] and general.[32] In the case of negotiable instruments, it must be a custom of the home market. It is not sufficient to be treated as such abroad.[33] In *Strathlorne Steamship Co. v. Baird & Sons*[34] the House of Lords emphasised these requirements. In that

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[24] Anson's Law of Contract, (26th ed. 1984), at 407.

[25] See the BEA 1882.

[26] *London Joint Stock Bank v. Simmons* [1892] A.C. 201.

[27] *Goodwin v. Robarts* [1875] 1 App. Cas. 476; *Rumball v. Metropolitan Bank* [1877] 12 Q. B. 194. See also *Venables v. Baring Bros.* [1892] 3 Ch. 527; *Bechuanaland Exploration Co. v. London Trading Bank* [1898] 2 Q.B. 658; and *Edelstein v. Schuler* [1902] 2 Q.B. 144.

[28] *Bechuanaland Exploration Co. v. London Trading Bank* (1898) 2 Q.B. 658.

[29] *Tucker v. Linger* [1883] 3 App. Cas. 508.

[30] *Swell v. Corp.* [1824] 1 C. & P. 392, 393.

[31] *Paxton v. Courtancy* [1860] 2 F. & F. 131; *Tucker v. Linger, supra; Gibbon v. Pease* [1905] 1 K.B. 810.

[32] Recognised and adopted by the commercial world in general. See *Easton v. London Joint Stock Bank* [1886] 34 Ch. 95, 113.

[33] *Goodwin v. Robarts* [1876] 1 App. Cas. 476; *Picker v. London and County Banking Co.* [1887] 18 Q.B. 515.

[34] [1916] S.C.(H.L.) 134.

case the Lord Chancellor said:[35]

> "In order that a custom or, to use a more exact phrase, a commercial usage, may be binding upon parties to a contract, it is essential that it should be certain, that it should be uniform, that it should be reasonable, and that it should be notorious."[36]

If a party to an EFT transaction alleges that an EFT order constitutes a negotiable instrument by mercantile custom, he must prove that by witnesses who speak from practical experience.[37] Courts must approve such custom, and it is unlikely that they will do before it is proved on some few occasions. It is suggested that custom does not seem to have been an active source of new forms of negotiable instruments in recent years.[38] However, to date, there is no such banking custom which satisfies these requirements.[39]

Thirdly, a payment order does not, by itself, embody contractual rights separate and distinct from the underlying transaction for which it is made, while the negotiable instrument does. An EFT is a method of payment. It is used to perform payment of an already established obligation. The negotiable instrument, unlike the payment order, does give separate rights to the holder, which are capable of enforcement separately from the underlying transaction. This distinction has an important result if, for example, it turns out that the drawer or payer does not owe the drawee or payee any obligation according to the underlying transaction. Since the negotiable instrument embodies, by itself, contractual rights separate and distinct from the underlying transaction, it is not affected by this underlying transaction. On the contrary, in the

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[35] Ibid, p.135.

[36] 'Notoriety' is 'a term so well known in connexion with the particular transaction that it was nothing but waste of time and writing to introduce it into the contract.' Ibid, per Lord Chancellor, p.136.

[37] Pennington, Hudson, and Mann, Commercial Banking Law, at 78.

[38] Ibid.

[39] However, banks can develop such practice by creating a standard form to all EFT orders which satisfy negotiability requirements. This is likely to happen if they find that in their interests. See *Goodwin v. Robarts*, supra, per Cockburn C.J. p.346.

case of a payment order, if it turns out that the payer instructs his bank to transfer funds to the payee while he does not owe him money according to the underlying transaction, the payee cannot keep the transferred funds. The payment order does not create rights separate from those of the underlying transaction.

1.2 [b] Under U.S.A Law.

Under U.C.C. § 3-104 a "negotiable instrument" means:

> "an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it: (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder; (2) is payable on demand or at a definite time; (3) does not state any other undertaking ...".

It is clear that a payment order, whether or not, transmitted by electronic does not satisfy the requirements of a "negotiable instrument" under U.C.C. § 3-104.[40] A payment order is not payable on demand or to the bearer. It is not transferable in the sense of negotiability under U.C.C. § 3-201. Payment orders in EFT transactions, unlike cheques, do not embody independent rights and liabilities for the payment of money. Rather the rights and liabilities of the parties to a payment order arise out of any agreement of the parties.[41] The sender of a payment order, unlike the drawer or maker of a negotiable instrument as regards the drawee or holder, is not liable to the payee before payment is made. Indeed, under U.C.C. § 4A-402, acceptance of a payment order by the transferring bank creates an obligation of the sender to pay the transferring bank the amount of the order, and no other person has any rights against

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[40] For a detailed discussion of the conditions of negotiability, see Norton J.J. & Whitly Sh. C., Banking Law Manual (1991), at § 12.02[2] (where it is said that seven requirements must be satisfied in an instrument to be called negotiable instrument. these are writing, signature, order or promise to pay, unconditional promise, sum certain in money, payment on demand or at a definite time, and payment to order or bearer. If an instrument does not meet these requirements, it cannot otherwise be made negotiable by contract or conduct of the parties).

[41] See Miller, Fred, "Uniform Commercial Code Article 4A, Funds Transfers", lectures in the Practising Law Institute, referred to by WESTLAW, 542 PLI/Comm 7, Database TP-ALL, Rank 39, under "electronic fund transfer". See also for the same writer, Uniform Commercial Code Article 4A: A Framework for Transmitting Large Amounts of Funds, [1990] 44 Consumer Finance Law Quarterly Report 150, at 153.

the sender with respect to the sender's payment order.[42]

The recent amendment of the definition of "item" in U.C.C. § 4-104 has settled this argument. That section has explicitly stated that a "payment order" under Article 4A does not constitute an "item". Nor, too, a credit or debit card slip. As such, payment orders and credit and debit card slips, e.g. sale slip in EFTPOS, do not constitute a "negotiable instrument".

1.3 The Payment Order v. Trust Fund.

1.3 [a] Under U.K. Law.

The question here is whether the initiation of an EFT transaction by a payment order creates a trust of the amount of the payment order in the hands of the transferring bank to the benefit of the payee. A trust fund can be express or implied. It is clear that no express trust in favour of the payee arises by a payment order, since no words creating a trust are usually used in payment orders.[43]

It is suggested that whether an order by one person to another constitutes a trust "is decided by reference to the intention of the grantor".[44] It is a question of construing the words in a given transaction to ascertain whether these words establish an intention to set up a trust.[45] There should be compelling evidence of an intention to create trust. "A verbal or secret trust is not recognised by Scots law".[46] An implied

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[42] Official Comment 3 to U.C.C. § 4A-402.

[43] Pennington, Hudson, and Mann, Commercial Banking Law, at 283; and Arora, A. Electronic Banking and the Law, at 50.

[44] Wilson, W.A. & Duncan A.G.M., Trusts, Trustee, Executors and Judicial Factors, at 21.

[45] See Menzies on Trusts, (2nd ed., 1913), at 3 ("Where there is no ... express trust declared, it becomes a question of construction as to whether a 'precatory trust' has been created by the terms used by the transferor."); Wilson, W.A. & Duncan A.G.M., Trusts, Trustees, and Executors, at 21 ("The question of whether a conveyance by one person to another constitutes a trust is decided by reference to the intention of the granter which is ascertained by a construction of the deed.") In English law, see Pettit Ph., Equity and the Law of Trusts (5th ed., 1984), at 38.

[46] Wilson, W.A. & Duncan A.G.M., Trusts, Trustees, and Executors, at 21 citing *Shaw's Trs. v. Greenock Medical Aid Society* [1930] S.L.T. 39.

trust may be deduced from the nature of the transaction and the surrounding circumstances if a trust in a EFT transaction were to exist. It is suggested that the "precise dividing line" between an express and an implied trust is "impossible to find".[47] However, an implied trust arises "where the intention of the settlor to set up a trust is inferred from his words or actions, i.e where his intention is not directly expressed but presumed".[48] This presumed intention is rebuttable.[49] It means that if the payer in EFT transaction, for example, provides sufficient evidence that his intention is not to create a trust fund, the court cannot presume the contrary from the transaction or any other surrounding circumstances.

It was held in *Lister and Co. v. Stubbs*,[50] and *Moseley v. Cressey's Co.*,[51] that the placing of money in a separate account by a bank which had been instructed to make a payment in the first case; the holding of money for a specific purpose in a bank account to be paid to a specific payee, in the second case, did not constitute a trust in favour of the intended payee.

However, the ratio of those two cases has not been followed in later decisions. In *Re Nanwa Gold Mines Ltd.*,[52] money was paid to a company by applicants for an issue of its debentures. The company placed the money in a separate bank account in its name. Meanwhile, it promised the applicants that if the debentures were not in fact issued, the money paid by them would be returned. It was held that in these

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[47] Hanbury and Maudsley, Modern Equity, 13th ed., at 227. See *Barclays Bank Ltd. v. Quistclose Investments Ltd.* [1970] A.C. 567; and *Hodgson v. Marks* [1971] Ch. 892.

[48] Pettit Ph. (5th ed.), supra, at 54. Some authors consider "resulting" and "implied" trusts as synonymous, though others treat "implied trust" as synonymous with "constructive trust". See Nathan and Marshall, supra, ch.7 (resulting trust), ch.8 (constructive trust); and Hanbury and Maudsley, suprs, ch.10 (resulting trust), ch.12 (constructive trust).

[49] Nathan and Marshall, supra, at 370; Pettit Ph., supra, at 120. See also *Shepard v. Cartwright* [1955] A.C. 431 where the House of Lords reaffirmed the rule that the evidence of subsequent acts, though not admissible in favour of the party doing the acts, is admissible against him.

[50] (1890) 45 Ch. 1.

[51] (1865) L.R. 1 Eq. 405.

[52] [1955] 1 W.L.R. 1080.

circumstances the money was held on trust for the applicants. *Re Kayford Ltd*[53] is another case where it was decided that if money is kept in a separate account for specific purpose with a condition that it should be returned to the persons who provided it, if certain conditions are not fulfilled, the money was held on trust for those persons.

In most EFT transactions the payer, who is a customer of the transferring bank, instructs his bank to transfer funds, in the case of credit transfer, from his account to a specific payee's account. The bank does not hold the money in a separate account for the purpose of transferring it to the payee. What the bank usually does is to debit the payer's account when the transfer is effected.

Thus, the argument of a separate account does not stand in an EFT transactions, since it is unlikely that a person would open a separate account credited with a particular amount of money designated for a particular transfer or EFT transaction. A person usually maintains an account with his bank to use it for different purposes. It is true that a customer who wants to use EFTPOS service, for example, should specify for his bank certain account, if he has more than one, to be debited for his EFTPOS purchases. This, however, does not constitute a trust fund since even in this case the account will be used for other transactions apart from EFTPOS ones. It is suggested that "the separation of the money is not the most essential element even in this case, because the two situations of trust and [EFT transaction] are totally dissimilar."[54]

It is settled law that the relationship between a bank and its customer is a

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[53] [1975] 1 W.L.R. 279. See also *Barclays Bank Ltd v. Quistclose Investments Ltd.* [1970] A.C. 567.

[54] Pennington, Hudson, and Mann, **supra**, p.284.

debtor and creditor, in the sense that the bank will be indebted to its customer by the amount of the credit balance in the customer's account.[55] The money in the customer's account is the bank's money. The bank undertakes to repay the same amount of money that the customer credits in his account at the branch where he opens his account.[56] Upon the bank's acceptance, the customer may ask to divert repayment of all his credit balance or part of it to a specified payee in another bank. Before that, the bank is free to use the customer's money as it likes; and for its own benefit. This is true in all different accounts that customers, in practice, use for their EFT transactions, such as EFTPOS account and ATM account. On the other hand "a trustee has no power to use trust money for his own benefit unless the trust instrument expressly authorises him so to do."[57]

The nature of an EFT order militates against considering it a trust fund. An EFT order to transfer funds from the payer's account to the payee's account can be revoked, so long as the EFT system allows and before the payment becomes final. This means that the payer has control over the funds up to either the time of execution of the payment order, or the time of payment depending on the EFT system used. The possible restriction is that it may not be practically possible to revoke the payment instructions. This is a practical restriction rather than a principle of law. This is in accord with the principle that "an order to pay addressed to one who is mere agent can be revoked before payment, but not so if the holder is a trustee for the creditor, for then the ownership of the property would have passed to the trustee, subject only to

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[55] *Royal Bank of Scotland v. Skinner*, 1931 S.L.T. 382, per Lord Mackay at 384 (O.H.) (in Scotland); *Foley v. Hill* (1848) 2 H.L.C. 28; and *Joachimson v. Swiss Bank Corporation* [1921] 3 K.B. 110 (in England).

[56] Ibid.

[57] *Space Investments Ltd. v. Canadian Imperial Bank (P.C.)* [1986] 1 W.L.R. 1072, 1073 per Lord Templeman.

the terms of his trust, and out of the control of the truster, the debtor."[58] The granter in a trust loses control over the funds once a trust is constituted, unless the trust instrument provides otherwise.[59] The payee in an EFT transaction cannot sue the transferring bank for the amount of the payment order, since he has no right to the money before it reaches his bank's account. This indicates that an EFT order does not make the transferring bank a trustee of the amount of transfer for the payee as a trust beneficiary. On the contrary, if the payment order creates trust funds, the payee as a beneficiary of the trust funds would be entitled to sue the transferring bank, as trustee, directly for the amount of the trust since his right in the trust starts from the moment of constituting the trust.

Thus, one may conclude that, neither the common language of most EFT orders, nor the nature of EFT transactions seems to support the creation of a trust fund in favour of the payee; and in the absence of the clearest possible evidence, courts are reluctant to discover implications of such intention.[60]

1.3 [b] Under U.S.A. Law.

It is clear from the nature of an EFT transaction, being a credit transfer through CHIPS or FedWire or a debit transfer through EFTPOS systems, that no express trust arises from such transactions in favour of the payee since no express words are usually used in those transfers. This does not mean that an implied trust might not be created. However, there should be an indication that there is an implied trust. This might be deduced, as is the case under British law, from the nature of the transaction

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[58] Menzies on Trustees, supra, p.10, discussing the distinction between "financial agents" and "trustees" citing *Henderson v. Rothschild* (1886) 33 Ch. 459 and *Garrard v. Lauderdale* (1831) 2 Russ. & My. 451.

[59] *Grant v. Baillie* (1869) 8 M. 77, 80 per Lord Neaves (where his Lordship considers that "once a trust is constituted, the person constituting it has, in the absence of stipulation, no more control over the funds which he has conveyed to the trustees").

[60] e.g. *Re Schebman* [1944] Ch. 83; *Vandepitte v. Preferred Accident Insurance Corp. of New York* [1933] A.C. 70. In Scotland, Menzies, supra, at 3, noticed that the courts' tendency is against the inference of a "precatory trust".

and the surrounding circumstances such as the intention and conduct of the parties involved.

It has been generally held that the establishment of a trust funds must be clearly expressed at the time the bank receives the money.[61] There is a well established distinction in the United States between a special deposit and a general deposit. In the latter, "the bank merely becomes the debtor of the depositor to the extent of the deposit, and the title to the money passes to the bank."[62] The special deposit, however, is "the delivery of either money or chattel to a bank under a special agreement or under circumstances sufficient to create a trust."[63] Such deposit must be for a special purpose, or for safe keeping.

It was held in *Mutual Accident Association of the Northwest v. Jacobs*[64] that a deposit of certain amount of money for a specific purpose, which was evidenced by a certificate of deposit, was a general one. The court found that the funds were paid to the bank by cheque on another bank, which went through a clearing house to be "mingled" with the general funds of the bank in the same manner as money deposited by other depositors. Trust funds should be clearly distinguished from other property held by the trustee or by those representing him.[65]

In *People ex rel. Russell v. The Farmers State & Savings Bank of Grant Park*[66] the Supreme Court of Illinois laid down the criterion upon which a given

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[61] The *Manhattan Co. v. Blake*, 148 U.S. 412, 13 S. Ct. 640, 37 L.Ed. 504 (1893); *Atlantic Gypsum Co. v. Federal Nat. Bank of Boston*, 76 F.2d 59 (1st Cir. 1935); *In re Ecklund*, 75 F.2d 747 (7th Cir. 1935); and *State v. People's Nat. Bank*, 75 N.H. 27, 70 A. 542 (1908).

[62] *Securities Fund Services, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 542 F. Supp. 323 (N.D.Ill., 1982) citing with approval *People ex rel. Russell v. Farmers State & Saving Bank of Grant Park*, 338 Ill. 134; 170 N.E. 236 (Ill., 1930).

[63] *Securities Fund Services, Inc. v. American Nat. Bank and Trust Co. of Chicago, supra, citing with approval* Baiar v. O'Connel, 284 Ill. App. 331, 1 N.E. 2d 805 (1936), aff'd 365 Ill. 208; 6 N.E. 2d 140 (1936).

[64] 141 Ill. 261; 31 N.E. 414 (Ill., 1892).

[65] *Union Nat. Bank v. Goetz*, 138 Ill. 127, 27 N.E. 907 (Ill., 1891).

[66] 338 Ill. 134; 170 N.E. 236 (Ill., 1930).

account is to be considered a trust fund by saying:[67]

> "There are but two kinds of deposits: special and general. The former included those where the bank becomes a trustee for a depositor by special agreement or under circumstances sufficient to create a trust, and general deposits are those where the bank merely becomes the debtor of the depositor. As a rule when money is deposited in a bank, title to such money passes to the the bank. The bank becomes the debtor of the depositor to the extent of the deposit, and to that extent the depositor becomes the creditor of the bank. Such deposit then constitutes a part of the assets of the bank, and in case of insolvency of the bank that deposit belongs to the creditors of the bank in proportion to the amount of their respective claims. Well recognised exceptions to this rule, are, first, where money or other thing is deposited with the understanding that that particular money or thing is to be returned to the depositor; second, where the money or thing deposited is to be used for a specifically designated purpose; and third, where the deposit itself was wrongful or unlawful".

This rule is generally established and accepted. It has not only been affirmed by other decisions of the same court,[68] but also by decisions of other states' supreme courts.[69] More importantly, this was upheld by the Supreme Court of the United States in *Blakey v. Brinson.*[70]

Thus, to decide whether, or not, the transferring bank in an EFT transaction becomes a trustee for the benefit of the intended payee of the appropriate amount out of the payer's credit balance, one must decide first whether, or not, the payer's account in the transferring bank constitutes a "special account" in the sense of the foregoing authorities and analysis. Banking practice indicates that customers usually instruct banks to transfer funds from their ordinary general accounts. Special accounts need in most cases special arrangements which may hinder the quick use of one's

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[67] Ibid, at 137 and 237-238 respectively.

[68] See, e.g., *People ex rel. Nelson v. People's State Bank of Maywood,* 354 Ill. 519, 188 N.E. 853 (Ill., 1933); *People ex rel. Nelson v. Stony Island Saving Bank,* 358 Ill. 118, 192 N.E. 682 (Ill., 1934); and *Baiar v. O'Connel,* 365 Ill. 208; 6 N.E. 2d 140 (Ill., 1936).

[69] The Supreme Judicial Court of Massachusetts decided so in *Norling & Bloom Co. v. Exchange Trust Co.,* 288 Mass. 444, 193 N.E. 1 (Mass., 1934); and the Supreme Court of Ohio adopted this rule in *Fulton v. Escanaba Paper Co.,* 129 Ohio St. 90; 193 N.E. 758 (Ohio, 1934).

[70] 286 U.S. 254, 76 L.Ed 1089, 52 S. Ct. 516, 82 A.L.R. 1288 (U.S.N.C., 1932).

funds, especially in commercially-based transactions. However, it might be argued that in some cases, even though very rare, a payer opens a specific account for credit or debit transfer purposes, or even for one specific transfer transaction. In these very rare cases, one may still argue that such arrangement does not constitute trust fund. Banks usually, unless otherwise instructed, "mingle" the payer's funds with their general funds; and use them in the same manner as other funds in their usual course of business. This is based on the traditional relationship of debtor and creditor.[71] However, it is highly unlikely that a customer would instruct his bank to keep his money intact in a separate account for a specific EFT transaction.

In EFTPOS transactions, cardholders must specify an account, if they have more than one, to be debited by their EFTPOS card transactions. Such accounts may be used for other purposes. This makes them "general" rather than "special". Thus, the transferring bank in an EFTPOS transaction i.e the purchaser's bank, is not a trustee of the amount of purchase for the benefit of the retailer or the supplier. However, let us assume that a customer of a certain bank instructed his bank to open a separate account especially for EFTPOS transactions; and not for any other reason. Does this arrangement make his bank a trustee of the funds credited in this separate account for the benefit of those retailers who offer EFTPOS services?

One suggests that even though funds are credited in a separate account for EFTPOS transactions only, this arrangement does not constitute a trust fund for, at least, three reasons. First, the purpose that has been identified, i.e for EFTPOS transactions, does not satisfy the requirement of a "specific purpose" in the sense of

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[71] See, generally, Natter R., Schlichting W., Rice T. and Cooper J., Banking Law, Vol. I, 1991, Matthew Bender & Co. Incor., at § 9.05 (hereinafter cited as Matthew Banking Law, Vol. I); Michie on Banks and Banking, 1973 with 1985 supp., at § 38; Norton & Whitley, Banking Law Manual, 1991, at § 11.04[2]; 10 Am. Jur. 2d banks § 430. See also 9 C.J.S. Banks and Banking § 267.

the foregoing authorities and analysis. Those EFTPOS transactions are not identifiable at the time of opening the account. One cannot be sure about the amount, place, and time of the transactions that the customer will make. Secondly, "a trust is not created unless there is a beneficiary who is definitely ascertained at the time of creation of the trust..."[72] It is unlikely that courts would consider retailers who offer EFTPOS services as definitely ascertained beneficiaries at the time of opening the account. It is also unlikely that EFTPOS retailers would be considered as "members of a definite class of beneficiaries",[73] simply because no purchaser is going to buy from all EFTPOS retailers. Finally, banks usually issue debit cards in EFTPOS schemes to customers with whom they have already a banking relationship. They would not issue such cards with conditions forbidding them from using the money in their normal business. According to this banking practice, such accounts do not constitute a trust funds.

The Massachusetts case of *Beecher v. Cosmopolitan Trust Co.*[74] is a direct authority on the point. The plaintiff paid cash to the defendant in Boston, with an instruction to transfer the funds to a named payee in Roumania. Due to the insolvency of the defendant, no transfer occurred. The defendant's assets were seized by an official receiver. The plaintiff alleged that the defendant i.e a trust company, held the funds in trust; and as such sought restitution of the initial value given for the credit before other unsecured creditors. His claim was rejected by the court upon the finding that there was no obligation on the company to keep the initial value separate from other assets. By crediting the funds in order to be transferred to the named payee, the

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[72] Restatement of the Law, Second, § 112.

[73] "The members of a definite class of persons can be the beneficiaries of a trust". Restatement, Second, § 120.

[74] 239 Mass. 48, 131 N.E. 338 (Mass., 1921). See also cases cited in 9 C.J.S. Banks and Banking § 274 (special deposits).

plaintiff became a creditor of the company, which undertook to make funds available to the named payee in Roumania. The bank used the funds in its usual business; and did not keep them separate from other funds.[75]

As is the case under the British law, a payee in EFT transactions has no right to the money before it reaches its account. The payer, theoretically, is entitled to revoke his payment instructions before their implementation. On the contrary, a beneficiary in a trust fund is entitled to the benefit conveyed upon him by the trust instrument as soon as the trust is constituted. The grantor of a trust funds, unlike the payer in EFT, loses control over the fund after delivering it to the bank trustee.

Finally, in practice, American banks keep trust funds in separate accounts in a certain department called the "trust department"; and hence do not use them in their business, unless they set aside in the trust department United States bonds, or other securities approved by the comptroller of the currency. Such arrangements are, in fact, statutorily required.[76] No deposits for ordinary banking services, e.g. funds for EFT transactions, can be kept in trust departments.

1.4 The Payment Order v. Assignation.

Since it is well established that, unless otherwise agreed, banks stand in a debtor status to their depositors, does an EFT order by the depositor to his bank to transfer certain amount of money from his account to his creditor constitute an assignation of this amount of money? An attempt is made in the following pages to answer this question.

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[75] In a similar case, a Canadian court held in *Re Dominion Ticket & Financial Corp.* [1924] 2 D.L.R. 807 that the payer in a credit transfer can trace the initial payment to a "foreign exchange account" held in the name of the transferring bank in the case of the latter's bankruptcy. The court considered that the transferring bank held the funds as a constructive trustee. For the nature of the relationships between the parties in credit transfers in the Canadian law, see Crawford B., Credit Transfers of Funds in Canada: The Current Law [1979] 3 Can. Bus. L.J. 119.

[76] 12 U.S.C. § 92a (c) and (d).

1.4 [a] Under U.K. Law.

Since there are substantial differences between Scots law and English law in this area, a discussion of this issue is held separately under both laws.

1.4 [a] [i] Under Scots Law.

It is important to discuss, briefly, the main features of the assignation law in Scotland before one decides whether, or not, an EFT order constitutes an assignation of the amount of the transfer to the benefit of the payee.

An assignation in Scotland does not need special words. In the words of Lord Justice-Clerk Inglis "no words directly importing conveyance are necessary to constitute an assignation, but that any words giving authority or directions, which if fairly carried out will operate a transference, are sufficient to make an assignation."[77] However, to be valid, it must be intimated to the debtor. Stair thinks that the "assignation itself is not a complete valid right, till it be orderly intimated to the debtor."[78] Intimation is necessary to complete the assignee's title, and to put the debtor in *mala fide* to pay to anyone other than the assignee.[79] It is usually made by the assignee but can be made by the assignor on his behalf.[80] The Transmission of Moveable Property (Scotland) Act 1862 provides two methods of intimation.[81] The first is by a notary public delivering to the debtor a copy of the assignation certified as correct.[82] The second is by transmitting a copy of the assignation, certified as

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[77] *Carter v. McIntosh* (1862) 24 D. 925, 933. See also *McCutcheon v. McWilliam* (1876) 3 R. 565 where Lord Justice-Clerk Moncreiff said, at 571, that "any words which express a present intention to transfer are sufficient as an assignation". For examples of situations which have been held to constitute assignation, see Wilson, The Scottish Law of Debt (2nd ed. 1991), at para. 27.1; and McBryde, The Law of Contract in Scotland, 1987, at 386.

[78] Stair, III, 1, at 568.

[79] Wilson, The Scottish Law of Debt, (2nd ed. 1991), at para. 27.3 citing Lord Young in *Grigor Allan v. Urquhart* (1887) 15 R. 56, 61.

[80] Ibid, at para. 27.3 citing *Libertas-Kommerz GmbH v. Johnson*, 1977 S.C. 191.

[81] See § 2 of the Act.

[82] Wilson, W.A., supra, at para. 27.3, suggests that a "certificate by the notary public in the form of Sched. C to the Act is sufficient evidence of intimation."

correct, to the debtor by post; a written acknowledgement of which by the debtor is sufficient evidence of intimation.[83]

It is noted that it seems now to be established that a mandate by the creditor authorising the debtor to pay a third party or authorising the third party to receive payment from the debtor may be equivalent to an assignation.[84] If the creditor is indebted to the third party it is a mandate *in rem suam* and cannot be revoked by the creditor. The time of intimation of the mandate is the *tempus inspiciendi*. The intention of the grantor must be determined from the terms of the document and the circumstances in which it was granted.[85]

Because of the requirement of intimation, the application of assignation principles to EFT orders needs a distinction between credit transfer orders and debit transfer orders.[86]

1.4 [a] [i] [1] Credit Transfer Orders.

Payment orders in credit transfers, as it is known in banking circles, do not constitute an assignation for the following reasons.

First, a payer in an EFT transaction can, to certain extent, revoke his instructions of transfer to the payee. Take, for example, CHAPS payment order. Such an order can be altered, abandoned, or even cancelled at any time prior to its release through the transferring bank's gateway. Moreover, a CHAPS payment order that has not been acknowledged by the payee's settlement bank will be considered as if it has

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[83] Ibid, at para. 27.3.

[84] Ibid, at para. 27.2 citing *Carter v. McIntosh* (1862) 24 D. 925 at 933 and *Executive Council for the City of Glasgow v. T. Sutherland Henderson Ltd.*, 1955 S.L.T. (Sh. Ct.) 33.

[85] Ibid, at para. 27.2, citing *National Commercial Bank of Scotland Ltd. v. Millar's Tr.*, [1964] S.L.T. (Notes) 57.

[86] Assignation and trust funds questions do not arise in ATM transaction since no third party (assignee in the first place, and beneficiary of trust in the second place) exists.

never been sent.[87] If a payment order were to constitute an assignation of the amount of transfer, the payer must lose any control e.g. revocation in particular, over the amount of transfer after the transfer order reaches the transferring bank. Payment orders do not amount, in principle, to an irrevocable mandate which may constitute assignation.

Secondly, although banks are usually debtors to their customers who instruct them to transfer their debt, or part of it, to a named payee, there are cases where a bank may accept such order from a customer even though such customer has insufficient funds in his account at the time of instructions. Banks may carry out such instructions by granting an overdraft to certain customers. In this special case it is very difficult to accept that a payment order constitutes an assignation, since there is no debt to be assigned.

Thirdly, the parties to EFT transactions have no intention to confer upon the payee the title of the amount of the transfer before such amount is credited to his account in his bank. Usually, the payer's intention is that his bank will cause a credit in the payee's account, and a debit in his account. This intention is usually shared by the transferring bank. The payee also expects to gain title to the fund when such funds reached his account in his bank. No payee likes to assume risks resulting from the transfer's process of the funds. If the funds transfer is not completed as intended, it is the parties' understanding that no payment is made. As such, payment orders transfer no title to the payee before the payment is made; and hence constitute no assignation.

1.4 [a] [i] [2] Debit Transfer Orders.

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[87] See for the effect of what is called a "Logical Acknowledgment", CHAPS Clearing Rules (1985), Rule 4(c).

In such transfers, the payer authorises the payee to receive funds from his account. The payee is usually furnished with an authorisation to be given to the payer's bank for payment. It is, thus, difficult to argue against the existence of intimation in Scots law when such authorisation is presented to the payer's bank, whether by the payee himself or by his agent, e.g. his bank. Some difficulty in Scots law may arise from the rule of § 53(2) of the Bills of Exchange Act 1882. That section reads:

> "In Scotland, where the drawee of a bill has in his hands funds available for the payment thereof, the bill operates as an assignation of the sum for which it is drawn in favour of the holder, from the time when the bill is presented to the drawee."[88]

Thus, if the authorisation of payment to the payee in debit transfers were to be construed as a bill of exchange its presentation to the payer's bank would operate as an assignation of the sum for which it is made in favour of the payee provided that the payer's bank has sufficient funds in the payer's account.

The payer's authorisation to his creditor, the payee, is not a "bill of exchange" as defined by § 3 of the "BEA 1882".[89] § 3(2) of "BEA 1882" provides that any instrument, which does not comply with the definition of the bill of exchange in § 3 is not a bill of exchange. However, It has been suggested to the Review Committee that the funds attached principle in Scots law applies "more widely than just to bills of exchange and cheques...;[and] it would seem possible that an electronic message

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[88] See *British Linen Co. v. Rainey's Tr.* (1885) 12 R. 825 (where a bill is accepted "payable at" a bank, presentment of that bill operates as an assignation of the acceptor's funds in the banker's hands to the extent of the sum in the bill). However, § 53(2) of BEA 1882 does not operate to effect assignation when payment by cheque is countermanded because § 75A (added by Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, § 11) provides that on countermand of payment by a cheque, the bank is treated as having no funds available for payment of the cheque.

[89] § 3(1) of the BEA 1882 provides:
"A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer."

which contained an order to pay would also, under Scottish law, have assignative effect".[90] If § 53(2) of the BEA 1882 is to be applicable to EFTPOS transactions, a Scottish bank that has insufficient funds in its customer's account to meet an EFTPOS payment demand should attach the available funds (*pro rata* if more than one EFTPOS transaction are made) until either: (i) the sale slip or a demand by electronic means is re-made because the purchaser has sufficient funds attached or otherwise; (ii) the payee, e.g., a retailer relinquishes its claim to the attached funds; (iii) five years have expired; or (iv) a judicial settlement is reached. Scottish banks usually transfer the attached funds to a suspense account till one of the above four conditions is satisfied. This shows that such uncertainty is unsatisfactory for Scottish banks, and for customers, too, under certain circumstances. This rule would cause practical difficulties; namely, which message, in EFTPOS transactions for example, has the assignative effect if the retailer choses to enquire about the purchaser's credit before sending a message instructing the transfer of funds. The Review Committee suggested a statutory solution by abolishing the "funds attached principle" in relation to negotiable instruments other than cheques.[91] Since this principle is a well-established principle in Scots law and such recommendation has not been accepted by the Government, one recommends a specific statutory exception to EFTPOS transactions from such principle.

1.4 [a] [ii] Under English Law.

There are two types of assignments under English law, namely statutory and equitable.

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[90] An argument put to the 'Review Committee', supra, at 59.

[91] the Review Committee Report, supra, recommendation 7(10).

1.4 [a] [ii] [1] Statutory Assignment.

According to § 136(1) of the Law of Property Act 1925, two important requirements must be met for a transaction to constitute a statutory assignment. Those are:[92]

i. A document must be signed by the assignor containing an absolute assignment of the chose in action; and

ii. An express notice in writing of the assignment must be given to the debtor by the assignee.

Since a credit balance in a bank's account constitutes a debt owed by the bank to its customer, it is a chose in action[93] and as such assignable.[94] However, it is argued that payment orders in EFT transactions do not constitute statutory assignment.[95]

Most of payment orders involve a transfer of part of the funds in the payer's account. On other words, it does not involve the transfer of the total debt due to the depositor by his bank. As such it does not constitute an assignment under § 136 of the Law of Property Act 1925, since an assignment of part of the debt is not sanctioned by this section.[96]

Second, payment orders do not always relate to funds standing to the credit of

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[92] See Pennington, Hudson and Mann, Commercial Banking Law, at 285; Arora, A., Electronic Banking and the law, at 51; Ellinger, Modern Banking Law, at 366-367; Chitty on Contract, (26th ed. 1989), at para. 2964; and Arora A., Recent Development in Money Transfer Methods [1980] L.M.C.L.Q. 416, at 420.

[93] Channell J. in *Torkington v. **Magee*** [1902] 2 K.B. 427,430, describes the "chose in action" as "a well known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not by physical possession."

[94] See, e.g., Atiyah P.S., An Introduction to the Law of Contract, (4th ed. 1989), at 378; Pennington, Hudson, and Mann, Commercial Banking Law, at 286.

[95] Ellinger, Modern Banking Law, at 366-368; Pennington, Hudson and Mann, Commercial Banking Law, at 285-291; Arora, A. Electronic banking and the Law, at 51-53; Goode R.M. (ed.), Electronic Banking, The Legal Implications, at 35.

[96] *William v. Atlantic Assurance Co. Ltd* [1933] 1 K.B. 81, 100; and *Walter and Sullivan Ltd. v. Murphy & Sons Ltd* [1955] 2 Q.B. 584. See also Ellinger, Modern Banking Law, at 367.

the payer's account with his bank at the time of instructions. A bank may decide to extent a line of credit to a valuable customer, and carry out his payment orders before receiving funds from such customer. The bank, in this special case, stands in a creditor's status with its customer. There is no debt to be assigned in such a case to argue that a payment order is an assignment. However, a bank, of course, relying on a previous dealing, expects its customer to credit sufficient funds to his account at some time either before the actual transfer or soon afterwards. It is argued, however, that it is "unrealistic to regard the debt to be owed by the bank at a future time as any thing but an expectancy. As such it is not assignable under section 136".[97]

Moreover, it is suggested that the "initiation of the electronic funds transfer alone cannot amount to a legal assignment of any part of the payer's credit balance, because the payment instructions can generally be revoked until the paying bank commits itself to making the payment."[98]

1.4 [a] [ii] [2] Equitable Assignment.

The arguments raised above do not rule out the classification of an EFT orders as an equitable assignment of a legal chose in action. Lord Macnaghten in *Brandt's Sons & Co. v. Dunlop Rubber Co. Ltd.*[99] noticed that the Judicature Act 1873, which is now re-enacted in the Law of Property Act 1925, "does not forbid or destroy equitable assignments or impair their efficacy in the slightest degree". So, a transaction which does not comply with one or more of the requirements of § 136 of the Law of

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[97] Ellinger, Modern Banking Law, supra, at 367 citing *Durham Bros. v. Robertson* (1898) 12 Q.B. 511; *Walker v. Bradford Old Bank Ltd.* (1884) 2 Q.B. 511. Assuming that the other requirements are met, an assignment of debt to be owed in the future time was held to be a contract to assign when the subject-matter of the assignment comes into existence. Parker J. in *Glegg v. Bromley* [1912] 3 K.B. 474, said at 490 that "nothing passes even in equity until the property comes into present existence."

[98] Arora, A., Electronic Banking and the Law, at 51.

[99] [1905] A.C. 454, 461.

the Property Act 1925 may still be a perfectly good and valid equitable assignment.[100]

A bank customer can assign part of his credit balance in one of two ways: (i) he may inform the assignee that he transfers a certain amount of money to him; or (ii) instruct his bank to discharge its indebtedness to him by paying a nominate creditor i.e the assignee.[101] No notice is required in equitable assignment,[102] but it is desirable since until the debtor receives it, he is entitled to pay the original creditor.[103] The notice determines the priorities in case of successive assignments.[104]

However, the informality of equitable assignments does not mean that every mandate or authorisation to make a payment amounts to an equitable assignment.[105] It was held in *Scott v. Porcher*[106] and *Morrell v. Wootten*[107] that an instruction to pay amounted to no more than a mandate to the mandatory which can give no right to the third party in the subject of the mandate; and it made no difference that the funds were held for such purpose. In both cases the payee was not aware of the transfer of the funds.[108] *Curran v. Newpark Cinemas and Others*[109] suggests that

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[100] See generally on the distinction between statutory and equitable assignment, Chitty on Contracts, (26th ed.), Vol.1, Chap. 19.

[101] Chitty on Contracts, (24th ed.), at para. 1160.

[102] See *Gorringe v. Irwell India Rubber Works* (1886) 134 Ch. 128; *Re Patrick* (1891) 1 Ch. 82; *Re Westerton* [1919] Ch. 191; *Re City Life Assurance Co. (Stephenson's case)* [1926] Ch. 191; *Re Trytel* [1952] 2 T.L.R. 32.

[103] *Stock v. Dobson* (1853) 4 De. G. M. & G. 11.

[104] *Dearle v. Hall* (1823) 3 Russ. 1. See Chitty on Contracts, (24th ed.), para. 1184-5.

[105] See Pennington, Hudson and Mann, Commercial Banking Law, at 286; and Arora, Electronic Banking and The Law, at 51. *C.f.* Chorley, Law of Banking (6th ed.), at 268-269.

[106] (1817) 13 Mer. 562.

[107] (1852) 16 Beav. 197. Compare with *Gibson v. Minet* (1791) 1 H. BL. 569.

[108] In *Morrell v. Wootten*, (1852) 16 Beav. 197, at 202-203, the court in an *obiter* statement observed that:
"[W]here a person, having money in the hands of another, directs him to pay it to a third party ... if the holder or depositee consents to do so, and the direction is communicated to the third person, the thing is complete and the payee can enforce the payment of the money; but it is absolutely necessary that the order should be communicated to the intended payee."

[109] [1951] 1 All E.R. 295.

a mere direction by a creditor to his debtor to pay the debt to a third party, who knows nothing of the matter, does not amount to an assignment; and the creditor could not be treated as an agent of the third party to notify the debtor on his behalf.

William v. Everett[110] suggests that, although the transferring bank informs the intended payee that it has been instructed to transfer funds to him, he still cannot sue the transferring bank for money had and received unless he can establish privity of contract with the bank. It is suggested that a "mere notification by the bank to the intended payee of the instructions of the payer does not constitute an offer, nor does the acknowledgement by the payee of the receipt of the notification amount to an acceptance."[111]

It is suggested, however, that it "is more generally accepted that a mere mandate to pay does not constitute an equitable assignment of funds, whether the payee is notified of the mandate or not."[112] Therefore, an EFT order from the payer to his bank i.e the transferring bank, to transfer a certain amount of money from his account to a specific payee falls within the previous analysis. A payee usually does not know that the transferring bank has been instructed either to credit his account, if he has one in the same bank; or to instruct another bank to credit the payee's account. Even if one considers the receipt of the credit message by the payee's bank as a notification notice to the payee himself - assuming that the payee's bank acts as an agent for the payee - the case is still within the limits of the previous analysis. The authorisation to pay does not constitute an equitable assignment, whether or not the

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[110] (1811) 14 East 582.

[111] Arora A., Electronic Banking and the Law, at 52. It seems that this analysis is in contradiction with *Greenhalgh and Sons v. Union Bank of Manchester* [1924] 2 K.B. 153. However, the statement concerned in that case went far wider than the facts of the case required; and there was no supporting authority for it.

[112] Pennington, Hudson, and Mann, Commercial Banking Law, at 288. See *Rodick v. Gandell* (1852) 11 De. G.M. & G. 763; and *Morgan v. Lariviere* (1875) L.R. 7 H.L. 423.

payee has been notified. This authorisation may be nothing more than a revocable mandate to the debtor.[113] Indeed, in most of EFT systems, the instructions to transfer funds can be revoked up to a certain time depending on the EFT system used. This contravenes the requirement that an assignor must not retain any control over the funds assigned, if an EFT order is to be considered an assignment.[114] Moreover, an assignment approach fails to explain the case where a customer instructs his bank to transfer funds from one of his accounts to another either in the same bank or in different banks. In such a case, one cannot say that the customer assigns his funds to himself. This indicates that the assignment approach cannot explain all different types of EFT orders.

There is no certainty regarding whether the above analysis is applicable to direct debit transfer orders. The House of Lords in *William Brandt's Sons and Co. v. Dunlop Rubber Co.*,[115] held that where a creditor with the consent of his debtor calls on a debtor of his debtor to pay his debt directly to him that is sufficient to constitute an equitable assignment. In that case, a firm of merchants agreed with the bank financing them that the prices of goods sold by them to purchasers should be paid by those purchasers directly to the bank. When the merchants sold goods to the defendants, the bank gave the defendants notice in writing that the merchants had transferred to the bank the right to receive the purchase money, and requested the defendants to sign an undertaking to remit the purchase money to the bank. It was

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[113] See *Percival v. Dunn (1885) 129 Ch. 128; Re Williams [1917] 1 Ch. 1; Rekstin v. Severo, e.t.c., and Bank for Russian Trade* [1933] 1 K.B. 47; *James Talcott Ltd. v. John Lewis & Co. Ltd.* [1940] 3 All E.R. 592; and *Re Danish Bacon Co. Ltd. Staff Pension Fund Trusts* [1917] 1 W.L.R. 248.

[114] Chitty on Contracts, (26th ed.), in arguing that Giro instruction is not an assignment said, at para. 2965, that "to attribute to the transferor an intention to effect an assignment militates against the true nature of the transaction. The one and only object of all the different types is to instruct the paying banker to perform a service on behalf of his principle, who is the transferor [citation omitted]. It is clearly contemplated that such an instruction may be revoked."

[115] [1905] A.C. 454.

held that that arrangement amounted to an equitable assignment, and that the bank could, therefore, recover the purchase price from the purchaser as an assignee.[116] This uncertainty is extended to payment orders in EFTPOS transactions.

Thus, for the avoidance of doubt, the Review Committee recommended that an express provision is needed to deny payment orders any assignability characteristics both in Scotland and England.[117] This recommendation indicates that it is undesirable to confer assignability upon such orders.

1.4 [b] Under U.S.A. Law.

Under the United States law, "an assignment requires an agreement whereby the assigner agrees to transfer presently all right, title and control over the subject matter of the assignment to the assignee."[118] It is not necessary that such an agreement must be in writing. It may be manifested by conduct.[119] In *Delbrueck Co. v. Manufacturers Hanover Trust Co.*[120] Moore J. decided that, under the law of the United States for "a valid assignment of chose in action, there must be a specific direction to transfer by the assigner and notice to the assignee."[121] The required notice to the assignee may also be given by the obliger. Prof. Williston suggests that an "order by the creditor given directly to the debtor requesting him to pay a third person does not in the absence of notice to that person make him an assignee of the claim. The request is merely a revocable mandate."[122] It is necessary that the

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[116] See also *Re Kent and Sawmills Ltd* [1947] Ch. 177; *Greenhalgh and Sons v. Union Bank of Manchester* [1924] 2 K.B. 153; and Chorley, Law of Banking (6th ed.) at 268-269.

[117] The Review Committee Report, supra, Chap. 18, Recommendation No.7(13).

[118] *Miller v. Wells Fargo Bank International Corp.*, 406 F. Supp. 452 (S.D.N.Y. 1975), aff'd 540 F. 2d 548 (2d Cir. 1976). See also *Paragon International, N.V., v. Standard Plastics Inc.*, 353 F. Supp. 88, 93 (S.D.N.Y. 1973).

[119] Ibid.

[120] 609 F. 2d 1047 (2nd Cir., 1979). Hereinafter referred to as "*Delbrueck* case".

[121] Ibid, at p.1051.

[122] Williston on Contracts, (3rd ed.), vol.2, at para. 426. The first sentence of this statement has been quoted by Moore J. in *Delbrueck* case, supra, at 1051. See also *Schreiber v. Keller Engraving Co.* 57 Misc 644, 108 N.Y.S. 658 (Sup. Ct. 1908).

"assigner must not retain any control over the fund - any authority to collect, or any power of revocation."[123]

Delbrueck case suggests that a fund transfer through CHIPS is an assignment of a chose in action. The payer's, i.e. Delbrueck's, deposit with its bank, i.e. Manufacturers, was a chose in action, and thus assignable.[124] The assignment occurred when Delbrueck (the creditor) instructed Manufacturers (its debtor) to transfer part of its debt to a specified third party, i.e. Herstatt bank (as an assignee) in the latter's account with another bank, i.e. Chase Manhattan. The transfer of such funds through CHIPS was "irrevocable" upon releasing the payment message.[125] The requirement of notice that must be given to the assignee has been met, according to the court's view, when Chase Manhattan, i.e. the payee's bank, received, as an agent for Herstatt (the assignee), the credit slip at its terminal following the transfer of the money to Herstatt's account with Chase Manhattan.

The decision in ***Delbrueck*** case was a decision on irrevocability of payment. In concluding that payment through CHIPS system was irrevocable at the time when the payment message was released by the transferring bank through the system, the court relied, *inter alia*, on banking practice associated with the CHIPS system regarding irrevocability of CHIPS payment messages;[126] and the common law of assignment of choses in action. The *Delbrueck* case was recently followed on the point of irrevocability of payment by the United States Court of Appeals for the Second

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[123] *Christmas v. Russell,* 14 Wall. 69; 81 U.S. 69; 20 L.Ed. 762 (U.S. Miss., 1871). See also *In re Wood's Estate,* 243 Pa. 211; 89 A. 975 (Pa., 1914) (an agreement which reserves to the original owner of the claim a right of revocation is not an assignment).

[124] Cited ***Miller's*** and *Paragon's* cases, supra .

[125] See Chapter Three, para. 3.2.1 [b] [ii] [2] on the finality of payment made through CHIPS.

[126] The mechinery of CHIPS is described in CHIPS promotional brochure published by the New York Clearing House Association. See Geva, B., "CHIPS Transfer of Funds", [1987] 14 J.I.B.L. 208.

Circuit in the recent case of ***Banque Worms v. Bank America International.***[127] Citing the *Delbrueck* case, the U.S. Court of Appeals found that the CHIPS transaction was irrevocable once the transfer had taken place. Thus, it seems that EFT orders through CHIPS constitute an assignment under the United States law.[128] Whether the same conclusion can be reached in relation to other payment systems, e.g. FedWire, is not decided.

However, according to U.C.C. § 4A provisions (which was enacted after *Delbrueck* case), a payment order does not constitute an assignment. A payee has no right to the funds transferred before his bank accepts the payment order. Thus, no funds are assigned to the payee from the time of instructing the transferring bank. Article 4A adopts the concept of "acceptance". U.C.C. § 4A-209 considers a payment order as a "request" by the payer to the transferring bank to take the necessary actions to cause the payment order to be carried out.[129] This request can be accepted or rejected. If an EFT order were to constitute an assignment, it is the assignment law that the debtor, i.e the transferring bank if the transfer is requested by the payer, cannot reject its creditor's instructions to pay what it owes him to a third party, i.e the payee. It makes no difference for the debtor to whom he pays so long as such payment discharges him from his debit. Thus, although Article 4A follows convention in using the term "funds transfer" to identify the payment from the payer to the payee, no money or property right of the payer is actually transferred to the payee at the time of instructing the transferring bank.[130] Moreover, U.C.C. § 4A-211 allows the sender

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[127] 726 F. Supp. 940 (2nd Cir., 1989).

[128] In an indirect comment, the ***Delbrueck's dicta*** was described by one writer as an "ill-considered United States dicta". See Cranston R. (ed.), The Single Market and the Law of Banking, 1991, at 206.

[129] The Prefatory Note of Article 4A.

[130] See U.C.C. § 4A-401 (Payment Date); and U.C.C. § 4A-404 (Obligation of the beneficiary's bank to pay the beneficiary).

of a payment order to cancel or amend such an order, orally, electronically, or in writing if a notice of such cancellation or amendment is communicated to the transferring bank at the time and in the manner affording it a reasonable opportunity to act upon such notice, before the bank accepts the payment order.[131] The cancellation and amendment right, given to the sender of an EFT order, in addition to the transferring bank's and other banks' right to reject a payment order contrast with the basic principles of the assignment law.

The recent comprehensive revision of Subpart B of Regulation J,[132] to make it consistent with U.C.C. § 4A, removes payment orders carried through FedWire from the shadow of the *Delbrueck* case.[133] That revision was crucial since Subpart B, which governs transfer of credits and debits of funds through FedWire, preempts all conflicting state laws and private contract provisions, including Article 4A.[134] According to such revision, Subpart B has expressly incorporated Article 4A and required that Article 4A will apply to transactions involving Federal Reserve Banks, even if the state in which the Federal Reserve Bank is located has not yet adopted

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[131] However neither the transferring bank, not the payer has an unqualified right to cancel or amend an payment order after its acceptance by the payee's bank. U.C.C. § 4A-211 (c)(2) severely limits cancellation in these circumstances. This is because the rights of the payee, and may be other third parties, are directly affected by the cancellation of an accepted payment order. See for more discussion on this issue, chapter three, para. 3.3.1 [b] [ii] [2].

[132] 12 C.F.R., § 210 (1985) issued by the Board of Governors of the Federal Reserve System. For a summery of its provisions, see Baker, D. and Brandel, R. "The Law of Electronic Fund Transfer Systems", (2nd ed. 1988) with 1991 Cumulative Supp. No.2, at 19.03[1]. Hereinafter cited as Baker & Brandel (1988). See also Geva, B., "FedWire Transfer of Funds" [1987] 104 B. L. J. 412; and Scott, H., "Corporate Wire Transfers and the Uniform Payment Code" [1983] 83 Colum. L.J. 1664.

[133] The revision by the Federal Reserve Board was made effective January 1, 1991.

[134] Regulation J is a promulgated by the Board of Governors of the Federal Reserve System, which is an agency of the United States. See *Federal Open Market Committee v. Merrill*, 443 U.S. 340, 352 (1979). Properly promulgated regulations of an agency of the United States have the force and effect of Federal law, and thus, preempt and override any inconsistent provision of state law. See *Fidelity Federal savings & Loan Association v. De La Cuesta*, 458 U.S. 141, 153 (1982); *Chrysler Corp. v. Brown*, 441 U.S. 281, 295-96; *Jones v. Rath Packing Co.*, 430 U.S. 519, 525-26 (1977), *rehearing den'd*, 431 U.S. 925 (1977); and *Childs v. Federal Reserve bank of Dallas*, 719 F. 2d 812 (5th Cir. 1983), *rehearing den'd* 724 F. 2d 127 (5th Cir. 1984). U.C.C. § 4A-107 explicitly provides that not only Regulations of the Board of Governors of the Federal Reserve System supersede any inconsistent provision of Article 4A, but also the operating circulars of the Federal Reserve Banks. The operating circulars are issued by a Federal Reserve Bank pursuant to a Federal Reserve Board Regulations, or under the Bank's own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board.

Article 4A.[135] The conclusion that can be drawn from this amendment is that payment orders under FedWire system, like those under Article 4A, do not constitute an assignment of funds.

Payment orders carried through other non-federal payment systems would be subject to the provisions of Article 4A if the Article is adopted by the state concerned. That means, such orders do not constitute an assignment. However, § 4A-501 permits the variation of Article 4A provisions by agreement. That section also provides that unless the contrary is stated a "Funds-transfer system rule" can override provisions of Article 4A. This means that a payment order may have an assignative effect, if a funds-transfer system rule provides so without an agreement to the contrary.

The assignment theory, however, does not explain all cases of EFT. The interests of the parties to the transfer may not be achieved by holding that payment orders constitute an assignment. Banks do not want to be seen as replacing their customers in performing their obligations to third parties. The risks that banks may face by assuming such a role would outweigh the benefits gained from such service, e.g. the fee. Payees, also, do not like to be seen as being paid before the payment is actually received by their banks; and hence bearing the risk of the transferring bank's or the intermediary bank's insolvency. Moreover, assignment theory does not explain a transfer between two accounts owned by the same person.

Payment orders may be carried out even though there are no sufficient funds in the payer's account in the transferring bank. Banks may accept instructions from their customers to transfer funds, even though those customers have no sufficient

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[135] 12 CFR § 210.25(b)(2) (1991). The amendments provide, however, that in the event of an inconsistency between the provisions of Subpart B and the provisions of article 4A, the provisions of subpart B will govern. 12 CFR § 210.25(b)(1) (1991).

funds in their accounts to cover the transfer. Banks' willingness to carry out such transfers comes from some business considerations. This practice depends on the special relationship between the banks and certain customers. A bank may give an overdraft to certain customers according to certain considerations. It may also rely on certain factors in assuming that its customer will manage to credit funds in his account at or before the time of the transfer. One suggests that in either case, a payment order does not constitute an assignment. In the first case where a bank gives an overdraft to its customer it is obvious that this customer no longer stands in its usual status as a creditor to his bank. A payer who is not a creditor in his relationship with his bank cannot be an assignor. The bank owes no debt to be assigned. In the second case where a bank assumes that the required funds will be available at or before the time of the transfer, one has to distinguish between two situations. Namely, whether the bank's expectations that the funds will be available at or before the time of the transfer are supported by sufficient evidence; or just a mere expectancy. If these expectations are supported by sufficient evidence, one suggests that an assignment of future debts may be established unless the payer has the right to revoke his payment orders. The evidence may take the form of a payment under an existing contract which will be due for the benefit of the bank's customer at or before the time at which the transfer is to be effected. In the absence of such sufficient evidence, it is generally held that an assignment of such a prospective right is ineffective.[136] In practice, banks do not demand clarification from their customers about their exact ways of meeting their financial liabilities resulted from granting an overdraft facilities. However, they usually ask for certain securities when they accept payment orders to

[136] See Williston on Contracts, (3rd ed.), at 56 and the cases cited therein at fn.7.

transfer large amounts of money if the customer has no sufficient funds in his account. They may, alternatively, retain the right to refuse the execution of the payment order if the customer fails to provide sufficient funds at the time of the transfer.

The nature of the EFT transactions militates against the assignment theory. In most cases, neither the payer, nor the banks involved in the transaction, intend to effect an assignment. Banks offer EFT transactions as a service to their customers. They receive instructions from their customers to carry out transfers without any intention to create an assignment. EFT is considered by the parties involved as a method of payment. This method of payment has been introduced for speed and efficiency considerations. It seems that there is no intention whatsoever to give the payee a right to claim the amount of transfer before the payment is made final. On the contrary, an assignment of a certain amount of money transfers the right to such money from the assignor to the assignee, immediately after the assignor informs the debtor of the assignment. It is suggested that to "make an effective assignment of a contract right, the owner of that right must manifest his intention to make a present transfer of the right without further action by him or by the obliger."[137] The manifestation of the intention to assign is a question of interpretation to be answered from all the circumstances including the assignor's words and other conduct.[138]

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[137] Farnsworth A., Contracts, (1982), at 754. The assignor may manifest his intention directly to the assignee. See also Simpson on Contracts, (1954), at 330; Kessler and Gilmore on Contracts, (1974), at 1204 where it said that "it is a hornbook law that an assignment is an act or manifestation by the owner of a right which indicates his intention to transfer, without further action, that right to another". It is also said by the same authors that "the courts have uniformly recognized that an agreement to pay out of a particular fund, without more, is not an assignment, but that to constitute an assignment there must be a manifestation of an intention by the assignor to relinquish control of the right assigned and to appropriate that right to the assignee". See *Christmas v. Russell*, supra; *Lone Stare Cement Corp. v. Swartwout*, 93 F. 2d, 261, 101 A.L.R. 75 (4 Cir. 1983); *Farmers' Bank v. Hayes*, 58 F. 2d 34, 37(6 Cir. 1932); *East Side Packing Co. v. Fahy Market*, 24 F. 2d 644, 645(2 Cir. 1928); *In re Dodge-Freeman Poultry Co.* 148 F. Supp. 647, 650 (D.C.N.H. 1965). See also *Wolters Village Management Co. v. Merchants and Planters National Bank of Sherman*, 223 F. 2d 793, 798 (5 Cir. 1955) where it was held that the intention of the parties determines whether, or not, a given instrument constitutes an assignment.

[138] Farnsworth A.E., (1982), Contracts, at 754. See also *Certified Collectors v. Lesnick*, 116 Ariz. 601, 570 P.2d 769 (1977) where a signed writing entitled "assignment" was held not to be assignment because it did not, *inter alia*, identify debt.

Usually, a payer looks to his bank to transfer the funds as an agent. The transferring bank considers the transfer as a service, which should be done to the customer like any other banking service. The payee would not consider himself, in the normal circumstances, as having received the payment before the amount of transfer is credited to his account in his bank. He would look to the payer, with whom he has a releationship, for the payment, but not to the transferring bank, nor even to his own bank. The payee's bank, also, would consider the receipt of the funds as a service done to its customer as any other banking service. Those are the normal expectations of the parties involved in EFT transactions. There is no indication, in the usual EFT transaction, of any intent to transfer an immediate right of the funds to the payee, in absence of which no assignment may be founded.[139] Moreover, it was held that an "agreement to pay out of a particular fund, however clear in its terms, is not an equitable assignment";[140] and that a written authorisation by a creditor to his debtor to pay a third party and charge the account of the drawer was not an assignment, since no intention to transfer the title has been evidenced.[141]

1.5 The Payment Order v. Mandate.

1.5 [a] Under U.K. Law.

Royal Products Ltd. v. Midland Bank Ltd.,[142] considers a payment order in credit transfer transactions "an authority or instruction by the payer to his bank to

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[139] See Williston on Contracts, (3rd ed.), vol. 2, at 1232, where it is argued that that "the ultimate test is the intention of the assignor to give and the assignee to receive present ownership of the claim".

[140] *Christmas v. Russell* 14 Wall. 69, 84; 81 U.S. 69, 84 (U.S. Miss., 1871).

[141] See *Structural Gypsum Co. v. National Com.* 105 N.J.Eq. 424, 148 A. 199 (1929), rev'd on other ground, 107 N.J.Eq. 32, 151 A. 839; *Edmund Wright Ginsburg Corp. v. C.D. Kepner Leather Co.* 317 Mass. 581, 59 N.E.2d 253 (1945); and *Samstage v. Orr*, 101 Ark. 582, 142 S.W. 1127 (1912) (where written order delivered by lessee to sublessee directed sublessee to pay rent to lessor "until further notice", and rent was then paid pursuant to the order, which amounts to an assignment). See also *Schreiber Keller Engraving Co.* 57 Misc. 644, 108 N.Y.S. 658; and *Alvord v. Luckenbach* 106 Wis. 537.

[142] [1981] 2 Lloyd's Rep. 194. See also *Scott v. Porcher* (1817) 34 L.T. 735; and *Morrel v. Wootten* (1852) 16 Beav. 197 (where it was held that an instruction to pay amounted to no more than a mandate to the mandatory which conferred no right or interest on the payee before payment).

transfer a given amount of funds to a specific payee's account".[143] The effect of CHAPS order according to Criminal Division of the Court of Appeal in *R v. King and Others,*[144] is "to direct the paying bank to debit the paying customer's account with £x (plus any charges) and to transfer the £x to the credit of the payee's account at another bank".[145] Emphasis should be made here on the use of the verb "direct". This means that a payment order is some sort of directions or instructions to the payer's bank to debit his account by the amount of the payment order and transfer such amount to the payee. The fact that the transfer of funds would be effected instantaneously does not mean that such order is not merely an authority or mandate to effect a fund transfer. In particular, it is not an assignment of funds.[146] That is because the payee's right to the funds transferred does not arise from the time of delivering the instructions to the payer's bank, but from the time of completion of the transfer. Staughton J. in *Libyan Arab Foreign Bank v. Bankers Trust* Co.,[147] considered that the credit balance with a bank constitutes a personal right which can be made available by two means: (i) delivery of cash; and (ii) a transfer of funds. According to that case, an account transfer is a process by which the payee's bank becomes indebted to the payee and the obligation of the transfering bank to the payer is extinguished *pro tanto*. "The original obligation of the payer's bank is not assigned; rather a new obligation by a new debtor is created".[148] The fact that the payer loses

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[143] [1981] 2 Lloyd's Rep. 194, 198 per Webster.

[144] [1991] 3 All E.R. 705.

[145] Ibid, per Lord Lane, at 709.

[146] *Cf.* Lord Chorley, Law of Banking, (1974), argues, at 268, that credit transfer through Girobank is effected by "means of an instruction, or mandate given by the creditor to his debtor to pay the amount of the debt to a third party, here his own creditor: and provided that ... the creditor has notice of, and accepts the transfer, the transfer will be complete; for an equitable assignment will result."

[147] [1988] 1 Lloyd's Rep. 259, 273.

[148] Wo, Lam Wing "Funds Transfer: A Risk Analysis" [1992] 1 J.I.B.L. 16, 16.

control over the funds at the time of releasing the payment message is a practical matter caused mainly by the method of payment and does not mean that he loses the right to such funds. That is because the payment message becomes practically irrevocable at that time. Where the payee's bank fails to acknowledge and receive such order, no payment is made to the payee. The payer can countermand his payment order in some payment systems where the design of the system allows his bank to stop the fund transfer before payment is made. A payment order in credit transfer transactions is properly described as a mandate from the sender of the order to a bank to transfer a sum of money to a specific payee.[149] In carrying out such mandate, the bank acts as an agent for the sender of the order, which is usually a customer of the bank.[150] Such mandate usually contains an instruction to a bank to transfer a certain sum of money to a specific payee, or payee's account. The payee's account may not necessarily be kept in the payer's bank. This implies that the transferring bank, unless instructed otherwise, may use the services of other banks to cause such transfer of funds. Thus, a credit transfer transaction may involve "a string of operations carried out by the different banks in a representaive capacity."[151]

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[149] Chitty on Contracts, (26th ed., 1989), at para. 2954 (an instruction to transfer funds through Giro constitutes a mandate to the bank); and Pennington, Hudson, and Mann, at 283.

[150] *Royal Products Ltd. v. Midland Bank Ltd.*, [1981] 2 Lloyd's Rep. 194, at 198 per Webster J.; and *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co.*, [1988] 2 Lloyd's Rep. 494. See also Ellinger, Modern Banking Law, at 367-371 (where it is concluded that, at 367-368, "money transfer orders involve a string of operations carried out by the different banks acting in a representative capacity"); Goode R.M. (ed.), Electronic Banking, The Legal Implications, at 35-37; Pennington, Hudson, and Mann, at 283; Chitty on Contracts, (26th ed. 1989), at para. 2954 (where it is argued that "the instructions given to the paying bank in one of the bank giro forms constitutes a mandate reminiscent of the authority conferred on the drawee bank by a cheque"); Ellinger, E.P., Banks and Extra-territorial Orders, [1989] L.M.C.L.Q. 363, 366, fn.12 in particular; Crawford, B., Credit Transfers of Funds in Canada: The Current Law, [1979] 3 Canadian Business Law Journal, 119, at 127-129; and Vroegop, J., The Role of Correspondont Banks in Direct Funds Transfers, [1990] L.M.C.L.Q. 547, 549 (where it is argued that the payer's instructions to its bank to transfer funds to a given payee constitutes an agency, which "fits readily" into the standard definitions of agency, e.g., Bowstead on Agency, (15th ed. 1985), at 1). See the two *obiter dicta* of the Court of Appeal in *Tenax Steamship Co. Ltd v. The Brimnes (Owners of) ("The Brimnes")*, [1975] 1 Q.B. 929; and *Mardorf Peach & Co. Ltd v. Attica Sea Carriers Corp. of Liberia ("The Laconia")*, [1977] A.C. 850 (credit transfer transaction is viewed as an agency of the transferring bank for its customer as a principal).

[151] Ellinger, Modern Banking Law, at 367-368. For the legal position and duty of banks involved in EFT transactions, see Ellinger, Modern Banking Law, at 367-374 (transferring bank, correspondent bank and recipient bank); King, R. "The Receiving Bank's Role in Credit Transfer Transactions", [1982] 45 M.L.R. 1; and Vroegop, J., The Role of Correspondent Banks in Direct Funds Transfers, [1990] L.M.C.L.Q. 547.

Where the transfer of funds is an in-house one, no separate agreement between the bank and its customer to effect a transfer of funds is necessary. Banks offer EFT as a banking service. This service is usually carried out according to the terms and conditions of the customer's account agreement with his bank. Webster J. in *Royal Products Ltd. v. Midland Bank Ltd.*,[152] insisted on excluding the necessity of a separate "contract" in in-house transfers, in the absence of an express one. His lordship used the word "operation" advisedly in an attempt to distinguish and exclude a contract. He thinks that the payment instructions did not bring in to existence, as between the payer and the transferring bank, any separate or distinct contract of any kind.[153]

Thus, a payment order in credit transfer transactions does not constitute a negotiable instrument, a creation of trust funds, or an assignation. It is merely an authorisation or mandate by the payer to his bank to cause a credit of the amount of the payment order in the payee's account in his bank. However, a special agreement may be entered into between the transferring bank and the payer to regulate a specific EFT transaction. Alternatively, a customer may add specific terms by including them in the payment order itself, e.g. time of payment. These terms need to be accepted by the bank.

Having concluded that payment orders constitute merely a mandate from the payer to his bank to transfer a given amount of money to a specific payee, two consequences, at least, follow. First, the payer has the right to countermand his payment order before its execution by the transferring bank. Second, the payee has no

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[152] [1981] 2 Lloyd's Rep. 194.

[153] Ibid, at 198.

title to the funds intended to be transferred before the completion of the transfer.[154] However, the instantaneous computerised fund transfer between the payer's bank and the payee's bank has, in practice, not only eliminated the payer's right of countermand, but also eliminated the time difference between the time of execution and the time of payment. This should not, however, obscure, at least in principle, these two results. The fact that the payer cannot in practice countermand his payment order because of the design of the payment system does not mean that the payer has lost his right as a matter of law.

Payment orders in debit transfer transactions are delivered to the payer's bank by the payee himself or by his bank. Relying on this pre-authorisation, the payer's bank will transfer the amount of the debit transfer order to the payee's account in his bank. Usually, the payee will deliver the payer's authorisation to his bank, which will credit, although provisionally, his account by the amount of the debit transfer order, and then the funds will be "pulled" from the payer's account.[155] There are two common applications of debit transfers: direct debits and EFTPOS.

In direct debit arrangements, the payee is authorised by the payer to issue to the payer's bank orders for the payment of money to his own account. This method is used, for example, for the payment of insurance premiums. The obvious risk in this system is the possibility of the payee (the creditor) abusing his authority to draw upon the payer's (the debtor's) account.[156] It is clear that such orders constitute a mandate or authority to debit the payer's account by the amount of the debit transfer order. It

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[154] Wo, Lam Wing "Funds Transfer: A Risk Analysis" [1992] 1 J.I.B.L. 16, 16.

[155] In contrast to credit transfer, where the payer's bank debits the payer's account by the amount of credit transfer and then funds will be "pushed" to the payee's account. See the UNCITRAL Legal Guide, supra, at paras. 8-13 (credit transfer), paras. 14-16 (debit transfer) and para. 17-29 (routing the funds transfer instructions); Geva, B., The Concept of Payment Mechanism, [1986] 24 Osgoode Hall L.J. 1, at 6-7; and Geva, B., The E.F.T. Debit Card, [1989] 15 Canadian Business L. J. 406, at 427.

[156] This risk becomes greater when the amount due varies from time to time.

is not clear, however, in which capacity the payee acts when he delivers the instructions to the payer's bank to debit the payer's account for the benefit of himself. One view suggests that the payer's bank is instructed by the payee as an agent for the payer.[157] Thus, the instructions to the payer's bank to debit the payer's account are seen as originating from the payer *via* his agent the payee. Adopting this view means that where the payee abuses his authority by requesting the transfer of a greater amount than he is authorised to request, the risk does not fall on the payer's bank, but remains with the payer. The bank has followed its instructions properly. It is the payee who exceeded his authority and it is to the payee that the payer must look to recover the overpayment.[158] Another model suggests that the payer's bank is authorised by the payer to pay his debts. The contract between the payer and the payee contains a term, perhaps implied, whereby the payee is to be paid by serving demands on the payer's bank. The bank is in the position of a paymaster.[159] Thus, the payer may look to his bank for the recovery of overpayments.

One argue that in view of banking practice the second view is the proper one. In cases of dispute over the amount of the debt, banking practice suggests that the payer's bank will place the accounts in their original position upon demand by the payer. Moreover, banks usually require indemnity from the payee who uses direct debit system. That is to protect themselves in cases where the payee demands greater amounts than those he is authorised to demand. If the payee is seen as an agent for the payer, there is no need for such indemnity since the bank will not be liable for

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[157] Ellinger, Modern Banking Law, at 344.

[158] Tyree, A., Electronic Funds Transfer in New Zealand, [1978] 8 New Zealand Universities Law Review 139, at 160-161.

[159] Ibid.

such abuse of authority on the part of the payee.[160] In practice, direct debit forms contain insructions and authority to the manager of the payer's bank (not to the payee) to pay the payee upon the latter's demand either of a periodical fixed or variable amount. Such instructions are revocable by the payer upon notice to his bank within an agreed time.

Although, the same analysis applies to EFTPOS transactions, such transactions tend to be regulated by special contracts. Debit cards are issued to users to utilise this method of payment according to an express account agreement. There are, at least, three parties involved in any EFTPOS transaction; a bank, a retailer or supplier of services, and a purchaser. This is the simplest form of an EFTPOS transaction, where both the retailer and the purchaser bank at the same bank. In this case, three separate contracts come into existence when the purchaser uses his card to buy goods or obtain services. First, there is the contract of sale of goods or supply of services between the purchaser and the retailer. Secondly, there is the contract between the bank and the purchaser, who is usually the bank's customer. According to this contract, which takes the form of an account agreement, the bank undertakes, *inter alia*, to honour its customer's EFTPOS valid purchases. The customer undertakes, *inter alia*, to reimburse his bank, usually by authorising it to debit an account. Thirdly, there is the contract between the bank and the retailer, under which the bank undertakes, *inter alia*, to credit the retailer's account by the amount of all EFTPOS valid purchases, or to collect these funds from the purchaser's bank if the purchaser banks with another bank. The retailer undertakes, *inter alia*, to pay the bank the agreed charges for all EFTPOS valid purchases, and accept valid EFTPOS cards. There might be more than

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[160] Ibid.

three parties involved in one EFTPOS transaction. When the retailer and the purchaser bank in different banks, four separate contracts, at least, come into existence. Those are the three contracts that have been mentioned earler, and a fourth contract between the retailer's bank and the purchaser's bank under which the purchaser's bank undertakes, *inter alia*, to reimburse the retailer's bank for all EFTPOS valid payments. The fourth contract may take the form of a master contract between many banks participating in an EFTPOS scheme.[161] Being a separate contracts, one would expect that the breach of one of them should not affect the performance of others.[162] Thus, the purchaser's bank is entitled to debit its customer's account by the amount of the purchase even if it is proven, for example, that the goods purchased were defective. The amendment of § 187(3) of the Consumer Credit Act 1974 by § 89 of the Banking Act 1987 supports this view. This amendment explicitly excludes an EFTPOS agreement from being a debitor-creditor-supplier agreement as defined by § 12 of the Consumer Credit Act 1974. The practical effect of this exclusion is that the purchaser's bank will not be jointly and severally liable with the retailer to the purchaser for any mirepresentation or breach of contract by the retailer under § 75 of the Consumer Credit Act 1974.

The structure of the transaction is analogous to the issue of a banker's irrevocable documantary credit, in which a seller sells goods to a buyer and relies for payment on the issuing bank's undertaking to pay on presentation of documents in

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[161] See for the relationship between the different parties in SWITCH card (one of the commonly used EFTPOS cards in U.K.) transaction and their legal positions as an example of EFTPOS cards in the United Kingdom, Algudah, F., The Legal Nature of the Switch Card Transaction, [1991] 4 The Scottish Student Law Review 14.

[162] See in credit card agreements, Goode R.M., Consumer Credit Law (1989) at para. 23.15 ("each of the three contracts generated by the use of the credit card is in principle autonomous and does not depend for its enforceability on performance of either of the others.").

conformity with the credit.[163] Apart from granting a line of credit, it also bears a close resemblance to the three-party credit card agreements. It is not, however, clear whether courts will treat the payment by EFTPOS card as conditional or absolute. In documentary credit, there is a presumption that the buyer's liability to pay the price is not discharged by the issue of the letter of credit, but merely suspended. Thus, if the issuing bank fails to pay the seller has the right to sue the buyer for the price. In other words the payment is conditional.[164] In credit card agreements, it was held that payment was absolute; and thus the seller or supplier cannot sue the purchaser if the credit card company becomes insolvent or otherwise fails to pay.[165] Banking practice suggests that payment is absolute. Retailers usually look for the credit of the bank and not the purchaser in meeting the payment. Unlike the documentary credit but like the credit card agreement, the retailer usually does not know the purchaser and keeps no address of him. Moreover, most of banks-retailers agreements provide that the bank agrees to pay the retailer the full amount of all valid and guaranteed transactions in accordance with the terms of such agreement.[166] This undertaking usually should be honoured regardless the financial status of the purchaser. Banks, however, usually keep the right to terminate the use of the card if the customer breaches his account agreement with the bank, e.g., for keeping insufficient funds in his account.

An EFTPOS order is the debit transfer order given to the purchaser's bank either by the retailer itself or by its bank to transfer a given amount, i.e. the price of the goods bought or services obtained by the purchaser's bank's customer, from the

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[163] See Goode R.M., Consumer Credit Law (1989) at para. 23.15, comparing the three-party credit card agreement with the irrevocable documentary credit.

[164] See, e.g., *W.J. Alan & Co. Ltd v. El Nasr Export and Import Co.* [1972] 2 Q.B. 189; [1972] 2 All E.R. 127 (C.A.).

[165] *Re Charge Card Services Ltd* [1986] 3 All E.R. 289 (Millett J.), affirmed by the Court of Appeal [1988] 3 All E.R. 764.

[166] For example, clause 3.1 of The Royal Bank of Scotland SWITCH card Retailer Agreement provides that "[t]he bank agrees to pay to the Retailer the full amount of all valid and guaranteed SWITCH transactions in accordance with the Instructions."

purchaser's account to the retailer's account. In delivering such order, the retailer relies on the purchaser's authorisation when it signs the sale slip. The purchaser's bank should honour such order according to the terms and conditions of the use of the EFTPOS card issued to its customer, the purchaser. It is also authorised to debit the purchaser's account by the amount transferred according to such terms and conditions. The EFTPOS debit transfer order, thus, constitutes a mandate by the purchaser to his bank to debit his account by the amount of the order to the benefit of the retailer. There is an express or implied term in the underlying contract of sale of goods (or supply of services) between the purchaser and the retailer (or supplier) that the payment is to be made by serving debit transfer orders on the purchaser's bank (as a paymaster), which already has a mandate to honour them. The risk that a purchaser's account may be overdebited by the retailer who abuses such authorisation is almost reduced by the fact that the purchaser's bank is not allowed to debit its customer's account by more than the amount on the sale slip, which is signed by the purchaser. Moreover, banks protect themselves by taking an indemnity from such retailers.

Where the EFTPOS scheme is an On-Line one, the instructions to debit the purchaser's account and credit the retailer's account can be delivered directly by the purchaser to his bank by the use of his card and PIN. It is argued that if the delivery of the instructions to the purchaser's bank is seen as made by the purchaser himself, such transfer of funds would be considered a credit transfer rather than debit transfer.[167] Even if this analysis is correct, the payment order is still a mere authorisation to the purchaser's bank to transfer funds from the purchaser's account to the retailer's account. The legal nature of such order would be the same as that in

[167] Geva B., The E.F.T. Debit Card [1989] 15 Canadian Business Law Review 406, at 428-429.

the case of credit transfer orders.

Concerning payment instruction through an ATM, it is analogous to those under credit transfer transactions. Where the bank's customer instructs the withdrawal of funds, it orders his bank to pay him the amount required and authorises the bank to debit his account. Thus, he gives a mandate to his bank *via* an ATM to perform such transaction. Where the ATM is owned by another bank, one suggests, in the absence of authority, that such a bank is in the same position as the intermediary bank in the case of credit transfer transactions. The bank shoud be seen as an agent for the customer's bank and not an agent for the customer in passing the payment or withdrawal instruction to the customer's bank. However, since no third party is involved, the problems of assignation or trust funds do not arise.

1.5 [b] Under U.S.A. Law.

Although *Delbrueck Co. v. Manufacturers Hanover Trust Co.*,[168] suggests that a payment order carried out through CHIPS is an assignment, it is overshadowed by the recent legislation on this point.[169] Article 4A denies payment orders any assignative effect. According to the *Corpus Juris Secundum*, the weight of American authority is strongly in favour of analysing credit transfer transactions in terms of agency.[170]

A "payment order", whether electronic or not, is not defined by § 1693a of EFTA, which is devoted to the general definitions. The definition of "electronic fund

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[168] 609 F. 2d 1047 (1979).

[169] See Cranston, R., (ed.), The Single Market and the Law of Banking, (1991), (where the editor in his contribution entitled "Payment and Clearing Systems in The European Community" commenting on the relationship between the transferring bank and the payee under English law said, at 206, that "[d]espite some ill-considered United States dicta to the contrary [citing *Delbrueck & Co. v. Manufacturers Hanover Trust Company* (1979) 609 F.2d 1047, 1051] payment is not effected by the assignment of any debt the payor's bank owes the payor").

[170] 9 C.J.S., § 172(c). See aslo Baker & Brandel (1988), at para. 29.03[2][a].

transfer" in general in § 1693a(6) of EFTA suggests that an EFT order is an instruction or authorisation to a bank to debit or credit an account. This construction is consistent with the provisions of the EFTA. § 1693(c)(5) compels banks to disclose to consumers the terms and conditions of providing EFT services, including the right to stop payment. This right, in particular, is inconsistent with the assignment law if payment orders were to be construed as an assignment. The assignment law denies the assignor the right to control the subject-matter of the assignment after it takes place.[171]

The definition of "paymenr order" in U.C.C. § 4A-103(a)(1) shows that a "payment order" is merely an instruction to banks to transfer funds to a given payee.[172] As such, a bank, unless bound by a separate agreement, may accept or reject such instructions.[173] Indeed, the payment order is characterised by the Reporters of Article 4A as a "request" by the payer to his bank to take action that will cause the payment order to be carried out. The "request" may be accepted or rejected by the transferring bank unless the bank has entered into an agreement to the contrary.[174] When the payment order is "accepted" by the transferring bank, the bank must "execute" the order by issuing another payment order, either to the beneficiary's bank, or to an intermediary bank, conforming with the first payment order to carry out the payer's payment order.[175] Each bank involved in the EFT process is free, unless bound by a separate agreement, to accept or reject the incoming payment order, which

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[171] See *Christmas v. Russell*, 14 Wall. 69, 81 U.S. 69, 20 L.Ed. 762 (U.S. Miss. 1871) and the discussion under para. 1.4 [b] above.

[172] See Miller F.H., Uniform Commercial Code Article 4A: A Framework for Transmitting Large Amounts of Funds [1990] 44 Consumer Finance Law Quarterly Report 150, 152 ("A payment order is simply an instruction by the sender of it to a bank to pay money to a beneficiary.").

[173] U.C.C. § 4A-209 (Acceptance of Payment Order); and U.C.C. § 4A-210 (Rejection of Payment Order).

[174] See Official Comment 3 to U.C.C. § 4A-209. See also Fry, P., Basic Concepts, supra, at 1413.

[175] U.C.C. § 4A-301 (Execution and Execution Date).

is also considered as a "request" to take action to cause the payment order to be carried out. If the intermediary's bank accepts a payment order by the transferring bank, it must "execute" it by issuing a conforming payment order to the beneficiary's bank to credit the beneficiary's account with it by the amount of the payment order. If the beneficiary's bank "accepted" the payment order, it must credit the beneficiary's account by the amount of the payment order; and, if instructed, to notify the beneficiary of such credit.[176] A payment order can be cancelled or amended by the sender of the order "if notice of the communication is received at a time or in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order."[177] However, "[a]fter a payment has been accepted cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank."[178] Allowing the payer to cancel or amend a payment order suggests that the title to the funds does not pass to the payee by merely instructing the bank to carry out a fund transfer. This militates, in particular, against considering the payment order an assignment or a creation of trust funds.

Thus, a "payment order" under the provisions of Article 4A constitutes a mere "request" to a bank to take action that will cause the payment order to be carried out.[179] This request can be accepted or rejected by the bank concerned, unless the bank is bound by a separate agreement. However, when such "request" is "accepted"

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[176] U.C.C. § 4A-209(b) (Acceptance of payment order by a beneficiary's bank); U.C.C. § 4A-404 (Obligation of the beneficiary's bank to pay and give notice to beneficiary).

[177] U.C.C. § 4A-211(b).

[178] U.C.C. § 4A-211(c).

[179] Article 4A's Prefatory Note.

by the bank concerned, it will be under a contractual obligation to take the necessary actions that will cause the payment order to be carried out. The kind of actions required depends on the position of the bank in the payment process, namely whether transferring, intermediary or beneficiary's bank. There is no duty on the transferring bank to guarantee that other banks will accept the transfer, e.g., the beneficiary's bank. That is because each bank in the payment process, where there are more than one, is entitled to accept and reject the payment order given to it by its preceding bank. If all banks accepted their payment orders, a payment usually will be made to the payee. If, however, one of the banks refused to accept the payment order the payer is entitled to his money back according to the "money-back guarantee rule" adopted by Article 4A.[180] The payee has no title to the amount of the payment order before the payment date.[181] The payment date may be determined by the payer in his payment order, but "cannot be earlier than the day the order is received by the beneficiary's bank".[182] If the payment order does not determine a payment date, payment is to be made to the beneficiary on the day the order is received by the beneficiary's bank.[183]

As a state law, Article 4A is overriden by Federal Law. However, the revision

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[180] This rule provides that where no payment is made to the payee, each bank in the payment process should return the amount of payment order, if paid, to its preceding instructor (sender of payment order). U.C.C. § 4A-402(c). See Baxter Th. & Bhala, R., Proper and Improper Execution of Payment Orders, [1990] 45 The Business Lawyer 1447, at 1461-1463; Nelson, N., Settlement Obligations and Bank Insolvency [1990] 45 The Business Lawyer 1473, at 1476.

[181] U.C.C. § 4A-404(a) (The beneficiary's bank's obligation to pay the beneficiary); and U.C.C. § 4A-401 (Payment Date).

[182] U.C.C. § 4A-401.

[183] Ibid. This seems to be in contrast with a federal law. § 4002(a)(1)(B) of The Expedited Funds Availability Act, 12 U.S.C. §§ 4001 et seq., provides that the proceeds of a wire transfer are to be made available to the beneficiary on the business day after funds are received. The Act does not indicate what it means to "receive" funds. However, Regulation CC, 12 C.F.R. § 229.10(b)(2), provides that an electronic payment is "received" when the bank receiving it has received both (i) payment in actually and finally collected funds; and (ii) information on the account and amount to be credited.

The point here is that a payee has no right to the funds at the time of delivering the payment order to the transferring bank, but at a later date. This takes a payment order from the ambit of assignment and trust funds arguments. See for the contradiction between Article 4A and the Expedited Funds Availability Act on the point under discusion, Baxter Th. & Bhala R., The Interrelationship of Article 4A with Other Law, [1990] 45 The Business Lawyer 1485, at 1488-1491. See for funds availability, in general, Huber S., Bank Officer's Handbook of Government Regulation, (2nd ed. 1989) with 1991 Cumulative Supp. No.2, chap.19.

of subpart B of Regulation J,[184] which governs EFT through FedWire to make it consistent with the provisions of Article 4A results in equating between the legal nature of payment orders through FedWire and those subject to Article 4A. Subpart B of Regulation J, which expressly incorporated Article 4A, is applicable to transactions involving Federal Reserve Banks even if the State in which the Federal Reserve Bank is located has not yet adopted Article 4A.[185] This brings payment orders carried out through FedWire within the foregoing analysis.

Article 4A does not cover debit transfers.[186] This means that the foregoing analysis does not apply to debit transfer orders. However, there is no difference, in principle, between EFTPOS transactions in United Kingdom and the United States. Thus, the legal nature of debit transfer orders under the United States law does not differ from that under the English Law.[187] It should be noted that the question of whether an ATM constitutes a branch of a bank is not relevant here since the issue here is the legal nature of the instructions given to the bank through an ATM and not the legal status of the ATM itself. In an earlier opinion of the Court of Appeals for the D.C. Circuit the court held that ATMs constitute branches because they satisfy the requirements of the definition of "branch" under the McFadden Act: they receive deposits, cash cheques, and lend money (via overdraft accounts or credit cards).[188] However, in a later case, the Second Circuit of the Court of Appeal held in the well-known case of *Independent Bankers Association v. Marine Midland Bank*[189] that an

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[184] 12 CFR § 210 et seq. (1991).

[185] 12 CFR § 210.25(b)(2) (1991).

[186] U.C.C. § 4A-104 and the Official Comment of that section. See also the Prefatory Note of Article 4A.

[187] Scots law is excluded from this statement because of the uncertainty concerning the effect of § 53(2) of the BEA 1882 in EFT transactions in Scotland.

[188] *Independent Bankers Association of America v. Smith* 534 F.2d 921 (D.C. Cir.), cer. den'd, 429 U.S. 862 (1976). The McFadden Act is codified as amended at 12 U.S.C. §§ 36,332 (1982).

[189] 583 F.Supp. 1042 (W.D.N.Y. 1983), *rev'd*, 757 F.2d 453 (2nd Cir. 1985), *cert. den'd*, 476 U.S. 1186 (1986).

ATM was not a bank's branch relying, inter alia, on the general intent of the McFadden Act "to strengthen national banks and achieve approximate competitive equality between the state and national banking systems."[190] The practical effect of considering an ATM a branch in the United States would result in restricting the installation and sharing of ATMs in the states that prohibit branching of national banks.[191]

The view that payment orders are merely an authority or a mandate to banks to effect an EFT transaction can be easily adopted by the common law rules, and even by statutory rules of contract and agency.[192] This is also consistent with the fact that the role of banks in most EFT transactions is essentially, in practice, mechanical in nature. The low price and high speed that characterise EFT transactions reflect this fact.

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[190] Ibid, 757 F.2d at 460. See for an analysis of the grounds of this decision and its significance, Rubin E., Automated Teller Machines and the Marine Midland Decision [1989] 44 The Business Lawyer 1082, at 1086-1091.

[191] For more analysis of this decision, see Felsenfeld C., Electronic Banking and its Effect on Interstate Branching Restrictions _ An analysis Approach [1986] 54 Fordham L. Rev. 1019. For a state-by-state survey of those states that restrict or allow state's branching, see Zimmer & Einhorn, The Law of Electronic Funds Transfer (1992), vol.2 under the name of the state concerned. This problem does not arise in the United Kingdom.

[192] Geva B., The evolving law of payment by wire transfer- an outsider's view of draft UCC Article 4A [1988] 14 Can. Bus. L.J. 186, at 188. However, Crawford B., on Crawford & Falconbridge Banking and Bills of Exchange, 8th ed., Vol. I, Canada Law Book, 1986, suggests, at 1018, that credit transfer constitutes only one of the functions performed by banks in their normal banker-customer relationship.

CHAPTER TWO

FAILURE TO MAKE AN ELECTRONIC FUND TRANSFER TRANSACTION

2.1 General.

Banks' failure to make an EFT transaction takes the form of either a complete failure to make an EFT or a failure to make an EFT properly. An example of bank's complete failure to make an EFT is the bank's unjustifiable denial of cash withdrawal from an ATM. A failure to make an EFT transaction properly means a performance of the transaction in question but without compliance with the terms and conditions of the bank's customer's instructions, e.g, untimely credit transfer.

Banks cannot be held liable for failure to make an EFT transaction unless they are bound to make it in the first place. This requires discussing first, whether banks are under a duty to accept and execute customers' instructions to make an EFT transaction.

2.2 Duty to Repay Customers' Funds Generally.

2.2 [a] Under U.K. Law.

Banks are under a duty to repay customers' funds. This liability is based on the legal nature of the banker-customer relationship. As a debtor of the amount of its customer's credit balance, a bank is liable to pay such debt to its creditor, i.e. its customer.[1] Under English law, a customer must make a demand for re-payment at the branch where the customer's account is kept before he has a cause of action against

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[1] In Scotland, see *Royal Bank of Scotland v. Skinner* [1931] S.L.T. 382 at 384 per Lord Mackay; and Davey V., Banker and Customer (1987), Scottish Banking Practice, at 12-13. In England, see *Foley v. Hill* (1848) 2 H.L.C. 28, at 36-37 per Lord Cottenham; and *Joachimson v. Swiss Bank Corp.* [1921] 3 K.B. 110 at 126-127 per Lord Atkin.

the bank.[2] Until such demand is made, there is no presently due debt owed by the banker to his customer.[3] The rationale behind such requirement is probably business efficacy.[4] It was held in *Joachimson v. Swiss Bank Corp.*[5] that there is an implied term in the banker-customer contractual relationship according to which the bank promises to repay its customer's credit balance at the branch where the customer's account is kept, and during the banking hours.[6]

Scots law is not in accord with English law as far as the requirement of demand is concerned. A debtor, under Scots law, is required to make payment of his presently due debt without the need for demand.[7] This was specifically held in relation to banker-customer relationship in *Macdonald v. North of Scotland Bank.*[8] In that case, Lord Justice-Clerk Cooper made it clear that although a customer who raises a petitory action against his bank for the outstanding credit in his balance without prefacing it by a demand "may be found liable in the expenses of an *ex hypothesi* premature and unnecessary action", there could be little doubt that the bank was still

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[2] See per Lord Cottenham in *Foley v. Hill* (1848) 2 H.L.C. 28, 36 where it was said that a bank has a duty to "repay to the principal, when demanded, a sum equivalent to that paid into [the bank]"; and per Atkin L.J. in *Joachimson v. Swiss Bank Corp.* [1921] 3 K.B. 110, 127 where it was said that "it is necessarily a term of [banker-customer] contract that the bank is not liable to pay the customer the full amount of his balance until he demands payment from the bank at the branch at which the current account is kept."

[3] Paget's Law of Banking, 10th ed. 1989, at p.161.

[4] See *Joachimson v. Swiss Bank Corp.* [1921] 3 K.B. 110 at 121, per Bankes L.J. "It seems to me impossible to imagine the relation between banker and customer, as it exists today, without the stipulation that, if the customer seeks to withdraw his loan, he must make application to the banker for it"; and at 130, per Atkin L.J. "[a] decision to the contrary would subvert banking practice". Adopting the doctrine of an immediately recoverable right of the customer's debt in his bank would probably contradict with the very nature of banking business. One possible result is that a bank can tender the amount of its customer's credit balance at any time causing the dishonour of all outstanding cheques to the detriment of the customer. Another result is that a customer would be entitled to demand his credit balance from any branch of the bank regardless of where his account is kept. See Paget's Law of Banking, 10th ed., at 161-162.

[5] [1921] 3 K.B. 110.

[6] See in particular per Atkin L.J. at 126-127. This proposition was upheld by the House of Lords in *Arab Bank Ltd. v. Barclays Bank (Dominion, Colonial and Overseas)* [1954] A.C. 495 at 531 per Lord Reid.

[7] Wilson, W.A., The Scottish Law of Debt, 2nd ed. 1991, at para.11.1 ("Whatever the position may be in England [citing *Joachimson's* case], there is no requirement in Scotland that the creditor must preface his action by a demand for payment").

[8] (1942) S.C. 369; [1942] S.L.T. 196.

his debtor and under an obligation to pay.[9]

2.2 [b] Under U.S.A. Law.

Banks are under a duty to repay their customers the amount of their deposits.[10] Like English law, but unlike Scottish law, demand is necessary for such repayment under the American law.[11] The customer is entitled to repayment at the branch where he deposited his funds. It was held in *Willis v. Barrow* that:[12]

> "[M]oney on deposit in the popular sense is a thing, a fund subject to the depositor's call. Such also is the language of business. It is known as a deposit. It is so designated in law, carrying distinct legal qualities. Money is deposited. Money is to be returned. The banker cannot be called upon at any place. His undertaking is to have money at a designated place, ready to pass it through the window when demanded according to banking rules."

This duty is based on the same ground as that under English law. A banker-customer relationship under the American law is also a debtor-creditor one so long as the deposit in the bank is concerned.[13] Thus, the bank as debtor must pay its debt, i.e. the customer's funds kept with the bank, to its customer, i.e, its creditor, when

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[9] Ibid, at 374, 203 respectively. One result follows from disregarding demand as a requirement to repayment of bank's deposit is, in addition to those mentioned above, that a bank would be entitled to plead as a defence the prescription of the customer's claim. The period of prescription will run from the time of deposit. Although banks, in practice, would not use such right for fear of bad reputation, there is a possibility of raising that as a defence in some cases. This, indeed, was so in Scotland up to the enactment of the Prescription and Limitation (Scotland) Act 1973. See *Macdonald v. North of Scotland Bank*, (1942) S.C. 369; [1942] S.T.L. 196 (where it was held that the time of prescription of a deposit, as a debt, runs from the time of its creation). The law of Scotland as it stands now is that a debt, including a deposit in a bank, extinguishes if it has subsisted for a continuous period of 20 years without relevant claim having been made in relation to it. However, although demand for repayment of a deposit is not a requirement in Scots law, for the purpose of prescription, time runs, unless otherwise agreed, from the time when a written demand for repayment of the deposit, or part of it, is made and not from the time of depositing the monies in the bank. See Prescription and Limitation (Scotland) Act 1973, Sched.2 para.2. See for more details in general, Wilson, The Scottish Law of Debt, (2nd ed. 1991), chap.14.

[10] *Beecher v. Cosmopolitan Trust Co.*, 239 Mass. 48, 131 N.E. 338 (1921); *Leather Mfrs. Nat. Bank v. Merchant' Nat. Bank*, 128 U.S. 26, 9 S.Ct. 3, 32 L.Ed. 342 (1888); *Huggins v. Commercial & Saving Bank*, 140 S.E. 177, 141 S.C. 480; and *Willis v. Barrow*, 119 So. 678, 218 Ala. 549.

[11] 9 C.J.S. Banks and Banking § 267; Natter R., Schlichting W., Rice T. and Cooper J., "Banking Law", Vol. 1, 1991 with Cumulative Supp. March 1992, Matthew Bender & Co. Incorporated, at § 9.05. Hereinafter cited as "Matthew Bender's Banking Law"; and Michie on Banks & Banking, Ch.10, § 38.

[12] 119 So. 678, at 680; 218 Ala. 549.

[13] *Beecher v. Cosmopolitan Trust Co.*, 239 Mass. 48; 131 N.E. 338 (Mass., 1921). See 9 C.J.S. Banks and Banking § 267(c) and the cases cited therein; Michie on Banks & Banking (1973 with 1985 Supp.), § 38 and the cases cited therein; Matthew Bender's Banking Law, (1991), Vol.1, § 9.05 and the cases cited therein; and Norton's & Whitley's Banking Law Manual (1991), § 11.04 and the cases cited therein. See also Symons & White, Banking Law (2nd ed. 1984), § 3.10, at 285 ("It is often stated that the bank-customer relation [e.g. in the checking account] is simply debtor-creditor. It is not. It is that and more. It is both debtor-creditor and contract: debtor-creditor as to the money deposited and contract as to the proper honouring and dishonoring of checks drawn. Since the debtor-creditor relation itself is a volitional contract relation, it is more accurate to say that the checking account is a contract relation.")

demanded.[14]

2.3 Duty to Make EFT Transactions.

Whether a bank is under a duty to accept, and then execute, its customer's instructions to make an EFT depends on the terms of the banker-customer relationship and the circumstances of the EFT transaction in question. This is discussed under the three commonly used EFT payment systems: credit transfer, EFTPOS and ATMs.

2.3.1 Electronic Credit Transfer Transactions.

A non-customer's EFT order to a bank to transfer funds to a given payee constitutes an offer which needs to be accepted by the bank in order to bind the bank for its failure to carry it out. Before the bank accepts such order, it is under no duty to execute it. The situation differs if the order to transfer is given to the bank by a customer who holds an account in that bank. The bank's liability for its complete failure to carry out such order depends on the terms of the customer's account agreement with his bank. If such agreement imposes a duty on the bank to accept its customer's EFT orders, the bank is liable for breach of contract if it rejects such instructions; or accepts them but either completely fails to carry them out or fails to carry them out properly as instructed. The issue is more complicated if the agreement between the bank and its customer does not address EFT transactions. A customer, for example, may have a checking account agreement with his bank without any mention of EFT services. Is there an implied term in such banker-customer relationships which imposes a duty on banks to accept, and then execute their customer's EFT orders?

2.3.1 [a] Under U.K. Law.

[14] Where such deposit is kept in a deposit account for obtaining interest, a customer must give his bank a notice before he can withdraw such deposit. This is usually subject to a contractual agreement between the bank and its customer.

It was held in *Joachimson v. Swiss Bank Corp.*,[15] that the terms of the banker-customer contractual relationship, include, *inter alia*:

> "[The bank's undertaking] to receive money and to collect bills for its customer's account. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them. The promise to repay is to repay at the branch of the bank where the account is kept, and during banking hours. It includes a promise to repay any part of the amount due ...".[16]

This is not an exclusive list of the terms of banker-customer relationship. The key point here is the implied term that a bank promises to repay its customer's funds "at the branch of the bank where the account is kept".[17] It is arguable that the bank's undertaking to repay the customer his funds, or part of them, at the branch of the bank where the customer's account is kept includes the transfer of funds to another bank's account.[18] Transferring the funds to another bank is not a repayment of the funds at the branch where the account is kept. The transfer of funds to another bank requires the customer's bank to instruct another bank or banks to cause a credit for the benefit of the payee. If the transferring bank is not a clearing member in the EFT system used, it needs the financial cover of a clearing bank that holds membership in the EFT

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[15] [1921] 3 K.B. 110.

[16] Ibid, per Atkin L.J. at 127.

[17] See also *Woodland v. Fear* (1857) 7 E & B 519; *R. v. Lovitt* [1912] A.C. 212; *Clare & Co. v. Dresdner Bank* [1915] 2 K.B. 576 at 578; *Richardson v. Richardson* [1927] P.228 at 232; *Isaacs v. Barclays Bank Ltd and Barclays Bank (France) Ltd* [1943] 2 All E.R. 682 at 684-685; *Frankman v. Anglo-Prague Credit Bank* [1948] 2 All E.R. 1025 at 1030; *Arab Bank Ltd. v. Barclays Bank (Dominion, Colonial and Overseas)* [1954] A.C. 495 at 531; and *Re Helbert Wagg & Co. Ltd's Claim* [1956] Ch. 323 at 343.

Staughton J., in *Libyan Arab Foreign Bank v. Bankers Trust Co.*, [1989] 3 All E.R. 252, at 252 noted that "[i]n the age of the computer it may not be strictly accurate to speak of the branch where the account is kept. Banks no longer have books in which they write entries: they have terminals by which they give instructions; and the computer itself with its magnetic tapes, floppy disk or some other device may be physically located elsewhere." However, although in that case, instructions to open an account in a London's branch of a given bank were given from a New York's branch, his lordship considered that the account was "kept" "at all material times" in London since the "actual entries on the London account were ... made in London". Ibid, at 252.

[18] Ellinger, Modern Banking Law, argues, at 122, that:
"The opening of current accounts for customers does, however, place an important obligation on banks. ... The bank's duty is to observe the customer's instructions to pay amounts due from him to third parties. The customer may order payment in two basic manners. One is by the use of cheques; the other is by executing a money transfer order or by authorizing some third party to execute it on his behalf."

system used. Moreover, a bank may have no correspondence relationship with the payee's bank, so it has to use the services of an intermediary bank. It is clear that electronic credit transfers require more than mere repayment of customer's funds at the branch where the account is kept. As such, one argues that in the absence of any agreement between the bank and its customer to accept electronic credit transfer orders, the bank is under no duty to accept such orders. This is so, although in practice banks usually execute customer's orders to make an EFT. However, imposing an obligation on banks to accept and execute EFTs is completely different matter.[19] The conclusion that one draws from this discussion is that the implied term of repayment of customer's funds "at the branch of the bank where the [customer's] account is kept" does not include the transfer of funds to a given account in another bank. Courts have not recognised any separate implied term in banker-customer relationship in EFT transactions to this effect.

This conclusion leads to another question. Namely, whether there is any duty on banks to notify customers of the refusal to accept and execute their payment orders, if they are under no duty to accept them. It seems that there is no authority on this point. In principle, silence does not constitute acceptance.[20] However, circumstances may indicate that acceptance could be presumed from silence. One example is where previous dealing between the bank and its customer shows that it is the bank's policy to inform customers when it refuses to carry out their payment orders. One suggests that although banks are under no duty to notify customers of their refusal to execute

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[19] See *Barclays Bank Plc v. Khaira and Another*, The Independent, Law Report, December 19, 1991 (Chancery Division), where it was held that although many banks did undertake the task of explaining to prospective guarantors the effect of the guarantee documents, it is, however, "logically fallacious to say that because banks routinely did offer explanation they were under a legal duty so to do."

[20] See generally, *Felthhouse v. Bindley* (1862), 11 C.B., N.S. 869, aff'd (1863), 7 L.T. 835.

their payment orders which they are not bound to accept and execute, sounding banking practice militates for such notification. A customer may assume that his bank, in absence of refusal, has accepted his instructions.

2.3.1 [b] Under U.S.A. Law.

2.3.1 [b] [i] Common Law Rules.

Unless being bound by an agreement, banks in the United States are under no duty to accept and execute electronic payment orders. Nor they are under a duty to inform the sender of the refusal to execute such orders before any specific period. That is because, like the case under British law, transferring funds to other bank's accounts or payees is far beyond mere repayment of customer's funds at the branch where the funds are kept. In particular, U.C.C. § 4-302 that requires banks either to pay or return customer's "item" before "midnight deadline"[21] is not applicable to EFT transactions. That is because "a payment order ... or a credit or debit card slip" is not an "item" as defined in U.C.C. § 4-401(9).

This was the case even before the recent amendment of U.C.C. § 4-401(9) to exclude "payment order", "credit or debit card slip" from the definition of "item".[22] It was held in *Houston Contracting Co. v. Chase Manhattan Bank, N.A.*,[23] that a telexed payment order did not constitute a "demand item" for the purposes of "midnight deadline" under U.C.C. § 4-302. In that case, a bank failed to execute a payment order that apparently would have created an overdraft, and to notify the

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[21] Defined in relation to collection of "item" by a bank in U.C.C. § 4-104(10) to mean "midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time the time for taking action commences to run, whichever is later".

[22] U.C.C. § 4-104(9) defines "Item" to mean "an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit slip".

The previous definition of "item" was "any instrument for the payment of money even though it is not negotiable but does not include money". See the old U.C.C. § 4-104(g).

[23] 539 F. Supp. 247 (S.D.N.Y. 1982).

sender of its refusal to do so before "midnight" of its receipt of the order. The court held that the bank was not liable for such an action. That was because the bank was not liable to honour the order; and that the telex order does not constitute a "demand item" to be subject to U.C.C. § 4-302 that requires its execution or return before "midnight" of the banking day of its receipt.

2.3.1 [b] [ii] Statutory Law Rules.

2.3.1 [b] [ii] [1] Consemer-based Transactions.

Under EFTA, a bank is not liable for its failure to act upon any instructions to transfer funds unless it is bound to do so by an account agreement with the sender.[24] In practice, banks are normally bound by an account agreement with consumers to accept and execute their payment orders to transfer funds to certain payee. The legal bases for such liability is contractual. Thus, the bank's failure to accept and execute an electronic credit transfer order according to the terms and conditions of the customer's account agreement, without a justifiable excuse,[25] constitutes a beach of contract. There is no duty on banks under EFTA provisions to notify consumers of their rejection of a payment order that they are under no duty to accept.

2.3.1 [b] [ii] [2] Commercially-based Transactions.

A receiving bank, unless bound by an express agreement or a funds transfer rule, is under no "duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order".[26] Article 4A treats

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[24] 15 U.S.C. § 1693h(a).

[25] See 15 U.S.C. § 1693h(a)(1) and (2), (b) and (c).

[26] U.C.C. § 4A-212, and Official Comment 3 of U.C.C. § 4A-209. U.C.C. § 4A-102(4) defines "Receiving Bank" as "the bank to which the sender's instruction is addressed". U.C.C. § 4A-102(5) defines "Sender" as "the person giving the instruction to the receiving bank". See also U.C.C. § 4A-209 ("a receiving bank accepts a payment order when it executes the order").

payment order as a "request" by the sender to a bank to "execute" or "pay" the order.[27] As a "request" it can be accepted and rejected by the receiving bank. Moreover, since Article 4A treats credit transfers as a series of payment orders between the parties involved, other banks are also under no duty, generally, to accept payment orders. However, if a bank entered into an agreement with a sender to accept its payment orders, it incurs a contractual obligation to accept and carry out its payment orders. Failure to do so, is a breach of contract.[28] The bank's refusal to accept payment orders contrary to a funds-transfer system rule exposes it to liability. Bank's liability for such breach is based on the terms of the agreement and not on the provisions of Article 4A.[29] The rationale behind such free acceptance policy, or what might be called the "rule of voluntarism" is summarised by the Prefatory Note of Article 4A as:

> "Substantial risk is involved in funds transfers and the bank may not be willing to give this service to all customers, and may not be willing to offer it to any customer unless certain safeguards against loss such as security procedures are in effect. Funds transfers often involve the giving of credit by the receiving bank to the customer, and that may involve an agreement."[30]

Acceptance by a receiving bank, other than the beneficiary's bank, occurs when the bank executes the order.[31] "Execution" occurs when the receiving bank (other than the beneficiary's bank)[32] issues a payment order intending to carry out

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[27] U.C.C. § 4A-209 Official Comment 1.

[28] See for the extent of liability in case of breach of an express agreement, U.C.C. § 4A-305(d).

[29] Fry, Basic Concepts, supra, at 1413-1414.

[30] See also Baxter & Bhala, Proper and Improper Execution, supra, at 1452-1454; and Official Comment 1 of U.C.C. § 4A-210.

[31] U.C.C. § 209(a). This is so subject to U.C.C. § 4A-209(d) (payment order cannot be accepted before the payment date if the receiving bank is both the originator's bank and the beneficiary's bank "book transfer", or the execution date if the bank is not the beneficiary's bank).

[32] U.C.C. § 4A-301. Since the beneficiary's bank does not issue a payment order carrying its sender's payment order it does not "execute" a payment order, but instead it "accepts" a payment order and "pays" the beneficiary. "Execution" refers to the act of the receiving bank in issuing a payment order "intended to carry out" the payment order that the bank received. Official Comment 1 of U.C.C. § 4A-301.

the order received by the bank.[33] The beneficiary's bank is usually bound by its account agreement with its customer, the beneficiary, to accept payment to the latter's account.[34] Under Article 4A, the beneficiary's bank accepts the payment order at the earliest of the following times:[35]

(i) when the bank either pays the beneficiary, or notifies him of receipt of the order or that his account has been credited with respect to the order;

(ii) when the bank receives payment of the entire amount of the sender's order by crediting an account of the bank or reaching a settlement through FedWire; or

(iii) when the bank opens next funds-transfer business day following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorised account of the sender.

The acceptance of a payment order by a receiving bank, other than a beneficiary's bank, binds it to execute such order properly.[36] The acceptance of a payment order by a beneficiary's bank binds the bank to "pay" the beneficiary and under certain circumstances to "notify" the beneficiary of receipt of the payment order.[37] This is discussed in detail below. However, the question is what happens if the payment order is rejected by the bank involved. Is there any duty on the bank that refuses to execute an order to notify the sender of that order of such rejection?

The answer to this question is yes regardless the position of the bank whether a beneficiary's bank or a receiving bank. If a receiving bank other than a beneficiary's bank decides to reject its sender's payment order it must notify that sender of such

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[33] U.C.C. § 4A-301(a).

[34] "A payment order received by the beneficiary's bank can be accepted but cannot be executed." U.C.C. § 4A-301(a).

[35] U.C.C. § 4A-209(b).

[36] U.C.C. § 4A-302.

[37] U.C.C. § 4A-404.

rejection provided that there is, on the execution date of that order, "a withdrawable credit balance in an authorized account of the sender sufficient to cover the order."[38] However, if the receiving bank decides that it will reject the order but does not give notice of rejection to the sender, it is not deemed to have accepted that order.[39] The only liability of the bank in this case is to pay interest to the sender on the amount of the payment order rejected for the number of days elapsing after the execution date to the earlier of either the fifth day[40] or the day the sender receives notice or learns that the order was not executed.[41] Although a receiving bank is under no duty to accept payment order unless it is obliged to accept by a special express agreement, it will have the use of the sender's money in his "withdrawable credit balance" until the sender learns that the order was not accepted. The sender could reasonably assume that money in sufficient "withdrawable credit" in his account with the bank was to be the source of payment of the funds transfer.[42]

The beneficiary's bank may accept a payment order by its inaction in two situations.[43] Those are: first, when the bank receives payment of the entire amount of the sender's order by either (i) making a final settlement of obligations (if the sender is a bank) through a Federal Reserve Bank; or (ii) crediting the beneficiary's bank's account with the sender (which is assumed to be a bank) or caused an account

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[38] U.C.C. § 4A-210(b). See Felsenfeld C., Strange Bedfellows For Electronic Funds Transfers: Proposed Article 4A of the Uniform Commercial Code and the UNCITRAL Model Law, [1991] 42 Alabama L. Rev. 723.

[39] By the negative inference of the Official Comment 1 of U.C.C. § 4A-210 ("Acceptance can occur only if the receiving bank executes the order").

[40] U.C.C. § 4A-211(d) (where an "unaccepted payment order is cancelled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.")

[41] U.C.C. § 4A-210(b). The final day of the period is counted as an elapsed day. Ibid. For the rate of interest applicable, see U.C.C. § 4A-506. "If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly." See U.C.C. § 4A-210(b).

[42] See the Official Comment 3 of U.C.C. § 4A-210.

[43] U.C.C. § 4A-209(b)(2) and (3).

of the beneficiary's bank in another bank to be credited;[44] second, where at "the opening of the next funds-transfer business day of the bank following the payment date of the order ... the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender".[45] Acceptance in the second case occurs at the opening of the next funds transfer business day of the beneficiary's bank. To prevent acceptance under these situations, it is necessary for the beneficiary's bank to send a notice of rejection to the sender before acceptance occurs, or within (i) one hour after that time, or (ii) one hour after the opening of the next business day of sender following the payment date if that time is later.[46]

Notice of rejection, in both cases, can be transmitted to the sender orally, electronically, or in writing.[47] No particular form or words is required. It is sufficient to indicate that the bank is rejecting the order or will not execute or pay it. Rejection is effective when the notice of such rejection is transmitted to the sender by a means that is "reasonable in the circumstances".[48] If such means of transmission is not "reasonable in the circumstances", rejection is effective when the notice is received by the sender.[49] No definition of this test is given. Transmitting the notice of rejection by an agreed means is reasonable in the circumstances.[50] Moreover, transmitting the notice of rejection by the same means used by the sender in

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[44] U.C.C. § 4A-209(b)(2). See also U.C.C. § 4A-403(a)(1) and (2).

[45] U.C.C. § 4A-209(b)(3).

[46] U.C.C. § 4A-210; and its Official Comment 2. See also U.C.C. § 4A-209(b)(3). U.C.C. § 4A-210(c) provides that "If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments". This prevents acceptance by passage of time under § 4A-209(b)(3).

[47] U.C.C. § 4A-210(a).

[48] Ibid.

[49] Ibid.

[50] Ibid.

transmitting the payment order that is rejected is probably reasonable in the circumstances.[51]

Thus, neither under the American law nor under the British law, banks are under a duty to accept and execute an EFT payment order, unless they are bound to do so by either a special agreement with their customers, a term in their account agreements, or a funds-transfer system rule. However, even if the customer's account agreement with his bank does not imply the acceptance of electronic credit transfer orders, a bank may unilaterally accept to execute its customer's payment orders. The bank's action to execute such order constitutes an acceptance to conduct such service to its customer. However, the two jurisdictions differ on the banks' duty to reject an unaccepted payment order in EFT transactions. While such duty is statutorily imposed on the American banks in commercially-based transactions, it seems that there is no such duty, absent contractual, on British banks.

2.3.2 EFTPOS & ATM Transactions.

Banks' duty to make EFTPOS and ATM transactions is usually governed by special account agreements. A person cannot use such facilities without having an account with a bank, which issues an access device, e.g., a card and a PIN to be used in making such transactions. Thus, issuing an access device to a customer to make a certain transaction or transactions, e.g. an EFTPOS or ATM cash withdrawals, indicates, *prima facie*, the bank's undertaking to honour customer's instructions for making such transactions as long as they are made within the terms and conditions of use.

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[51] See Geva, B., The Evolving Law of Payment by Wire Transfer- An Outsider's view of Draft UCC Article 4A, [1988] 14 Canadian Business Law Journal 186, at 208 (commenting on the test of "commercial reasonableness" adopted by an earlier draft of Article 4A).

2.3.2 [a] Under U.K. Law.

Under British law, the terms and conditions of such agreements should be written and expressed in a plain language.[52] Normally, such an agreement takes the form of a standard form application for the access device in question. By signing such form, the bank's customer binds itself to the terms and conditions of the use of such device; and the bank undertakes to provide such service. These terms and conditions should provide "a fair and balanced view of the relationship between the customer and the card issuer".[53] In practice, banks retain the right to vary such terms and conditions without the customer's consent. However, banks are required to give customers a reasonable notice before any variation takes effect.[54] Thus, a bank is under a duty to accept its customer instructions to pay for goods and services obtained by the use of an EFTPOS card issued to such customer by the bank. It is also under a duty to dispense cash to its customer if instructed to do so by the use of an ATM cash card issued by the bank. All that is, of course, subject to the terms and conditions of the use of such cards.

2.3.2 [b] Under U.S.A. Law.

There is no difference, in principle, as far as this point is concerned, between British and American jurisdictions. Under § 1693c of EFTA, the terms and conditions of any EFT should be disclosed at the time the consumer entered into such service. Disclosing such terms and condition to the bank's customer at the time of opening an

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[52] § 14.1 of the Code of Good Banking (1991).

[53] § 14.1 of the Code of Good Banking (1991).

[54] § 14.2 of the Code of Good Banking (1991). See also § 14.3 of the Code of Good Banking (a possible annual document to be sent to customers consolidating the variations of the terms and conditions of their cards).

account agreement for EFT services is sufficient. The disclosure should be made in "readily understandable language".[55] A bank is under a duty to notify a consumer in writing at least twenty-one days prior to the effective date of any change in such disclosed terms and conditions if such change would result in greater cost or liability for such consumer or decreased access to the consumer's account.[56] A bank may, however, implement a change in these terms and conditions without prior notification if that was immediately necessary to maintain or restore the security of the EFT system or the consumer's account.[57] In *Feinman v. Bank of Delaware*,[58] the defendant bank changed the terms of the account agreement with the Feinman by denying them cash withdrawals from an ATM without prior notifications. The bank argued that the denial of cash was immediately necessary to maintain and restore the security of the plaintiffs' account. The security reason given by the bank was, *inter alia*, that the plaintiffs had overdrawn their account by the use of ATMs in the past and presented a risk to do so in the future.[59] The court held that since the bank can not reverse an ATM transaction to restore a positive balance; and because of the very real possibility of future attempts by the plaintiffs to overdraw their account by way of ATM withdrawals, the bank has reasonably concluded that there was a security risk at the time it was decided to place the "deny cash" restriction on the account,[60] which

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[55] See 15 U.S.C. § 1693c(a) for such disclosure and other necessary disclosures.

[56] 15 U.S.C. § 1693c(b).

[57] 15 U.S.C. § 1693c(b). Subject to confidentiality rules, subsequent notification is required if such change is made permanent by the bank.

[58] 728 F. Supp. 1105 (U.S. Dist. 1990). The "deny cash" restriction in that case was not intentional, and resulted from a bona fide error.

[59] This includes an arranged overdraft. However, when the decision to deny the customer the withdrawal of cash through ATMs was made, the plaintiffs' account had previously been overdrawn, at least in part, by ATM withdrawals.

[60] The court held that it was irrelevant that the consumer's account had a positive balance when the "deny cash" restriction was keyed into the computer system. The crucial event was that the decision to "deny cash" was based on the information reasonably available at that time and not the physical event of keying the restriction into the bank's computer system. See *Feinman v. Bank of Delaware*, 728 F. Supp. 1105, 1113 (U.S. Dist. 1990).

justified doing so without giving a prior notification to the plaintiff.[61]

2.4 Scope of Banks' liability for Failure to Make an EFT.

2.4.1 Electronic Credit Transfer Transactions.

2.4.1 [a] Under U.K. Law.

2.4.1 [a] [i] The Transferring Banks.

A transferring bank that is obliged by agreement to carry out a certain customer's EFT orders, must take the necessary steps to execute such orders properly. Its failure to do so is a breach of that contractual duty. A bank that decides to execute its sender's payment order is under a duty to take reasonable care in executing such order as instructed.[62] This duty is based on the role of the transferring bank in the fund transfer process. The transferring bank carries out customer's payment orders in a representative way.[63] Banks act under the overall obligation to exercise reasonable care and skill in and about customers' business.[64] Since banks charge for such services, they may properly be described as agents for reward. Bowstead on agency argues that every agent for reward is bound to exercise reasonable care and skill in carrying out the instructions of his principal.[65] This proposition is supported by

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[61] Ibid, at p.1111.

[62] See, e.g., *Westminster Bank Ltd v. Hilton* (1926) 135 L.T. 358 at 362 per Atkin L.J. Rev'd on appeal without affecting this point (1926) 136 L.T. 315 (H.L.); *Royal Products Ltd v. Midland Bank Ltd* [1981] 2 Lloyd's Rep. 194, at 198 per Webster J.; *Lipkin Gorman v. Karpnale Ltd.*,[1989] 1 W.L.R. 1340, per Parker L.J., at 1376. See also Crawford and Falconbridge, Banking and Bills of Exchange, (8th ed.) at p.746 ("The most significant implied term [in banker-customer relationship] is that the bank will use reasonable care and diligence in the discharge of its instructions and the performance of all its banking functions".)

[63] See *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co.*,[1988] 2 Lloyd's Rep. 494 (where a bank instructs another to transfer funds from its account with it to another account with another bank acted as agent); *Royal Products Ltd v. Midland Bank Ltd* [1981] 2 Lloyd's Rep. 194 (Transferring bank carries out credit transfer instructions as an agent for its customer); *The Brimnes*, supra, and *The Laconia*, supra, (both suggest that the transferring bank acts in credit transfer as an agent for its customer, the payer). See also Ellinger, Modern Banking Law, at 368 ("The transferring bank is engaged in giro transactions in a representative capacity. ... It follows that the transferring bank, as agent, is obliged to carry out the instructions given with reasonable skill and care."); Crawford B., Credit Transfers of Funds in Canada: The Current Law, [1979] 3 Canadian Business Law Journal, 119, at 127-129; and Vroegop, J., The Role of Correspondent Banks in Direct Funds Transfers, [1990] L.M.C.L.Q. 547, 549 (where it is argued that the payer's instructions to its bank to transfer funds to a given payee constitutes an agency).

[64] Ibid. See also Chorley, Law of Banking, (6th ed. 1974), at 267; Arora A., Electronic Banking and the Law, at 70-72.

[65] Bowstead on Agency, (15th ed.), at p.144. His premise has been relied upon by Steyn J. in a recent electronic credit transfer case i.e. *Barclays Bank Plc. v. Quincecare Ltd. and Unichem* [1988] 1 F.T.L.R. 507, at 516. His Lordship added at the same page that "[t]here is no logical or sensible reason for holding that bankers are immune from such an elementary obligation".

Barclays Bank Plc v. Quincecare Ltd.[66] In that case, which is an electronic credit transfer case, Steyn J. said:[67]

> "[W]hen the bank in the present case acted on an order to transfer by immediate money transfer money from the [payers'] current account to [the payees'], the bank was acting as [the payers'] agent. ... Prima facie every agent for reward is ... bound to exercise reasonable care and skill in carrying out instructions of his principal ... . There is no logical or sensible reason for holding that bankers are immune from such an elementary obligation. In my judgment it is implied term of the contract between the bank and the customer that the bank will observe reasonable skill and care in and about executing the customer's orders."

The transferring bank's main duty is to adhere strictly to its customer's instructions. Thus, where it accepts an EFT order, it must comply with the terms of such order and carries it out properly. This takes the form of issuing a payment order to the next bank in the transfer process conforming with the payer's payment order. Banks' duty to adhere strictly to a customer's mandate has been recognised in context of confirmed documentary credit. In that context, Devlin J. in *Midland Bank Ltd v. Seymour*,[68] noted that:[69]

> "It is hard law sometimes to deprive an agent of the right to reimbursement if he has exceeded his authority, even though the excess does not damage his principal's interests. The corollary ... is that the instructions to the agent must be clear and unambiguous."

Devlin J.'s view is, however, mitigated by Webster J. in *Royal Products Ltd v. Midland Bank Ltd*[70] in relation to credit transfer orders. The plaintiffs argued that the doctrine of strict compliance applicable in the confirmed documentary credit transactions was also applicable to credit transfer transactions. The plaintiffs' aim was

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[66] [1988] 1 F.T.L.R. 507. This case has been approved by the Court of Appeal in *Lipkin Gorman v. Karpnale Ltd.*, [1989] 1 W.L.R. 1340; [1989] F.L.R. 137.

[67] At 516-517.

[68] [1955] 2 Lloyd's Rep. 147.

[69] Ibid, at 168.

[70] [1981] 2 Lloyd's Rep. 194, at 199.

that a transferring bank must strictly comply with its customer's payment orders. Webster J. in *Royal Products'* case rejected such argument since the credit transfer transaction is not a "documentary credit" within the meaning of that expression contained in the Uniform Custom and Practice for Documentary Credits.[71]

The practical effect of this decision is that a transferring bank is not necessarily in breach of its mandate to carry out its customer's payment order by the fact of its failure to secure the funds reaching the payee's account. It may escape liability if it proves that reasonable care and skill has been taken to make the transfer. The strict compliance argument in relation to credit transfers was ruled out by the *Royal products'* case. What the transferring bank is required to do is to observe due care and skill sanctioned by current banking practice in its performance of customer's payment orders.[72]

The transferring bank's duty to take reasonable care and skill covers all stages of the EFT transaction. It covers receiving, interpreting, ascertaining, and acting upon customer's payment orders in accordance with customer's instructions.[73] It does not seem to extend to inquiring about the purpose of the transfer.[74] The *dictum* of Ungoed-Thomas J. in *Selangor United Rubber Estates Ltd v. Cradock (No.3)*,[75] and its adoption by Brightman J. in *Karak Rubber Co. Ltd v. Burden (No.2)*[76] putting a

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[71] Ibid, at 199. Webster J.'s view was quoted, with approval, by Ellinger in discussing the position of the transferring bank and its duty in Giro transfers. see Ellinger, Modern Banking Law, at 368-369. For the legal nature of payment by "documentary credit", see *United City Merchants (Investments) Ltd. v. Royal Bank of Canada and Others* [1983] A.C. 168 (H.L.); and Gutteridge and Megrah, The Law of Bankers' Commercial Credits, (6th ed.), at 221.

[72] See Ellinger, Modern banking law, at 369.

[73] By analogy with cheques, see *Selangor United Rubber Estates Ltd. v. Cradock (No.3)* [1968] 1 W.L.R. 1555, at 1609 per Ungoed-Thomas J.

[74] This does not mean that banks may not ask customers to fill in the funds transfer order the purpose of the transfer. Indeed, there is such requirement in the standard transfer form of the Society for Worldwide Interbank Financial Telecommunications (SWIFT).

[75] [1968] 1 W.L.R. 1555, 1609; [1968] 2 All E.R. 1073.

[76] [1972] 1 W.L.R. 602; [1972] 1 All E.R. 1210.

higher standard of care on paying banks did not pass without criticism.[77] Ungoed-Thomas J. in *Selangor's* case held that the paying bank had been negligent in honouring a cheque drawn on the plaintiffs' account without any, or any sufficient inquiry as to the purpose for which it was being applied.[78] Brightman J. in *Karak Rubber* case held that the bank's duty of care includes the duty to make inquiries as may, in given circumstances, be appropriate and practical where the bank has, or a reasonable banker would have, grounds for believing that the signature on a cheque was not authorised.[79] Applying this standard of care, by analogy, to EFT transactions means that a transferring bank will be under a duty to inquire about the underlying transaction behind the funds transfer. This standard is undoubtedly a high one.

However, Steyn J. in *Barclays Bank Plc v. Quincecare Ltd*[80] did not adopt that standard. His lordship refused to impose a duty on the paying bank to inquire or question instructions to pay if they appear to be in accordance with customer's instructions. His lordship held that a bank should give careful consideration to the competing factors on either side; and then on the fair balance between them the bank must refrain from executing a payment order if and for so long as it is put on inquiry in the sense that the bank has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of its customer. Shortly after *Quincecare* case, the Court of Appeal in *Lipkin Gorman v. Karpnale Ltd*[81] has rejected that high standard of care. May L.J. in that case said that "[t]here is nothing in [the banker-customer relationship], express or implied, which could

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[77] See, e.g, Paget's law of Banking, (10th ed. 1989), at 203-204; Goode R.M., Commercial Law (1982), at 514.

[78] [1968] 1 W.L.R. 1555, at 1634.

[79] [1972] 1 W.L.R. 602, at 629.

[80] [1988] 1 F.T.L.R. 507.

[81] [1989] 1 W.L.R. 1340.

require a banker to consider the commercial wisdom or otherwise of the particular transaction."[82] It is submitted that "both *Quincecare* and *Lipkin Gorman* appear to set the contractual duty of care at a lower, and more realistic, standard than that applied in *Selangor* and *karak*. ... this represents a fairer balance between the competing factors on either side."[83]

The transferring bank's duty of care in carrying out an EFT transaction reflects itself in certain specific obligations. First, the transferring bank must comply with the terms and conditions of its customer's payment orders. The compliance with such terms and conditions takes the form of issuing another payment order to the payee's bank (or an intermediary bank if necessary) conforming with the payer's payment order. Such order must reflect in all material aspects the payer's payment order. The amount of payment, the payee's name or account number, the payee's bank, the time of payment and the funds transfer system used are material elements in any payment order. The bank's noncompliance with one of these terms, at least, is a breach of the banks duty to take reasonable care in executing customer's payment order. Thus, where the payer orders the use of a particular funds transfer system, e.g. Giro System, the transferring bank must honour such order by using such system. Moreover, the bank must take reasonable care to ensure that its payment order is received by the payee's bank or the intermediary bank (where it uses one). A transferring bank that carries out a payment order through CHAPS, for example, will receive a "Logical Acknowledgement" from the payee's settlement bank informing it that the order is

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[82] Ibid, at 1356. Alliott J., the trial judge in the same case, [1987] 1 W.L.R. 987, held against imposing such duty on the paying bank. His lordship said, at 1006, that a "bank is not required to act as an amateur detective".

[83] Paget's Law of Banking, (10th ed. 1989), at 205.

received and accepted.[84] Thus, and as banking practice suggests, a reasonable transferring bank would be expected to send another EFT order to the payee's bank if it does not receive such an acknowledgement. Without sending such an acknowledgement to the transferring bank by the payee's bank, the transfer will not appear on the Bank of England's settlement figures between the clearing banks at the end of that business day. The fact that the transferring bank does not receive such acknowledgement, should alert it that the payment order has not received by the payee's bank. Thus, it is arguable that if the transferring bank fails to send the order again it would be liable for breaching its duty to take reasonable care in executing the customer's instructions.[85] The most common breach is the bank's failure to make payment on time if a payment date is specified in the payment order. Banks usually disclaim liability for such delay in transfer by contractual agreement. Customers need strong bargaining power to negotiate the waiver of such term.

Second, the transferring bank must take reasonable care in selecting a reliable correspondent bank if needed. A transferring bank may be held liable for selecting an intermediary bank, which later became bankrupt causing losses to the payer, if it is proven that the transferring bank had doubts on its financial status, e.g., had some information that the bank faces liquidity problems.[86] It is suggested that a transferring bank, which employs an intermediary bank, delegates, in fact, part of its task in the

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[84] Rule 4(c) of CHAPS Clearing Rules (1985) Provides that:
"By sending to the Payer Settlement Bank a LAK (Logical Acknowledgment) for a CHAPS payment the Payee Settlement Bank agrees, after authentication verification: -
(i) In the case of payments addressed to one of its own offices, to give same day value to the Payee Customer.
(ii) In the case of payments addressed to another organisation to give same day value to that organisation.
(iii) That when payments types 11 or 21 (Mandatory Advice) are used it will, in addition, endeavour to notify its customer, to whose account the funds will be credited, on the same day, irrespective of any standing arrangements with that customer".

[85] See Arora A., Electronic Banking and the Law, at 72.

[86] See *Royal Products Ltd v. Midland Bank Ltd* [1981] 2 Lloyd's Rep. 194 (suggesting without ruling that a transferring bank would be liable for such failure. Confidentiality rules militate against passing such information to others).

payment process to such bank as its agent; and hence, makes it a sub-agent in relation to the transferring bank's customer.[87] The transferring bank is liable to its customer for its correspondent's breach of the latter's duty to use reasonable care and skill in carrying out the transfer.[88] The fact that the correspondent bank is a separate legal entity rather than a branch of the transferring bank is irrelevant. Webster J., in *Royal Products v. Midland Bank* quoted with approval Lord Chorley in his Law of Banking as saying:[89]

> "As between the customer and his banker, however, the latter is liable for the acts of his correspondent in exactly the same way and within the same limits as for those of his managers and servants, for it is immaterial to the customer whether the banker operates through a branch or through a correspondent, unless, of course, the banker expressly stipulates that he is not to be so liable."

However, although an agent is vicariously liable to its principal for the negligence of a sub-agent, this liability can be disclaimed by contract.[90] That was evidenced in the express words of the last sentence of the passage quoted above. In practice, banks tend to utilise such right in their dealing with customers.[91] Exemption clauses for this effect have been upheld by courts.[92] It is suggested that as far as such clauses appear to be reasonable, it is highly unlikely that they would be affected by the provisions of the Unfair Contract Terms Act 1977.[93]

Third, the transferring bank's duty of care requires taking proper precautions

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[87] Vroegop, J., The Role of Correspondent Banks in Direct Funds Transfers, [1990] L.M.C.L.Q. 547, 549.

[88] *Royal Products v. Midland Bank* [1981] 2 Lloyd's Rep. 194, at 198.

[89] [1981] 2 Lloyd's Rep., 194, at 198. See Lord Chorley, The Law of Banking, 6th ed., at 374.

[90] Ellinger, Modern Banking Law, p.369. See *Equitable Trust Co. of New York v. Dawson Partners Ltd.* (1927) 27 Lloyd's Rep. 49 (issuing bank in documentary credit is liable for faults of its correspondent); and *Mackersy v. Ramsays, Bonars & Co.* (1843) 9 Cl. & F 818 (a bank is instructed by its customer to collect a bill of exchange drawn on a merchant abroad. It was held liable for the fault of its correspondent in collecting the bill).

[91] See Chitty on Contracts, (26th ed. 1989), at para. 2989, where it is noted that "most modern banking forms include a clause under which a correspondent is engaged at the customer's risk and expenses".

[92] *Calico Printers' Association Ltd. v. Barclays Bank Ltd.* (1931) 36 Comm. Cas. 71; aff'd (1931) 145 L.T. 51.

[93] Ellinger, Modern Banking Law, at 370. See also Chitty on Contracts, (26th ed. 1989), at para. 2958 commenting on this point by saying that since "the paying bank is not in a position to exercise any control over its correspondent, such a clause appears to be reasonable".

and organising business appropriately so as to ensure that the services undertaken are carried out efficiently.[94] Thus, where a credit transfer is carried out by the use of CHAPS, for example, the transferring bank must take care to ensure that the designated receiving bank has funds made available to it on the same day as the order to make payment is given, provided that the order reaches the bank before CHAPS cut-off time.[95] The transferring bank is responsible to take reasonable care and skill to ensure that its equipment is adequate to communicate payment messages and to settle payments. It should also maintain such equipment to keep this adequacy.[96] It is suggested that it is not enough for the bank to take care in appointing technical advisers and engineers if they do not carry out their tasks with appropriate skill and care.[97] However, the transferring bank, which uses CHAPS in its credit transfer, is unlikely to be held under a duty to ensure that the British Telecom lines or the package switching system for CHAPS is reasonably maintained. The bank has no control over such systems. They are operated by independent third parties. Unless the transferring system is operated by an agent of the bank, or operates as an agent for the bank, a bank should not be under a duty to maintain such systems.[98]

There is a persuasive authority to support the proposition that a transferring bank is under no duty to advise its customer of the best available EFT systems to

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[94] See Arora A., Electronic Banking and the Law, at 70.

[95] Ibid, at 71. See Rule 9 of CHAPS Clearing Rules (1985) (Cut-off and settlement procedures).

[96] e.g., CHAPS Clearing Rules (1985) provide in Rule 4(e) that:
"Each Settlement Bank is responsible for ensuring that the hardware used in any Gateway which it may use is adequate to permit the receipt and acknowledgment of all CHAPS Payment and Non-Payment messages which it can reasonably foresee".
Rule 4(f) provide that:
"A Settlement Bank which has reason to anticipate an increase in the volume of its CHAPS payments which could have a significant impact on any other Settlement Bank must give adequate warning of that increase to the CHAPS Operational Sub-Committee".

[97] Arora A., Electronic Banking and the Law, supra, at 71 citing *Greaves & Co. (Contractors) Ltd v. Baynham Meikle* [1975] 3 All E.R. 99.

[98] Arora, Electronic Banking and The Law, supra, at 72. C.f. Goode, R.M., Electronic Banking, The Legal Implications, supra, at 77.

transfer his funds. Nor, it is under a duty to warn him of the disadvantages of choosing one particular transfer system rather than another. It was held in *Schioler v. National Westminster Bank Ltd.*[99] that the defendant bank did not owe the plaintiff customer a duty of care to advise or warn her of the possible tax repercussions of remitting to England for realisation of warrant denominated in Malaysian dollars. *Redmond v. Allied Irish Bank Plc,*[100] suggests the defendant bank did not owe the plaintiff customer a duty of care to advise or warn him of the risks of paying in for collection a cheque crossed "not negotiable - account payee only" in circumstances where he was the named payee. It was recently held in *Barclays Bank Plc v. Khaira and Another*[101] that although banks routinely offer explanations to prospective guarantors on the legal effect of signing a guarantee, they are under no legal duty so to do. However, if the transferring bank did in fact embark on such advice it must do so with reasonable care.[102]

This is the scope of the transferring bank's contractual duty to take reasonable care and skill in carrying out its customer's payment orders. However, it must be noted that the scope of banks' duty of care depends, in general, on all the circumstances of transaction in question.[103] This was also held to be the case in relation to electronic credit transfers.[104]

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[99] [1970] 2 Q.B. 719; [1970] 3 All E.R. 177.

[100] [1987] 2 F.T.L.R. 264.

[101] Unreported, see The Independent, Law Report, December 19, 1991 (Chancery Division).

[102] *Box v. Midland Bank Ltd* [1979] 2 Lloyd's Rep. 391 (where a bank is under no duty to predict the outcome of certain customer's application for a service, but if it does, however, predict such outcome, which turns out to be inaccurate, it could be held liable if the customer relied on such inaccurate prediction to his detriment). The bank may also find itself subject to the scope of the House of Lords' decision in the landmark case of *Hedley Byrne and Co. Ltd v. Heller and Partners Ltd* [1964] A.C. 465; [1963] 2 All E.R. 575; [1963] 1 Lloyd's Rep. 485 (delictual duty of care). See the House of Lords' remarks on this case in *Caparo Industries Plc v. Dickman* [1990] 2 W.L.R. 358, in particular, per Lord Oliver at 587, Lord Bridge at 576.

[103] *Governors of Peabody Donation Fund v. Sir Lindsay Parkinson & Co. Ltd.* [1985] A.C. 210, per Lord Keith at 240-241.

[104] Steyn J. in *Barclays Bank Plc. v. Quincecare Ltd* [1988] 1 F.T.L.R. 507 said, at 517, that "[e]verything will no doubt depend on the particular facts of each case".

A transferring bank might also be found liable for breaching a statutory duty to take reasonable care in providing customers with EFT services. Banks, as providers of EFT services, are covered by § 13 of the Supply of Goods and Services Act 1982.[105] Under that section, which is not applicable to Scotland, a supplier of goods or services is under a duty to take reasonable care in so doing. However, this duty is not a distinct one, but a codification of the common law duty of care.

A transferring bank might also be held liable, in negligence, for its failure to carry out a payment order. It is likely that the requirements for such duty would be established in EFT transactions. A person who instructs a bank to transfer funds from one account to another has a "special relationship" with such bank to justify the imposition of a duty on the bank to take reasonable care in carrying out such instructions. It is also "foreseeable" in most cases that the transferring bank's failure to carry out such instructions would result in some sort of loss to that person. However, one cannot assume that in every case of bankers' failure to carry out payment orders, the loss suffered by such failure would be "foreseeable", and thus recoverable. One example of such loss is consequential damages, which may vary infinitely. It is noticed that courts would not impose, generally, a duty of care in delict if it is not "fair, just or reasonable" to do so.[106]

However, it seems that courts would likely to reject the imposition of a duty of care in delict in credit transfer transactions since the bank and its customer would be in a contractual relationship. Lord Scarman in *Tai Hing Cotton Mill Ltd v. Liu*

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[105] The Review Committee's Report, supra, at p.41.

[106] See *Caparo Industries Plc v. Dickman*, [1990] 2 W.L.R. 358. See also Morris, Gillian S., The Liability of Professional Advisers: Caparo and after' [1991] J.B.L. 36 at p.41.

Chong Hing Bank Ltd[107] gave a leading statement on the imposition of a duty of care in delict, where the parties are in contractual relationship. His lordship said:[108]

> "Their lordships do not believe that there is anything to the advantage of the law's development in searching for a liability in tort where the parties are in a contractual relationship. This is particularly so in a commercial relationship. Though it is possible as a matter of legal semantics to conduct an analysis of the rights and duties inherent in some contractual relationships including that of a banker and customer either as a matter of contract law when the question will be what, if any, terms are to be implied or as a matter of tort law when the task will be to identify a duty arising from the proximity and character of the relationship between the parties, their Lordships believe it to be correct in principle and necessary for the avoidance of confusion in the law to adhere to the contractual analysis: on principle because it is a relationship in which the parties have, subject to a few exceptions, the right to determine their obligations to each other, and for the avoidance of confusion because different consequences do follow according to whether liability arises from contract, eg in the limitation of action."

Lord Scarman's view has been adopted by several cases.[109] The courts have shown themselves highly resistant to the argument that the law of delict may be used to "plug the gaps" left by a contract,[110] or to circumvent a contractual chain.[111] It was held that where a customer who had the choice to sue his banker for breaching its duty of care in contract and delict, and chose to sue in contract and failed, cannot sue in delict.[112] The precise limits of this judgement are still being worked out. It is suggested that there are, at least, three situations in which this rule does not preclude the imposition of a duty of care in delict between parties who stand in a contractual relationship.[113] In relation to the credit transfer transactions, these

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[107] [1986] A.C. 80; [1985] 2 All E.R. 947 (P.C.).

[108] Ibid, at 107, 957 respectively.

[109] e.g. *Greater Nottingham Co-operative Society Ltd. v. Cementation Piling and Foundation Ltd* [1989] Q.B. 71; [1988] 2 All E.R. 971;, and *Banque Financiere de la Cite SA v. Westgate Insurance Co. Ltd* [1988] 2 Lloyd's Rep. 513.

[110] e.g., *The Bank of Nova Scotia v. Hellenic Mutual War Risk Association Ltd (The "Good Luck")* [1989] 2 Lloyd's Rep. 238; and *Reid v. Rush and Tompkins* [1989] 3 All E.R. 228.

[111] e.g. *Duncan Stevenson MacMillan and Others v. A.W. Knott Becker Scott and Others* [1990] 1 Lloyd's Rep. 98; and *Pacific Associates Inc. and Another v. Baxter and Others* [1989] 2 All.E.R. 159.

[112] *National Bank of Greece SA v. Pinios Shipping Co. (No. 1)* [1989] 1 ALL E.R. 213; [1988] 2 Lloyd's Rep. 126.

[113] Paget's Law of Banking, (10th ed. 1989), at 164-165.

situations are:

(i) The transferring bank may find itself liable in delict to its customer (the sender of the payment order) for misrepresentations or misstatements made before the acceptance of the payment order,[114] or before the entering into a general contractual agreement, e.g. banker-customer relationship;[115]

(ii) The transferring bank may be held liable under a duty of care in delict, if the events which give rise to such duty are simply outside the range of matters which can realistically be treated as within the scope of the payment order;[116] and

(iii) In a large class of cases it has always been, and probably remains possible, for a bank's customer to sue either in contract or in delict; in such cases, liability in delict is co-extensive with liability in contract.[117]

The last proposition has been supported recently by Steyn J. in *Barclays Bank Plc. v. Quincecare Ltd.*[118] His lordship said:[119]

> "[N]otwithstanding what was said in *Tai Hing Cotton Ltd. v. Lue Chong Hing Bank Ltd.* ... a banker may in a case such as the present be sued in tort as well as in contract[120] ... . But the duties in contract and tort are co-extensive, and in the context of the present case nothing turns on the question whether the case is approached as one in contract or tort."

2.4.1 [a] [ii] The Intermediary Banks.

The failure to make a credit transfer could result from an intermediary bank's fault. This bank may fail to execute the payment order properly. The liability of the

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[114] See *Esso Petroleum Co. Ltd. v. Marden* [1976] Q.B. 801; [1976] 2 ALL. E.R. 5.

[115] *Woods v. Martins Bank Ltd.* [1959] 1 Q.B. 55; [1958] 3 All E.R. 166. See also the leading case of *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.* [1964] A.C. 465; [1963] 2 All E.R. 575.

[116] See *Banque Financiere de la Cite SA v. Westgate Insurance Co. Ltd.* [1988] 2 Lloyd's Rep. 513 (C.A.), in particular, at 558-559.

[117] See *National Bank of Greece SA v. Pinios Shipping Co. (No. 1)* [1989] 1 All E.R. 213, per Lord Lloyd's L.J., at 222-223.

[118] [1988] 1 F.T.L.R. 507.

[119] Ibid, at p.517.

[120] *Midland Bank Trust Co. Ltd. v. Hett Stubbs & Kemp* [1979] Ch. 384.

intermediary bank for such failure depends on the terms of its correspondence relationship with the transferring bank. The correspondent bank carries out the transferring bank's instruction by either (i) making payment to the payee if the payee's account is kept with it; or (ii) passing on conforming instructions to the payee's bank to credit the payee's account by the amount of the payment order.[121] The payee's bank, at the end of the payment process, will credit the payee's account by the same amount, and if instructed, notify the payee of such transfer. It will reimburse itself by debiting the intermediary bank's account with it, if the intermediary bank did not inform it of crediting its account with it by the amount of transfer.

The intermediary bank's failure to carry out the payment order as communicated to it by the transferring bank constitutes a breach of the correspondent agreement. The extent of such liability depends on the contractual terms of such agreement between the two banks. Their relationship is analogous to that between the transferring bank and the payer. The question that may arise is whether the transferring bank's customer can directly sue the intermediary bank, with which he has no contractual relationship, for its failure to effect his payment order properly? This question has become an important one because of the now common banking practice to disclaim liability for correspondent's acts and omissions. It is probably this very point that raises such question.[122]

A direct claim by a transferring bank's customer against an intermediary bank

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[121] In correspondent agreements, banks maintain current accounts with each other, known in banking circles as "nostro" and "vostro" accounts to settle such transfers. "Vostro" account is the account of another bank with the transferring bank, such as the intermediary bank's account with the transferring bank. "Nostro" account is the transferring bank's account with another bank such an intermediary bank. An overall arrangement may be reached by participant banks in a given payment system for settling accounts between themselves.

[122] The only other possibility would be for the transferring bank's customer to show that his bank, i.e., the transferring bank, was in breach of contract or negligent in its choice of correspondent. However, it is almost impossible for the transferring bank's customer to prove such claim.

may fail, at least in England, for absence of privity of contract. Although the intermediary bank is a sub-agent of the transferring bank's customer, he, the customer as a principal, may not directly sue, under English contract Law, the intermediary bank.[123] *Royal Products Ltd. v. Midland Bank Ltd*,[124] suggests that an intermediary bank cannot be directly sued by a transferring bank's customer in contract for its failure to make an electronic credit transfer. It was held in that case that "National [the intermediary bank] owed no duty of any kind to Royal Products [the payer] ... National are not to be regarded as having been agents of Royal Products and did not, therefore, owe them any of the duties, including a fiduciary duty, owed by an agent to his principal."[125] There is no privity of contract between the transferring bank's customer, i.e. the payer, and the intermediary bank in English law. According to this principle, "only a person who is party to a contract can sue on it".[126] Thus, since a customer is not a party to the contract between his bank and its correspondent, he is not entitled to directly sue the correspondent if the latter fails to implement the customer's payment order.[127] There is a considerable authority in English law to the effect that an agent is liable to his principal for the default of a sub-agent, but because of the absence of privity of contract, the sub-agent is not directly liable to the

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[123] *Calico Printers' Association Ltd. v. Barclays Bank Ltd.* (1931) 145 L.T. 51 (C.A.). The payee, in turn, does not have, under English law, an action in contract against any bank in the payment process apart from his bank.

[124] [1981] 2 Lloyd's Rep. 194.

[125] Ibid, at 198.

[126] Per Lord Haldane in *Dunlop Pneumatic Tyre Co., Ltd. v. Selfridge & Co., Ltd.* [1915] A.C. 847, 853. See also, e.g., *Price v. Easton* (1833) 4 B. & Ad. 433, 434 per Littledale J.; *Beswick v. Beswick* [1968] A.C. 58 (H.L.); and *Woodar Investment Development, Ltd. v. Wimpey Construction U.K., Ltd.* [1980] 1 W.L.R. 277 (H.L.).

[127] For an argument against the application of this doctrine in relation to the correspondent bank in direct funds transfer, see Vroegop,J., The Role of Correspondent Banks in Direct Funds Transfers, [1990] L.M.C.L.Q. 547. The principle of privity of contract has been opposed by Lord Denning in *Drive Yourself Hire Co. (London), Ltd. v. Strutt* [1954] 1 Q.B. 250, 273; and *Beswick v. Beswick* [1966] Ch. 538, 553, 557. However, his lordship's trial to undermine this principle did not stand in the House of Lords in *Beswick v. Beswick* [1968] A.C. 58, and later decisions.

principal.[128]

Scots law recognises the right of a third party to sue under a contract. The *jus quaesitum tertio* doctrine[129] in Scots law permits such claim in certain circumstances. Foremost of all, the requirement that there must be *a pactum in favorem tertio*. Moreover, it was held that *a jus quaesitum* must be irrevocable.[130] The parties to a contract may confer *a favorem* on a third party if they intended to do so. It is not enough for the third party to show that he incidentally benefits. Therefore, if such conditions are met in the agreement between the transferring bank and its correspondent, the payer, although not party to that agreement, is entitled to enforce performance of the agreement according to its terms,[131] or recover damages for non-performance,[132] if such agreement conferred upon him a *favorem*. It is, however, arguable that such agreement would confer a *favorem* upon the transferring bank's customer. One suggests that this depends on whether it is clear enough in the transferring bank's instructions to its correspondent that the latter is implementing a payment order for the benefit of the transferring bank's customer, or merely an instruction by the transferring bank to transfer a given amount of money to a given account number or payee's name. Only in the former case, a transferring bank's

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[128] *Mackersy v. Ramsays, Bonars & Co.* (1843) 9 C. & F. 818; *Cairns, Noble & Co. Ltd. v. Ashwin & Co.* (1920) 5 Lloyd's Rep. 120; *Equitable Trust Co. of New York v. Dawson Partners Ltd.* (1927) 27 Lloyd's Rep. 49; *Calico Printers' Association v. Barclays Bank Ltd.* (1931) 145 L.T. 51 (C.A.); *Kahler v. Midland Bank* [1950] A.C. 24; *Stewart v. Reavell's Garage* [1952] 2 Q.B. 545; *Royal Products Ltd. v. Midland Bank Ltd.* [1981] 2 Lloyd's Rep. 194, 198, per Webster J.; and *Balsamo v. Medici* [1984] 1 W.L.R. 951. Contrast *De Bussche v. Alt* (1878) 8 Ch. 286 (sub-agent was held directly accountable to his principal for secret profit made by him); and *Powell & Thomas v. Evan Jones & Co.* [1905] 1 K.B. 11 (sub-agent was held directly accountable to his principal for commission received from a third party).

[129] It was held in *Hill Samuel & C. Ltd. v. Laing* [1989] S.L.T. 760 , 763 that "[t]he phrase '*jus quaesitum tertii*' may be used in two senses; it may relate to the right to sue on a contract, and it may also relate to having a right to property derived from a contract." The court referred to Gloag on Contracts (2nd ed.), at 234-235.

[130] See e.g., *Blumer v. Scott* (1874) 1 R. 379, 387; *Carmichael v. C's Exrx.*, [1920] S.C. (H.L.) 195; *Drysdale's Trs. v. D.* [1922] S.C. 741 ; and *Allan's Trs. v. L.A.*, [1971] S.C. (H.L.) 45.

[131] e.g. *Carmichael v. C's Exrx., [1920] S.C. (H.L.) 195.*

[132] e.g *Robertson v. Fleming* (1861) 4 Macq. 167; and *Tully v. Ingram* (1891) 19 R. 65. Prof. Walker, in Principles of Scottish Private Law, (4th ed., 1988), vol.II, at 127, thinks that the *tertius* is entitled to recover damages for non-performance. However, Gloag, Contracts (2nd ed., 1985), at 239, thinks he is not.

customer may be entitled to sue the intermediary bank under the doctrine of *jus quaesitum tertio*.

Another possible cause of action against the correspondent bank by the transferring bank's customer is negligence. However, even if the intermediary bank was negligent in handling the payment order, its failure to effect such order properly will most probably result in an economic loss. The law of negligence relating to liability for causing an economic loss has traditionally only possible where the loss was caused by a negligent statement, as opposed to a negligent act. That was, in fact, the decision of House of Lords in the leading case of *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*[133] It is unlikely that courts would treat the intermediary bank's failure to make a credit transfer as a negligent statement.[134]

2.4.1 [a] [iii] The Payee's Banks.

Generally, the payee's bank receives the payment order, and credits the funds to the payee's account as an agent for its customer, the payee.[135] This bank is under a duty to collect such payment by the most expeditious means and to use proper skill and care in so doing.[136] Its failure to do so does not only constitute a breach of its customer's account agreement, but also a breach of its correspondent agreement with either the transferring bank or the intermediary bank. The absence of privity of contract makes it difficult, under English law, for both the transferring bank (where there is an intermediary bank) and its customer to directly sue the payee's bank for

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[133] [1964] A.C. 465; [1963] 2 All E.R. 575; [1963] 1 Lloyd's rep. 485.

[134] It is argued by one commentator that "[s]ince an international funds transfer consists of a series of messages, it would seem to fit easily into [negligent statements] group, thus providing the initiator of a negligently executed funds transfer with a remedy for economic loss against whichever bank in the chain caused the loss." See Vroegop, The Role of Correspondent Bank, supra, at 553.

[135] *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia, The Laconia* [1977] A.C. 850 (H.L.). See also Chitty on Contracts (24th ed.), Vol.II, at 242-243; and King, R., The Receiving Bank's Role in Credit Transfer Transactions, [1982] 45 M.L.R. 1.

[136] Arora, A. Electronic Banking and the Law, at 71.

its failure to receive the funds, and credit them to the payee's account. The principle of *Jus quaesitum tertio* in Scots law justifies, in principle, a direct claim by the payer, or the transferring bank, against the payee's bank for its failure to effect the payment.

A claim against the payee's bank by the transferring bank or its customer based on negligence would probably face the same fate as the one between the transferring bank's customer and the intermediary bank. The payee's bank failure to receive the payment order, or its failure to credit the amount received to the payee's account does not constitute negligent statement, and thus no economic loss would be recoverable.

A bank, whether transferring, intermediary, or payee's, could be liable for its failure to make a credit transfer under an EFT system rule. For example, a payee's bank which received a payment order through CHAPS is liable to acknowledge the order, to include the amount to be paid in its settlement figures for the day reported to the Bank of England and to credit the payee's account. If its customer instructed it to reject payment, it must either not acknowledge the payment or transmit a message through CHAPS to the transferring bank notifying it that payment is not accepted.[137]

The discussion shows that banks' liability (whether transferring, intermediary, or payee's bank) in electronic credit transfer is shaped with uncertainty. This uncertainty increases where the issue under consideration is not resolved by either a funds transfer system rule, or a private agreement. Parties to a credit transfer transactions should be made relatively more certain about their rights and obligations in commercial transactions, so they can identify, price, allocate and insure against the risks inherited in such transactions.

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[137] Arora, A., Electronic Banking and the Law, supra, p.73.

2.4.1 [b] Under U.S.A. Law.

2.4.1 [b] [i] Common Law Rules.

There is no difference, in common law, between the transferring bank's position in relation to its customer in the American and British law. A customer has a contractual relationship with his bank under both jurisdictions. The terms of this relationship consist of the terms and conditions of the customer's account in addition to the express and implied terms of their relationship as a bank and customer. Those terms are superseded by the terms of any special agreement or instructions between the bank and its customer in a given transaction. Thus, if the customer agreed with his bank to transfer a given amount of money according to certain terms, such terms should be applied before any other terms, such as the terms of his general agreement with his bank. In carrying out its customer's instructions, the transferring bank, in credit transfer, acts as an agent.[138] Such agency relationship can be implied from the circumstances of the transfer and need not be express.[139] The existence of an agency relationship between a bank and its customer and its nature and extent may be shown by reference to the situation of the bank and its customer, the subject of the agency, and the acts of both the bank and its customer.[140] The payee's bank at the end of

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[138] e.g., *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 464 F. Supp. 989; 609 F.2d 1047 (2nd Cir. 1979); *Evra Corp. v. Swiss Bank Corp.*, 522 F. Supp. 820 (N.D. Ill. 1981), rev'd, 673 F.2d 951 (7th Cir.), cert. denied, 459 U.S. 1017 (1982); *Central Coordinates, Inc., v. Morgan Guaranty Trust Company*, 129 Misc. 2d 804, 494 N.Y.S.2d 602 (Sup. Ct. 1985); and *Securities Fund Services, Inc., v. American National Bank and Trust Company of Chicago*, 542 F. Supp. 323 (N.D. Ill. 1982). Baker & Brandel, (2nd ed. 1988) in discussing the nature of relationship between customer and transmitting bank in international credit transfer transactions noted, at para. 29.03[2][a][i], that "[a]lthough most customer-bank relationships had been viewed as contractual debt arrangements, since mid-1970s U.S. courts have adopted agency theory analysis for certain transfer situations." See also 9 C.J.S., § 172(c) (the weight of American authority is strongly in favour of analysis in terms of agency); and Crawford, B., Credit Transfers of Funds in Canada: The Current Law, [1979] 3 Canadian Business Law Journal 119, at 124-130.

[139] *Securities Fund* case, supra.

[140] See, generally, *Kalman v. Bertacchi*, 57 Ill. App.3d 542; 373 N.E.2d 550, 556 (1st Dist. 1978) cited in a credit transfer case by Leighton J. in *Securities Fund* case, supra.

the payment chain usually acts as an agent of its customer, the payee.[141] The intermediary bank usually acts as an agent for its transferor. The terms of their agency relationship are governed by their correspondent agreement.

The fundamental obligation of the transferring banks in credit transfer transactions is to comply with the payer's instructions. That is to carry out customer's payment orders properly. The most important terms in any payment order are usually the amount of the transfer, the payee's name or account number and the time of payment. This is evident in case law. Banks were often held liable for their failure to transfer the right amount of funds,[142] on the right time,[143] to the right payee.[144] This does not mean, however, that the transferring bank is strictly liable. American courts have reasoned that the transferring bank is not, in the ordinary case, under an absolute duty to secure the completion of the transfer. If it acts reasonably and prudently in strict accordance with its instructions it will not be liable even though the

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[141] *Delbrueck & Co., v. Manufacturers Hanover Trust Co.*609 F.2d 1047 (1979). Contrast, *Securities Fund Services, Inc., v. American National Bank and Trust Co. of Chicago*, 542 F. Supp. 323 (N.D. Ill. 1982) where it was held that the payee's bank was an agent of the payer and that under the facts alleged had breached its duty of care. However, it is suggested that the court in the *Securities Fund* case "simply referred to the defendant [the payee's bank] as being a collecting bank, and thus did not see the differences between credit and debit transfers. Arguably, the beneficiary bank is only an agent of its customer and not at the same time an agent of the originator [i.e., the payer]". See Stockmann R., Liability of Intermediary and Beneficiary Banks in Funds Transfer: A Comparative Study of American and German Law [1990] International Tax & Business Lawyer 215, at 236. Hereinafter referred to as Stockmann, Comparative Study.

[142] e.g., *Walker v. Texas Commerce Bank, N.A.*, 635 F. Supp. 678 (S.D. Tex. 1986) where a bank which transferred $2,250,000 instead of the instructed amount of $2,225,000 was found in breach of "its implied contract of deposit, and failed to exercise ordinary care."

[143] e.g., *Compania Anonima Venezolana De Navegacion v. American Express International Banking Corp.*, No. 84 Civ. 2047 (PKL) where it was held that a transferring bank's failure to transfer funds on time to a given payee constituted a breach of contract. See also *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982), cert. denied, 459 U.S. 1017 (1982); and *Central Coordinates, Inc. v. Morgan Guar. Trust Co.*, 129 Misc. 2d 804, 494 N.Y.S.2d 602 (Sup. Ct., 1985) (where it has been accepted in both cases that a transferring bank's customer has a contractual cause of action against an intermediary bank for its failure to effect a credit transfer on time, although no privity of contract did exist between them).

[144] e.g., *Securities Fund Services v. American National Bank & Trust Co.*, 542 F. Supp. 323 (N.D. Ill. 1982) (where $2 million has been transferred by fraud to the wrong payee, the court rejected the payer's claims based on conversion and bailment theories but sustained causes of action for negligence, agency and breach of third party beneficiary contract); *Bradford Trust Co. v. Texas American Bank-Houston* 790 F.2d 407 (5th Cir. 1986) (where a bank was found liable for its failure to follow its own security procedure which, if followed, would have prevented a loss of $800,000 transferred by fraud to a wrong payee); *Abyaneh v. Merchants Bank, North* 670 F. Supp. 1298 (M.D. Pa. 1987); and *Kashanchi v. Texas Commerce Medical Bank*, N.A., 703 F.2d 936 (5th Cir. 1983).

credit fails to reach the hands of the intended payee.[145]

The payee's bank as an agent of the payee is under a contractual duty to receive the payment order and credit the funds to the designated payee's account. In some cases, where it is required, it may be under a duty to notify the payee that it has received and credited funds to his account. Failing to do so is sanctioned by a claim by the payee for damages under the terms of his account agreement.[146] It could also be liable to its transferor, the intermediary bank. This usually founded on their correspondence agreement.

To the extent that the terms of such contractual arrangements are not preempted by a federal or state law they should govern the parties' rights and obligations, including banks' liability. Those obligations, one suggests, are inherent in such transaction, and need not be express in any agreement between banks and their customers. It was held that the transferring bank's failure to transfer certain amount of funds on a given time constituted a breach of contract.[147] That is mainly because, as the case under British law, banks carry out customers' instructions in a representative way and thus must adhere to their mandate as instructed by their customers. The divergence between the English (but not the Scottish) and the American law are obvious when it comes to the payer's right to directly sue an intermediary bank (in the absence of direct contractual agreement between them) for its failure to effect the payer's payment order.[148]

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[145] 9 C.J.S., § 172(d). See Crawford B., Credit Transfers of Funds in Canada: The Current Law [1979] 3 Can. Bus. L.J. 119, at 127.

[146] Stockmann, Comparative Study, supra, p.236.

[147] e.g., *Compania Anonima Venezolana De Navegacion v. American Express International Banking Corp.*, No.84 Civ. 2047 (PKL).

[148] The pursuer, both under Scots law and American law, can directly sue an intermediary bank for its failure to carry out his payment order properly while privity of contract doctrine under the English law prevents such person from suing an intermediary bank without the existence of a contractual relationship.

Under the American law, two different rules have been developed; the "New York rule" and the "Massachusetts rule". Both rules were developed in relation to collection of funds in cheques cases.[149] However, one suggests that they are also applicable to credit transfer transactions.[150] Under the "New York rule" the payer could only sue his bank, the transferring bank. His bank, however, is liable to him for the actions of the subsequent banks in the payment process.[151] Subject to a contractual term or a statutory provision to the contrary, the transferring bank undertakes to transfer the funds to the payee as an independent contractor and therefore is itself liable to its customer for the fault of its own agents.[152] The intermediary bank is one of those agents.[153] Like the situation under the English law, there is no privity of contract between the payer and the intermediary bank under this rule; and hence no contractual cause of action against the intermediary bank's failure to carry out the payment order exists as far as the payer is concerned. On the contrary, the payer, under "Massachusetts rule", can directly sue an intermediary bank for its failure in carrying out the payment order. The transferring bank is only liable for its own failure and negligence, out of which it can not contract. Subsequent banks in the payment process are directly liable to the payer for their own negligence.[154] The

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[149] See Scott H., The Risk Fixers, [1978] 91 Harvard L.R. 737. Hereinafter referred to as Scott, The Risk Fixers.

[150] This is so because a payee in debt transfer instructs his bank to collect an amount of item from certain payee. In credit transfer the payer instructs his bank to transfer funds to a certain payee. Where the payee's bank in the first case has no correspondence relationship with the payer's bank, and the transferring bank in the second case has no correspondence relationship with the payee's bank, both of them should seek the services of an intermediary bank. There is no difference between the position of the payee in the first case, and the payer in the second case, in relationship to the intermediary bank. Both of them has no direct contractual relationship with it. For almost the same view, see Stockmann, Comparative Study, supra, at 234.

[151] See, e.g., *Federal Reserve Bank of Richmond v. Malloy*, 264 U.S. 160 (1924); *Exchange National Bank v. Third National Bank*, 112 U.S. 276 (1884); *Youmans Jewelry Co. v. Blackshear Bank*, 141 Ga. 357, 80 S.E. 1005 (1914); *Harter v. Bank of Brunson*, 92 S.C. 440, 75 S.E. 696 (1912); *California Nat'l Bank of Sacramento v. Utah Nat'l Bank*, 190 F. 318 (8th Cir. 1911); *Smith v. National Bank of D.O. Mills & Co.*, 191 F.226 (N.D. Cal. 1911); and *City of Douglas v. Federal Reserve Bank of Dallas*, 2 F.2d 818 (5th Cir. 1924).

[152] As to the collecting bank, see Stockmann, Comparative Study, supra, at 224.

[153] See *City of Douglas v. Federal Reserve bank of Dallas*, 2 F.2d 818 (5th Cir. 1924); and *First Nat'l Bank v. Federal Reserve Bank*, 6 F.2d 339 (8th Cir. 1925).

[154] See *Federal Reserve Bank v. Malloy*, 264 U.S. 160, 164 (1924).

transferring bank, however, is also liable for the selection of a responsible and a properly qualified intermediary bank, to which it should properly pass the payer's instructions.[155] The underlying theory of this rule is that the payer's bank has an implied authority to employ sub-agents for effecting the payer's instructions who then became the agents of the payer.[156] Thus, the intermediary bank is not an agent of the transferring bank, but of the payer. An intermediary bank is directly liable to the payer for its failure to carry out the payment instructions delivered to it by the transferring bank.[157]

The "Massachusetts rule" has been applied in electronic credit transfer in *Evra Corp. v. Swiss Bank Corp.*[158] In that case, both the District Court and the Court of Appeal for the Seventh Circuit had accepted a direct claim by the payer against an intermediary bank although there was no privity of contract between them. This suggests that intermediary banks, in electronic credit transfer, are agents of the transferring bank's customer, i.e., the payer, until the transaction is completed. It also suggests the disclaimer of the transferring bank's liability for the actions of the subsequent banks in the payment process. Both courts held that what the transferring bank undertook to do was to transmit a telex message to the intermediary bank and that it did so without breaching any contract with the payer.[159] The view that a payer in credit transfer is entitled to directly sue an intermediary bank has been affirmed later by *Central Coordinates, Inc., v. Morgan Guar. Trust Co.*[160] There, it was held

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[155] See Stockmann, Comparative Study, supra, p.225.

[156] Ibid.

[157] See for the position of the intermediary in a collection process under this rule, *First Nat'l Bank v. Federal Reserve Bank*, 6 F.2d 339, 345 (8th Cir. 1925).

[158] 522 F. Supp. 820 (N.D. Ill. 1981), *rev'd*, 673 F.2d 951 (7th Cir. 1982), *cer. den'd*, 459 U.S. 1017 (1982).

[159] *Evra* case, supra, 673 F.2d, at 960. For more discussion on this point, see Stockmann, Comparative Study, supra, at 234.

[160] 129 Misc. 2d 804; 494 N.Y.S. 602 (N.Y.Sup. 1985).

that a transferring bank's customer was entitled to sue an intermediary bank in contract for its failure to effect payment on time, although no privity of contract did exist between them. Thus, it seems that American courts have adopted the "Massachusetts rule" in electronic credit transfer transactions.

In suing banks for their failure to comply with customers' payment orders, different causes of action have been alleged. Those include, breach of customer-banker relationship or exceeding banks' mandate under agency law, negligence, breach of fiduciary duties, conversion, bailment, breach of warranty, strict liability, and breach of third-party right under contract. Courts upheld claims under contract and agency relationship, negligence, third-party beneficiary, but struck out the rest of causes of action in credit transfer cases.[161] In *Compania Anonima Venzolana De Navegacion v. American Express International Banking Corp.*,[162] the plaintiff sued its bank, i.e.

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[161] The district court in *Evra* case, supra at 829, did not uphold the payer's claim under a fiduciary duty theory. Relying on *People ex. rel. Barrett v. Central Republic Trust Co.*, 300 Ill. App. 297, 302-303; 20 N.E.2d 999, 1001-1002 (1939), the court stated that "a fiduciary relationship exists only when confidence is reposed on one side and there is a resulting superiority or influence on the other side." supra, at 829. Since in the circumstances no such thing was exercised over the payer by the intermediary bank, the court found that Swiss Bank, the intermediary bank, did not breach any fiduciary duty. Strict liability's cause of action was rejected by the court in *Central Coordinates, Inc, v. Morgan Guar. Trust Company*, 129 Misc. 2d 804, 494 N.Y.S.2d 602 (N.Y.Sup. 1985). The court rejected the plaintiff's argument that a bank's liability for its failure to transfer the instructed funds on time is analogous to the case of strict products liability, because banks provide EFT as services and not as products. Ibid, 129 Misc. 2d 804, at 808. In addition, the court held that the plaintiff has failed to point to any regulation or statute which would impose strict liability upon the bank. Neither EFTA, nor Regulation J (12 C.F.R., subpart B) imposes such liability. Conversion as a ground for banks' liability for transferring the amount of payment order to a wrong payee was rejected by the court in *Securities Funds* case, 542 F. Supp. 323 (N.D. Ill. 1982). In that case the court denied the applicability of the conversion claim to this situation. The traditional action of trover does not operate on chattels generally, but specifically capable of identification as being the actual property or thing wrongfully taken and converted (the court cited *Kerwith v. Balhatchett*, 147 Ill. App. 561, 566 (1909)). It was held that a bank deposit is a chose in action or debt (*In re Oxford Marketing, United States v. Kallen*, 444 F.Supp. 399 (N.D.Ill. 1978)), and it is an intangible right and not specific property owned by the depositor (*Kerwith v. Balhatchett*, 147 Ill. App. 561 (1909); *Siegel v. Trac-Ler Karenola Radio & Television Corp.*, 333 Ill. App. 158 (1948) (abstract opinion); and *Janes v. First Federal Saving and Loan Ass'n*, 11 Ill. App.3d 631 (1973), aff'd in part, rev'd in part on other grounds, 57 Ill.2d 398 (1974). The court held, at p.328, that since common law does not recognise an action for conversion of intangible rights, an action for conversion of wire transfer cannot be sustained. Bailment was another cause of action which the court in *Securities Fund* case, supra, has rejected. The court held that the transferring bank, in the circumstances, was not the bailee of the funds transferred for delivery because the bank "received the wire transfer for deposit to an account, not for any special circumstances, safekeeping or subsequent return to the depositor intact." Ibid, at 328. Finally, the court in *Compania Anonima Venezolana*, supra, has rejected the payer's argument that its bank, the transferring bank, had warranted the performance of the transfer when it had stated that it will perform international banking services in a "competent and professional manner." The court held that under New York law, the proper law in this case, the warranty standard for imposing liability without proof of fault does not apply to transactions between a profession and its customers, citing *Milau Associates, Inc., v. North Avenue Development Corp.*, 42 N.Y.2d 482, 486; 398 N.Y.S.2d 882, 884; 368 N.E.2d 1247, 1250 (1977). This cause of action has been rejected, too, by *Central Coordinates, Inc., v. Morgan Gauranty Trust Co.*, supra.

[162] No. 84 Civ. 2047 (PKL).

the transferring bank, for damages caused by its failure to timely transfer funds to a given payee. The court found that the bank's failure to transfer funds on time constituted a breach of contract.[163] In *Evra Corp. v. Swiss Bank Corp.*,[164] the plaintiff Hyman-Michaels, i.e. the payer, sued Swiss Bank, i.e., intermediary bank, *inter alia*, in contract for its failure to receive its payment order on time and sending it to the payee's bank as instructed by his bank, Continental Illinois National Bank and Trust Company of Chicago 'CINB'. The District Court upheld the claim for breach of contractual duty of care on the grounds that a contract existed between Hyman-Michaels and CINB establishing a duty of care to transmit the wire transfer payment accurately and in a timely manner,[165] and that the intermediary bank owed the plaintiff the same duty.[166] Swiss Bank was held to be the agent of Hyman-Michaels owing it the same duty that the transferring bank owed it. Although the plaintiff filed suit against the transferring bank, CINB, neither the District Court, nor the Appeal Court discussed whether CINB as a transferring bank could have been held vicariously liable to its customer for its correspondent's, i.e., Swiss Bank's, breach of duty. It is suggested that such possibility was not necessarily excluded if Swiss Bank was Hyman-Michaels' agent.[167] Thus, both courts applied the "Massachusetts Rule" without discussing the "New York Rule".[168] In *Walker v. Texas Commerce Bank, N.A.*,[169] a bank which transferred $2,250,000 instead of the instructed amount of

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[163] However, since the plaintiff's loss was consequential the court did not award damages because the loss was not contemplated by the parties at the time of entering into the contract under the principle of *Hadley v. Baxendale*, (1854) 9 Exch. 341; 156 Eng. Rep. 145. Recoverable damages for banks' failure to effect payment orders will be discussed later in chapter six.

[164] Supra.

[165] *Evra*, supra, 522 F. Supp. 820, at 829.

[166] Ibid, at 827.

[167] Stockmann, Comparative Study, supra, at 234 citing *Shrewsburry v. Dupont Nat'l Bank*, 10 F.2d 632, 635 (D.C. Cir. 1925).

[168] Stockmann, Comparative Study, supra, at 234.

[169] 635 F. Supp. 678 (S.D. Tex. 1986)

$2,225,000 was found to be in breach of "its implied contract of deposit". The contractual cause of action was constantly upheld by courts in later EFT decisions as a ground for banks' liability for their failure to effect payment orders.[170]

Another cause of action for banks' failure to effect credit transfer is negligence. The District Court in *Evra* case found that Swiss Bank (the intermediary bank in the case) owed a duty of care to the transferring bank's customer to maintain a reliable system of receiving telex messages.[171] For a general tortious claim to succeed, there should exist a duty of care owed to the plaintiff by the defendant, a breach of that duty, and a loss proximately caused by such breach. The existence of such duty is a question of law, and in determining whether it exists, it must be found that the occurrence involves was reasonably foreseeable.[172] The likelihood of loss, the magnitude of the burden of guarding against it, and the consequences of placing that burden on the defendant are factors to be considered in determining whether, a legal duty exists.[173] It was held in *Securities Fund* case that the transferring bank's correspondent, which was in this case the payee's bank, owed the payer a duty to take due care in handling the wire transfer. That duty was breached when the bank credited the instructed funds to different payee from that in the payment order.[174]

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[170] See *Central Coordinates, Inc., v. Morgan Guaranty Trust Company*, 129 Misc. 2d 804; 494 N.Y.S. 2d 602 (1985) (same facts and decision as *Evra*); and *Securities Fund Services, Inc, v. American National Bank and Trust Co. of Chicago*, 542 F. Supp. 323 (N.D. Ill. 1982) where SFS the initiator of the wire transfer sued the correspondent of the transferring bank, although no privity of contract did exist between them. The court in this case drew an analogy the position of SFS with Hyman-Michaels, the transferring bank with Continental bank, and the correspondent bank with the Swiss Bank, in Evra case. It concluded that the initiator of the transfer has an agency relationship with the intermediary bank, and hence the latter owed the former a duty of care which its actions in handling the transfer may have breached. See also *Bradford Trust Co. v. Texas American Bank-Houston*, 790 F.2d 407 (5th Cir. 1986).

[171] 522 F. Supp. 820, 828-829 (N.D. Ill. 1981), rev'd on the point of recoverability of consequential damages, 673 F.2d 951 (7th Cir. 1982), *cert. den'd*, 103 S.Ct 377 (1982). It seems that the existence of duty of care in negligent was not affected by the reversal. See 673 F.2d 951, at 957.

[172] *Cunis v. Brennan*, 56 Ill.2d 372, 308 N.E.2d 617 (1974); *Evra* case, supra; and *Securities Fund* case, supra.

[173] Stockmann, Comparative Study, supra, p.235, citing *Cross v. Chicago Hous. Auth.*, 74 Ill. App. 3d 921, 925, 393 N.E.2d 580, 583 (1979).

[174] The fact that in that case the account number appeared on the payment order was the same account number that the bank credited the funds to, did not change the court's view. The court also held that the loss of the amount credited to the wrong payee was a foreseeable loss of that breach.

It was argued by the defendant in *Compania Anonima Venezolana De Navegcion v. American Express International Banking Corp.*,[175] that there was no independent cause of action for tort where there was no breach of a duty distinct and apart from the breach of contract.[176] The court held that was true where there has been complete non-performance on the contract.[177] If the bank attempts to perform contractual duty for its customer, the law imposes a duty on the bank to exercise reasonable care and skill in the performance of such duty.[178] Liability in tort may exist in cases where there has been defective contract performance.[179] In *Compania Anonima Venezolana* case, the transferring bank agreed with its customer to transfer funds to certain payee's bank, and did so, except it communicated the instructions by airmail instead of telex which caused a delay in payment. This act by the transferring bank raised the issue of whether it fulfilled its "duty 'to exercise the care of a reasonable [banker] as to what [it did] or [did] not do' with respect to the position of [the payer]".[180] The court held that the transferring bank did not fulfil that duty, and hence was negligent.

An intermediary bank can be directly sued by the transferring bank's customer for its failure to take care in carrying out its payment order, although no privity of

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[175] Supra.

[176] *Hargrave v. Oki Nursery, Inc.*, 636 F.2d 897, 899 (2nd Cir. 1980) was cited.

[177] Citing *Commonwealth Motor Parts Ltd. v. Bank of Nova Scotia*, 44 A.D.2d 375, 379; 355 N.Y.S.2d 138, 143 (1st Dep't 1974), aff'd, 37 N.Y.2d 824; 377 N.Y.S.2d 482, 339 N.E.2d 888 (1975).

[178] *Securities Fund* case, supra, citing *Rosenbaum v. Branster Realty Corp*, 93 N.Y.S.2d 209, at 212; and *Melodee Lane Lingerie Co. v. American District Telegraph Co.*, 18 N.Y.2d 57, at 64, 271 N.Y.S.2d 937, at 941, 218 N.E.2d 661, at 667 (1966).

[179] The court cited *Rosenbaum v. Branster Realty Corp.*, 276 A.D. 167, 93 N.Y.S.2d 209, 211 (1st Dep't 1949); Prosser & Keaton, The Law of Tort, par.92 at p.660 (5th ed. 1984). See also *Melodee Lane Lingerie Co. v. American District Telegraph Co.*, 18 N.Y.2d 57, 271 N.Y.S.2d 937, 218 N.E.2d 661 (1966); C.f. *Corporate Leasing, Inc. v. AFA Protective Systems, Inc.*, 101 A.D.2d 768, 476 N.Y.S.2d 134, 135 (1st Dep't 1984); *Burlew v. American Mutual Insurance Co.*, 99 A.D.2d 11, 16 (4th Dep't), aff'd, 63 N.Y.2d 412, 482 N.Y.S.2d 720, 472 N.E.2d 682 (1984).

[180] Leisure J. the district Judge in *Compania Anonima Venezolana* case quoting from *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 464 F. Supp. 989, 993 n.6 (S.D.N.Y.), aff'd, 609 F.2d 1047 (2nd Cir. 1979).

contract does exist between them. Such an action is grounded on the doctrine of third-party beneficiary. According to that doctrine, where a contract is made between two persons for the direct benefit of a third person not a party to that contract, that third person may sue for a breach of the contract.[181] The test to be applied is whether the benefit to the third person is direct to him or is only an incidental benefit. He may only sue if he has a direct benefit from the contract.[182] Whether a third person has a direct benefit from the contract is to be determined within the language of the contract.[183] This depends on the intent of the parties to the contract, and must be determind case-by-case.[184] That theory was upheld in relation to EFT transactions by *Securities Fund* case. In that case, the payer had successfully pleaded its status as third-party beneficiary to a contract entered into between the transferring bank and its correspondent. The court found that the payer's benefit from the contract between the transferring bank and its correspondent, the intermediary bank, was the proper transfer of his funds so as not to cause him any loss. It was also held that the payer did not need to be named within the contract between the transferring bank and its correspondent, since it was evident that it fell within the group designated to benefit from the contract.[185]

The third-party beneficiary doctrine was also applied in another electronic credit transfer case. In *Central Coordinates v. Morgan Guar. Trust Co.*,[186] the payer

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[181] *Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 178 N.E. 498 (1931).

[182] *Securities Fund* case, supra, at 329.

[183] *Securities Fund* case, supra, at 329, citing *Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 257-258 (1931); and *Accord. People ex rel. Resnick v. Curtis & Davis, Architects & Planners, Inc.*, 78 Ill.2d 381, 400 N.E.2d 918 (1980).

[184] *Securities Fund* case, supra, at 329 citing *Midwest Concrete Products Co. v. LaSalle Nat'l Bank*, 94 Ill. App.3d 394, 418 N.E.2d 988, 990 (1981); *Kravitz v. Lake County*, 62 Ill. App.3d 101, 379 N.E.2d 126, 128 (1978).

[185] *Securities Fund* case, supra, at 329. It is not prerequisite condition that a third person who benefitted from the contract to be named if he otherwise sufficiently described or designated. See *Candlewick Lake Utilities Co. v. Quinones*, 82 Ill. App.3d 98 (1980); *Gothberg v. Nemerovski*, 58 Ill. App.2d 372 (1965).

[186] 129 Misc. 2d 804; 494 N.Y.S.2d 602 (N.Y.Sup. 1985).

based its action, *inter alia*, on that doctrine against an intermediary bank that failed to carry out a timeous transfer, although it had no direct contractual relationship with it. The court accepted the payer's pleading as valid in principle.[187] The intermediary banks' liability to the transferring banks' customers in credit transfer transactions under the doctrine of third-party beneficiary brings the American and Scottish law into one side as far as this point is concerned. The Scottish law principle of *jus quaesitum tertio* is the equivalent of the American doctrine of third-party beneficiary. What is not clear, however, is whether Scottish courts would hold the interest of the transferring bank's customer in having his payment order properly handled so as to avoid any loss, as a sufficient *favorem* conferred upon him by that agreement.

2.4.1 [b] [ii] Statutory Law Rules.

2.4.1 [b] [ii] [1] Consumer-based Transactions.

§ 1693h of EFTA provides that a bank is liable for its:

> "failure to make an electronic fund transfer, in accordance with the terms and conditions of an account, in the correct amount or in a timely manner when properly instructed to do so by the consumer ...".

Banks' liability for failure to make an electronic fund transfer, including electronic credit transfer, is founded on breach of the terms and conditions of the customer's account and the payment order. This liability, therefore, is based on contract. This section emphasises the banks duty to comply with its customer's instructions, particularly the "amount" and the "time of payment" terms. The specification of these two terms does not exclude banks' liability for failure to comply with other material terms, such as the payee's identity. Nor it means that banks are

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[187] 129 Misc. 2d 804, at 807. However, the payer failed to recover consequential damages because according to the circumstances of the case the loss was not contemplated by the parties at the time of entering into the contract of transfer according to the principle of *Hadley v. Baxendale*, (1854) 9 Ex. 341; 156 Eng. Rep. 145.

not liable for complete failure to make a credit transfer for a consumer customer. However, a consumer must have sufficient funds in his account that are not subject to any legal process or other encumbrance restricting such transfer.[188] However, if a consumer has insufficient funds, such insufficiency must not have resulted from bank's failure "to credit, in accordance with the terms and conditions of an account, a deposit of funds to the consumer's account which would have provided sufficient funds to make the transfer".[189] The Board of Governors of the Federal Reserve System has been given a discretion to add other exceptions which would excuse banks from liability for their failure to make an EFT generally.[190] But since the Board chose not to implement § 1693h of EFTA generally by regulation, no other exceptions were added.[191] The Board explained its decision by saying:

> "The Board is authorized [in § 1693h] to add to the list of instances in which the institution is absolved from liability. The Board is concerned that adding to this "laundry list" might reduce consumer protection and unduly complicate the regulation. Since Section [1693h] explicitly states that a financial institution is liable only when it fails to act in accordance with the terms and conditions of its agreement with its customer, institutions may wish to review their customer agreements."[192]

Banks were not happy with such decision. They wanted the Board to use its discretion to add more exceptions. In response, the Board has allowed banks to add exceptions themselves by redrafting their customer's agreements.[193] However, banks should be careful in doing so. First, such agreements should not "contain any provision which constitutes a waiver of any right conferred or cause of action created

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[188] 15 U.S.C. § 1693h(a)(1)(A) and (B).

[189] 15 U.S.C. § 1693h(a)(2).

[190] 15 U.S.C. § 1693h(a)(1)(E).

[191] Baker & Brandel (1988), supra, para.16.03[3][a].

[192] 44 Fed. Reg. 59, 464 (1979).

[193] Baker & Brandel (1988), supra, para. 16.03[3][b].

by [EFTA]".[194] Second, courts may apply the general limitations on such agreements under U.C.C. § 4-103(1), under which a bank may not disclaim responsibility for "its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure."[195]

The extent of banks' liability for their failure to make a credit transfer in consumer-based transactions varies according to whether such failure was intentional or unintentional. In the former case, the bank responsible for such failure is liable to its consumer customer for "all damages proximately" caused by such failure.[196] This liability is reduced to "actual damages proved" if the bank's failure was unintentional and which resulted from a bona fide error, notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.[197]

2.4.1 [b] [ii] [2] Commercially-based Transactions.

Under Article 4A, banks' liability, and indeed rights, arise as a result of acceptance of payment orders. This means that the underlying theory of banks' liability under Article 4A is that each party to a funds transfer has an independent contractual relationship with its immediate transferor.[198] Neither bank is liable for the acts of other banks as to the payer, i.e., the originator. The transferring bank's customer no longer has a direct claim against an intermediary or beneficiary's bank under the theory that those are his agents.[199] However, he may have a claim under the doctrine of third-party beneficiary. Under Article 4A intermediary and

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[194] 15 U.S.C. § 16931 of EFTA. See for more discussion on this section, Baker & Brandel (1988), supra, para. 16.05[2].

[195] However, courts may restrict the application of U.C.C. § 4-103 to transactions governed by Article 4 of the U.C.C. only.

[196] 15 U.S.C. § 1693h(a).

[197] 15 U.S.C. § 1693h(c).

[198] See Stockmann, Comparative Study, supra, p.243.

[199] Ibid.

beneficiary's banks are directly liable to the transferring bank's customer in certain circumstances.[200] This direct cause of action would orginate in statutory law.[201] In particular, the agency theory in common law as a ground for banks' liability for their failure to implement a credit transfer has been explicitly denied by Article 4A. U.C.C. § 4A-212 provides, in part, that:

> "A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this Article or by express agreement."

This means that Article 4A, unlike Article 4[202] and common law rules, does not adopt either the "Massachusetts Rule" or the "New York Rule".[203] Banks' liability is based on contractual relationships and statutory rules. However, there is an exception to the rule that banks under Article 4A are not agents for any other party in the funds transfer transaction. U.C.C. § 4A-206 provides that where a payment order, addressed to a transferring or intermediary bank, transmitted to a "funds-transfer system" or other third party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank.[204] Thus, if a payment order is issued by a transferring

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[200] See the discussion below.

[201] Stockmann, Comparative Study, supra, at 243.

[202] The provisions of Article 4 reflect the adoption of the "Massachusettes Rule". U.C.C. § 4-201(a) provides that "[u]nless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional." Although the primary object of this provision is to determine that collecting banks in cheques, and other items transactions handled them as agents and do not purchase them, it and other provisions in Article 4 support the point in discussion. U.C.C. § 4-202(3) provides that "a bank is not liable for the insolvency, neglect, misconduct, mistake or default of another bank or person or for loss or destruction of an item in transit or in the possession of others."

[203] Stockmann, Comparative Study, supra, at 242-243; c.f., Felsenfeld C., Strange Bedfellows, supra, where it is argued, at 749, that "Article 4A U.C.C. has been criticised for representing a banker's rather than a bank customer's view of the world. Adoption of the Massachusetts rule is one example of this representation."

[204] "Fund-transfer system" is defined by U.C.C. § 4A-105(5) to mean "a wire transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed." Although FidWire falls within the scope of this definition, it is explicitly excluded from the application of U.C.C. § 4A-206 by the section itself.

bank to an intermediary bank through a "funds-transfer system", this system is deemed to be an agent of the transferring bank. Consequently, It is liable for the system's failure to transmit the payment order as an agent according to the principles of the agency law. This is very crucial since Article 4A does not govern the liability of funds-transfer systems. This is left to the law of contract, rules of the funds-transfer system, or any other applicable law.[205] A transferring bank's customer is entitled to sue, under this section, his bank as a principal of the funds-transfer system for the negligence of this system, as an agent, in handling his payment order.

The exclusion of the FedWire from the ambit of U.C.C. § 4A-206 seems to cause some inconsistency with Regulation J.[206] The Regulation has adopted the "New York Rule", and holds a Federal Bank liable only to "its immediate transferor for a failure to credit the amount of a transfer item or request to the transferee's account caused by a Reserve Bank's failure to exercise ordinary care or to act in good faith."[207] Thus, Article 4A does not consider FedWire as an agent of the sender and as such not liable for its failure, while Regulation J. holds a Reserve Bank liable for its immediate preceding sender for the mistaken actions of FedWire System. This inconsistency can be resolved by the rule that provisions of federal law preempt and override any inconsistent provisions of state law.[208] Regulation J. is a regulation promulgated by the Board of Governors of the Federal Reserve System, which is an agency of the United States.[209] Properly promulgated regulations of an agency of the

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[205] See Official Commont 2 of U.C.C. § 4A-206.

[206] 12 C.F.R. § 210 as amended at 51 F.R. 21745, June 16th, 1986.

[207] 12 C.F.R. § 210.38(b)(1).

[208] *Fidelity Federal Saving & Loan Ass'n v. De La Cuesta*, 458 U.S. 141, 153 (1982); *Chrysler Corp. v. Brown*, 441 U.S. 281, 295-96 (1979); and *Joens v. Rath Packing Co.*, 430 U.S. 519, 525-26 (1977), rehearing den'd, 431 U.S. 925 (1977). See Baxter Th., and Bhala R., The Interrelationship of Article 4A with Other Law, [1990] 45 Business Lawyer, 1485, 1493.

[209] *Federal open Market Committee v. Merrill*, 443 U.S. 340, 352 (1979).

United States have the force and effect of the federal law, and as such preempt and override any inconsistent provisions of state law, such as the Uniform Commercial Code. Thus, to the extent that Article 4A is inconsistent with Regulation J., the latter will preempt and override its provisions. This common law rule was in the mind of Article 4A draftsmen when they drafted Article 4A-107, which provides that "Regulations of the Board of Governors of the Federal Reserve System and operating circular of the Federal Reserve Banks supersede any inconsistent provisions of this Article to the extent of the inconsistency." This express codification of this rule is important because it provided for the supremacy of not only Regulation J. but also the operating circular of the Federal Reserve Banks over the provisions of Article 4A which otherwise do not have the force and effect of the federal law because Reserve Banks are not federal agencies.[210] Therefore, one concludes that although Article 4A does not convey an agency status on Fedwire in relation to its immediate preceding sender, it is an agent of such sender under Regulation J with the consequence that banks employing FedWire are responsible to the originator of a funds transfer for mistakes caused by it.[211]

Article 4A states in some detail what is the liability of each bank involves in the credit transfer. In addition, where there is no agreement on a certain issue between the parties, the Article provides for the actions required by the bank concerned; and the liability incurred. This is mainly divided into two parts: the receiving banks which are not beneficiary's banks (receiving banks), and beneficiary's banks. This division will be followed in discussing banks' liability in commercially-based transactions for

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[210] e.g. *Committee for Monetary Reform v. Board of Governors of the Federal Reserve System*, 766 F.2d 538, 540 (D.C. Cir. 1985).

[211] See Stockmann, Comparative Study, supra, at 244.

failure to make credit transfers.

i. The Receiving Banks.

A receiving bank's failure to make a credit transfer takes one of the following forms. First, a bank's failure to accept a payment order that it is obliged by an express agreement to accept. Second, a noncompletion of the funds transfer even though the receiving bank executed the payment order properly. Third, an improper execution of the payment order by the receiving bank.

a- Liability for failure to accept a payment order contrary to an express agreement.

A receiving bank that is bound to accept a payment order under an express agreement is liable for breach of such agreement if it fails to execute such order. U.C.C. § 4A-212 provides that:

> "If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this Article"

The scope of liability depends on the terms of the agreement. Where there is no agreement, U.C.C. § 4A-305(d) provides that a bank will be liable for the sender's expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are not recoverable unless expressly agreed in writing by the bank concerned. In addition, reasonable attorney's fees are recoverable if demand for payment of the above losses is made and refused by the bank before raising an action. [212]

The bank's complete failure to act upon instructions is not necessarily to be contrary to a separate express agreement. It could be against an express term in the

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[212] U.C.C. § 4A-305(e).

sender's account agreement with the bank, or in violation of an arrangement with the bank concerned. Such arrangement need not be reduced to a formal document signed by the parties.[213]

As discussed earlier, a receiving bank that is under no duty to accept a payment order, must send a notice of rejection to its sender.[214] Failure to do so, exposes the bank to the liability for payment of interest on the amount of the payment order. That is because the bank's customer loses the use of his funds until he knows that his bank refuses to execute his order. He is justified to assume that the amount of the payment order in his account is out of his use since the bank will debit his account by the same amount. This cause of action is based on restitution since the bank that does not execute his customer's order will have the use of the funds provided for such an order in its commercial transactions.[215]

b- Liability for noncompletion of the transfer.

The assumption here is that the noncompletion of the transfer occurs even though the receiving bank executes the payment order properly. In this case, the noncompletion is caused by other banks. A payment order that is properly executed by the receiving bank could be rejected by the beneficiary's bank. That is because that bank, unless bound by an agreement, is under no duty to accept the payment order. In this case, the amount of the payment order should be refunded according to the "money back guarantee rule" to the sender of the payment order if it has already been paid.[216] If the amount of the order was not made available to the bank, there is no

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[213] See the Prefatory Note of Article 4A.

[214] See para. 2.3.1 [b] [ii] [2].

[215] The Official Comment 3 of U.C.C. § 4A-210.

[216] U.C.C. § 4A-402(c).

duty on the sender to pay it. Another reason for noncompletion of the payment is a bankruptcy of one of the banks involved in the transfer. The liability of the receiving bank to refund its sender depends on whether, or not, the sender has instructed the routing of the transfer through the bankrupt bank. An originator of a payment order may designate a particular intermediary bank to its bank. If its bank carries out the payment order properly by routing the transfer through that designated intermediary, which suspends payment before completion of payment, the risk of the intermediary bank's suspension of payment falls on the originator and not on the originator's bank. Each sender, according to the "money-back guarantee rule", should be refunded except the sender that designates the bankrupt bank. That sender, however, is subrogated to the right of the bank that refunded the bankrupt bank.[217]

c- Liability for failure to execute properly.

Proper execution requires the receiving bank to take proper action at the proper time. Although not expressly stated, these are the two aspects of propriety that is evident in Article 4A.[218] Proper action means that when a receiving bank accepts a payment order it is obliged to issue a payment order complying with the terms of the sender's payment order.[219] This compliance is reflected in complying with the amount of the payment order, the identity of the beneficiary, the beneficiary's bank, the intermediary bank, the designated funds-transfer system, and the manner of transfer.[220] Proper time means a compliance with customer's instructions as to the time of execution and time of payment.

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[217] U.C.C. § 4A-402(e). Interest may be refundable in ceratin circumstances. See ibid.

[218] Baxter & Bhala, Proper and Improper Execution, supra, at 1454.

[219] U.C.C. § 4A-302(a)(1). For the definition of "execution date", see U.C.C. § 4A-301(b).

[220] See Baxter & Bhala, Proper and Improper Execution, supra, at 1454-1458.

I. Proper Action.

1. The amount term.

The receiving bank must comply with the amount as stated in the sender's payment order. Thus, if the sender's payment order instructs the bank to "pay $1000" the receiving bank's payment order to the intermediary bank or the beneficiary's bank must instruct it to "pay $1000".

2. The beneficiary term.

The receiving bank must comply with the identification of the beneficiary. Thus, if the originator's payment order instructs the receiving bank to pay "David James in his account number 123456", the receiving bank's payment order must instruct payment to "David James in his account number 123456". If the originator's specification of the beneficiary's name and account number does not identify the same person, the receiving bank is authorised to rely on the account number only so long as, before accepting the payment order, the originator "had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary."[221] If the originator is a bank it is assumed that it is aware of such practice and need not to be notified in advance.[222]

3. The beneficiary's bank term.

Article 4A does not expressly state that the beneficiary's bank is an essential term of a payment order.[223] It does so by implication. The definition of a payment

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[221] U.C.C. § 4A-207(c)(2).

[222] U.C.C. § 4A-207(c)(1).

[223] Baxter & Bhala, Proper and Improper Execution, supra, at 1455.

order requires naming a beneficiary, and there can be no beneficiary without a beneficiary's bank under the provisions of Article 4A. Thus, a receiving bank must specify the same beneficiary's bank that its customer specified in its payment order. Not doing so constitutes an improper execution of the payment order, and a breach of the terms of its sender's instructions.

4. The intermediary bank term.

A sender may specify in its payment order an intermediary bank through which the funds transfer is to be routed. As a term in the payment order, it must be followed by the receiving bank. The receiving bank must, in order to execute properly, transfer funds *via* the designated intermediary bank.[224] It can route the payment through another intermediary bank before the designated intermediary bank if there is some reason to do so, such as a lack of a correspondent-bank relationship or a bilateral credit limitation, but in no way it is entitled to ignore the designated intermediary bank.[225] The designation of an intermediary bank may mean "that the beneficiary's bank is expecting to obtain a credit from that intermediary bank and may have relied on that anticipated credit. If the receiving bank uses another intermediary bank the expectations of the beneficiary's bank may not be realized."[226]

A sender may identify its designated intermediary bank by an identifying number, name, or both. In the first case, the receiving bank is entitled to rely on the number given as the proper identification of the intermediary bank. It is under no liability to investigate whether such number identifies such bank.[227] The sender is

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[224] U.C.C. § 4A-302(a)(1)(i), and U.C.C. § 4A-305(b).

[225] This is unlike the designated funds-transfer system, which could be circumvented in certain circumstances.

[226] The Official Comment 2 of U.C.C. § 4A-302.

[227] U.C.C. § 4A-208(a).

obliged to compensate the receiving bank for "any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order."[228] Although Article 4A is silent regarding the second case, one suggests that a receiving bank is entitled to rely on the given name as a proper identification of the designated intermediary bank. In the third case, there will be no problem if both the name and the identifying number identify the same bank. The receiving bank executes such order properly by issuing a conforming payment order to that bank as an intermediary bank. However, problems may arise if the name and number supplied by the sender identify different banks. Three factors, at least, affect the scope of the receiving bank's liability in the last case. First, whether, or not, the bank's sender is a bank.[229] Secondly, whether, or not, the receiving bank, at the time it executes the sender's order, knows that the name and number given identify different banks. Thirdly, whether, or not, the payment in question has been completed.[230]

i. Where the sender is a bank.[231]

Where the designated intermediary bank's number and name supplied to a receiving bank by a sender, which is a bank, identify different banks, the receiving bank may rely on the number as the proper identification, provided that it does not know, at the time of execution, that the name and number identify different banks. The receiving bank is under no liability to inquire whether the name and number identify the same bank, nor whether the number refers to a bank. If no bank exists

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[228] U.C.C. § 4A-208(a)(2).

[229] U.C.C. § 4A-105(a)(2) defines "bank" to mean "a person engaged in the business of banking and includes a saving bank, saving and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article."

[230] U.C.C. § 4A-208.

[231] U.C.C. § 4A-208(a)(1).

under such number, no payment will take place; and the receiving bank must refund its sender the amount of payment order if already received, according to "the money-back guarantee rule".[232] But if a bank exists under such number; and this bank accepts the order by executing it, it will be considered as an intermediary bank for completing the transfer. This means that the payment is not routed through the designated intermediary bank. However, the receiving bank is relieved from liability for failure to use the designated intermediary bank[233] since the identifying number is supplied by the sender. The sender is liable to compensate the receiving bank "for any loss or expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order."[234]

ii. Where the sender is not a bank.

If the sender of a payment order is not a bank; and that the name and number of its designated intermediary bank identify different banks, the receiving bank may rely on the number as the proper identification of the intermediary bank, provided that the bank proves that it has informed the sender, before the acceptance of its order, that it will rely on the number rather than the name in case of discrepancy.[235] If the receiving bank met such requirements, and relying on the number supplied by its sender, issued a payment order to the bank identified by that number, it complied with its sender's instructions as to the designated intermediary bank.[236] The receiving bank is entitled to be compensated by its sender for "any loss or expenses incurred ... as a result of its reliance on the number in executing or attempting to execute the

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[232] U.C.C. § 4A-402(c).

[233] U.C.C. § 4A-302(a)(1); and see U.C.C. § 4A-305(b) (the measure of damages for such failure in the normal circumstances).

[234] U.C.C. § 4A-208(b)(1).

[235] U.C.C. § 4A-208(b)(2) ("The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.").

[236] i.e., not in breach of U.C.C. § 4A-302(a)(1).

order".[237] However, if notice is not given to the sender, the receiving bank can rely on the name of the intermediary bank if it does not know, at the time it executes the order, that the name and number identify different banks. No liability on the receiving bank to determine whether there is discrepancy between the name and number of the intermediary bank.[238] If the receiving bank was aware of the conflict in the name and number of the intermediary bank, reliance on either one in executing the sender's payment order is a breach of the receiving bank's obligation to comply with its sender's designation of an intermediary bank if such reliance leads to the use of another bank.[239] The receiving bank is liable to pay damages to its sender according to the measure of damages stated in U.C.C. § 4A-305(b).

Since a receiving bank must route its sender's payment order through the designated intermediary bank, the sender that designated such bank bears the risk of the insolvency of the designated bank.[240] If the designated intermediary bank is the insolvent bank in a non completed transfer, the sender that designated such bank is the one that bears the risk of insolvency, rather than the designated intermediary bank's preceding sender as the case would have been had no intermediary bank been designated. The underlying policy behind shifting the risk in such way is that the party who dealt directly with the insolvent bank should not bear the risk of its insolvency since its choice of that bank was controlled by the instructions under which it was acting.[241]

However, if a sender does not specify any intermediary bank, the receiving

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[237] U.C.C. § 4A-208(b)(1) and (2).

[238] U.C.C. § 4A-208(b)(3).

[239] U.C.C. § 4A-208(b)(4). See also U.C.C. § 4A-302(a)(1).

[240] U.C.C. § 4A-402(e).

[241] See for more detail about banks' insolvency rules under Article 4A, Nelson N., Settlement Obligations and Bank Insolvency, [1990] 45 The Business Lawyer 1473.

bank can still select one, provided that the transfer will be carried out "expeditiously" to its destination, and the intermediary bank is chosen with "ordinary care".[242] In any case, the receiving bank must pass on the terms of the payment order as received by its sender to the intermediary bank. The failure to comply with these requirements constitutes an improper execution of a payment order.

5. The funds-transfer system term.

A sender that wants assurance that the funds transfer will be expeditiously completed is entitled to specify a particular funds-transfer system. If the sender specified a particular "funds-transfer system"[243] to be used in carrying out its payment order, the receiving bank is obliged, generally, to comply with such term.[244] If, for instance, a payer instructed its bank to transfer funds through CHIPS, the receiving bank must, in the normal circumstances, execute such payment order through CHIPS. Transferring the funds *via* FedWire, for example, is an improper execution of the sender's payment order. However, such instructions can be disregarded in certain circumstances without constituting an improper execution of the sender's payment order. Indeed, "in some cases it may be prudent for the bank not to follow [such] instructions."[245] The sender's choice of a designated funds-transfer system, may not be followed by the receiving bank, if the latter, in "good faith",[246] determines that it is "not feasible"[247] to use such designated system, or if use of that system would

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[242] U.C.C. § 4A-302(b)(ii). See Baxter & Bhala, Proper and Improper Execution, supra, at 1456.

[243] See U.C.C. § 4A-105(5).

[244] U.C.C. § 4A-302(a)(1).

[245] The Official Comment 2 of U.C.C. § 4A-302.

[246] Defined by U.C.C. § 4A-105(6) as "honesty in fact and the observance of reasonable commercial standards of fair dealing." Compare this definition of "good faith" with that under U.C.C. § 1-201(19) ("honesty in fact in the conduct or transaction concerned").

[247] Not defined by the Uniform Commercial Code. One suggests that interpretation of such term could cause dispute between receiving banks and senders of payment orders where the departure from the designated funds-transfer system resulted in failure to effect payment. The Official Comment 2 of U.C.C. § 4A-304 states that a computer breakdown in the designated system, which may prevent prompt execution of the payment order, is one example where a bank is justified in considering the use of such

"unduly delay"[248] completion of the funds transfer.[249]

If no funds-transfer system is chosen by the sender, its bank may use any funds-transfer system, provided that *its use* is "reasonable in the circumstances".[250] It is *the use* of funds-transfer system which must be "reasonable in the circumstances", and *not the funds-transfer system* itself.[251] This means that *the use* of a given system can be commercially reasonable in one transfer in certain circumstances, but not in a similar transfer in different circumstances. One suggests that factors such as the amount of the payment order, the security procedures employed by the bank and the urgency of the transfer, are to be taken into account when deciding the commercial reasonableness of the use of a given system in a given transfer. This is important, because in most cases the sender of a payment order will not specify a particular funds-transfer system to be used, but will use a general term such as "by wire" or "electronic transfer" or "as soon as possible". Banks should consider such words as signifying that "the sender wants a same-day transfer".[252] It is expected that the receiving bank, in this case, will use a telephonic or electronic communication to transmit its order to the intermediary bank, and instructs it to use similar means in transmitting the order to the beneficiary's bank.

6. The Manner of transmission term.

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system in the circumstances as "not feasible".

[248] There is no definition of the term "unduly delay" in the U.C.C. However, it is suggested that "power outage or computer failure" are examples. See Baxter & Bhala, Proper and Improper Execution, supra, fn.51, p.1456.

[249] U.C.C. § 4A-302(b).

[250] U.C.C. § 4A-302(b)(i).

[251] For the requirements of the commercial reasonableness of a security procedure that a bank is required to offer to its customers to escape liability due to unauthorised payment orders, see U.C.C. § 4A-202(c). This subsection addresses those requirements in detail. Commercial reasonableness is considered by the subsection as a question of law. This is, however, different from the requirement that the use of a given EFT system should be "reasonable in the circumstances". See for a discussion on the requirement that a security procedure must be "commercially reasonable", French J., Unauthorized and Erroneous Payment Orders, [1990] 45 The Business Lawyer 1425, at 1430-1435.

[252] The Official Comment 1 of U.C.C. § 4A-302. Compare with the Court of Appeal's decision in *Evra* case, supra, 673 F.2d 951, at 956 (7th Cir. 1982) where it was held that the mere use of "electronic funds transfers are not so unusual as to automatically place a bank on notice of extraordinary circumstances if such a transfer goes awry."

In most cases, selecting a funds-transfer system will determine the manner of transmission. However, when the sender does not designate a funds-transfer system, the manner of transmission becomes more significant. The receiving bank is obliged under U.C.C. § 4A-302(a)(1) to comply with its sender's instructions as to the means by which its payment order is to be transmitted. The sender may state in its payment order that such order is to be carried out "telephonically" or "by wire transfer" or otherwise indicates that the funds transfer is to be carried out "by the most expeditious means".[253] If the sender uses any of these three manners of transmission in its payment order, the receiving bank must carry out that order by the "most expeditious available means"; and must instruct the intermediary bank (if any) to do likewise.[254] This does not mean that receiving bank must execute the sender's payment order by transmitting its payment order by the particular means of transmission designated by the sender. It may execute such order by any means as expeditious as the means designated by the sender.[255]

A sender of a payment order may choose not to specify a manner of transmission, but rather a payment date. In such case, the receiving bank is obliged to transmit its payment order to the next bank "at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible."[256] The last part of the sentence allows banks, depending on the circumstances of the fund transfer, to use an expeditious funds-transfer system or an ordinary one. However, if a payment order instructs payment to a beneficiary

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[253] U.C.C. § 4A-302(a)(2).

[254] Ibid.

[255] U.C.C. § 4A-302(c).

[256] Ibid.

to be made in the same day or next calendar day, the receiving bank could not properly execute the payment order by "dropping a payment order at the local postal service depository".[257]

If the sender does not specify the means by which its payment order is to be carried out, nor specified a payment date, the receiving bank may execute such order "by transmitting its payment order by first class mail or by any means reasonable in the circumstances".[258]

II. Proper Time.

The execution of the sender's payment order must be made in the proper time. The proper time that the receiving bank is to carry out its sender's payment order at can be determined by the sender. This can be done by specifying an "execution date", a "payment date" or both in the payment order. The receiving bank must comply with the "execution date" term and the "payment date" term if the execution of its sender's payment order is to be carried out properly. These two terms are discussed separately.

1. The execution date term.

The execution date is "the day on which the receiving bank may properly issue a payment order in execution of the sender's order."[259] It refers to the time a payment order should be executed rather than the date of the actual execution of such order.[260] In practice, the sender will specify a payment date rather than an execution date. Senders may leave that to their banks, but most payment orders are meant to be executed immediately.[261] It cannot be earlier than the day the order is received by

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[257] Baxter & Bhala, Proper and Improper Execution, supra, at 1457.

[258] U.C.C. § 4A-302(c).

[259] U.C.C. § 4A-301(b).

[260] Official Comment 2 of U.C.C. § 4A-301.

[261] Official Comment 2 of U.C.C. § 4A-301.

the transferring bank.[262] If not expressly stated in the payment order, execution date is deemed to be the day on which the order is received by the receiving bank.[263]

Execution on the execution date is timely, and thus, a receiving bank does not breach this term in the payment order. However, a bank may fail to execute the payment order on time. The two possibilities are a late execution, and an earlier one. In either one, a bank incurs liability to its preceding sender. First, late execution is a breach of the payment order's terms if results in delay in payment. The sender is entitled to be compensated for such breach.[264] Second, earlier execution does not entitle the receiving bank to an earlier payment, i.e. before the execution date. "Payment by the sender is not due until the execution date of the sender's order."[265] This means that the receiving bank will be liable for the loss of interest for the period between the actual execution date, and the agreed execution date if it is already has sufficient funds to cover the payment order. However, a transferring bank may run a higher risk by executing an order before the execution date. This is because the sender has the right to cancel or amend its payment order before it is accepted by the receiving bank.[266] It is also has such right after the receiving bank's acceptance of the payment order provided that the funds-transfer system used allows cancellation or amendment without agreement of the bank.[267] Thus, where a sender uses his right to cancel or amend a payment order which has been executed by the receiving bank before the execution time specified in the payment order, the bank bears the risk

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[262] U.C.C. § 4A-301(b).

[263] Ibid.

[264] For the measure of damages in this case, see U.C.C. § 4A-305(a).

[265] U.C.C. § 4A-402(c).

[266] U.C.C. § 4A-211(b). However, this is so provided that a notice to such effect is received by the bank at a time and in a manner affording it a reasonable opportunity to act on such instructions.

[267] U.C.C. § 4A-211(c). See also U.C.C. § 4A-211(c)(1).

resulting from not complying with the "execution date" term in the payment order. In this case, the sender is not obliged to pay the bank the amount of the payment order before the order is accepted,[268] which cannot occur before the execution date.[269] However, the bank is obliged to pay either the intermediary's bank (if any) or the beneficiary's bank when payment was made available to the beneficiary. That is because they have separate contracts. The receiving bank that executes early must bear the loss as far as its sender is concerned if that sender has the right to cancel the order; and that such order could have been, but for the early execution, cancelled. Nevertheless, the bank has the right to recover payment from the paid beneficiary if the latter has been paid by mistake. However, if the beneficiary received the amount of the payment order in good faith in payment of a debt owed to the beneficiary by the transferring bank's sender, the law of mistake and restitution may allow beneficiary to keep all or part of the money received.[270] If the receiving bank's sender owed the paid money to the paid beneficiary, the bank that has paid its sender's debt is subrogated to the beneficiary's rights against its sender on the debt.[271]

2. The payment date term.

The payment date is "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank."[272] Unlike the execution date, the payment date is normally set forth in the payment order. It cannot be any earlier than the day the order is received by the beneficiary's bank. If no payment date is specified in the

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[268] U.C.C. § 4A-402(c).

[269] U.C.C. § 4A-209(a).

[270] U.C.C. § 4A-209(d) and the section's Official Comment 9.

[271] The Official comment 9 of U.C.C. § 4A-209. See also U.C.C. § 1-103.

[272] U.C.C. § 4A-401.

payment order, the payment date is deemed to be the day the order is received by the beneficiary's bank. Thus, the payment order's silence with respect to payment date conveys the specific message that the payment date is the date of receipt of the order by the beneficiary's bank.[273] The receiving bank's failure to execute a payment order timely may affect its compliance with the payment date. If the payment order specified a payment date, the receiving bank must act in a manner calculated to allow payment to the payee on the payment date or as soon thereafter as is feasible.[274]

The practical result for noncompliance with the "payment date" term in payment orders results in delay in payment. If a funds transfer is completed but improper execution of the payment order as to the payment date term has caused a delay in payment to the beneficiary, the receiving bank liable for that is obliged to "pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution" of the payment order.[275] It is noted that the "normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position it would have been in if the funds transfer had been completed on the same day."[276] Article 4A followed common law rules in delayed transfers by not allowing the recovery of consequential damages as a general rule.[277]

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[273] U.C.C. § 4A-401. See Fry, Basic Concepts, supra, at 1422; and Baxter & Bhala, Proper and Improper Execution, supra, at 1450-1451.

[274] U.C.C. § 4A-302(a)(2). The interaction between the payment date term and the manner of transmission term was discussed above under the manner of transmission term.

[275] U.C.C. § 4A-305(a).

[276] The Official Comment 1 of U.C.C. § 4A-305. For the rate of interest paid, see U.C.C. § 4A-506.

[277] Ibid. Additional damages including consequential damages are recoverable to the extent provided in an express agreement of the bank that caused the delay. See U.C.C. § 4A-305(c). See also the cases discussed under common law section, which suggest that banks are liable for failure to carry out payment orders on time, although consequential damages are not recoverable as a general rule. For example, see *Compania Anonima Venzolana De Navegacion v. American Express International Banking Corp.*, No. 84 Civ. 2047 (PKL) (the plaintiff sued its bank, i.e. the transferring bank, for damages caused by its failure to timely transfer

ii. The Beneficiary's Banks.

The beneficiary's (or the payee's) bank, at the end of the payment process, is under two main obligations: the obligation to pay the beneficiary the amount of the transfer; and the obligation to notify the beneficiary where required. "No obligation is owed to either the sender of the payment order accepted by the beneficiary's bank or to the originator of the funds transfer. The obligation created by acceptance by the beneficiary's bank is for the benefit of the beneficiary."[278] Both obligations need separate discussion.

a- The obligation to pay the beneficiary.

Like any receiving bank, the beneficiary's bank is generally under no obligation to accept a payment order unless it is bound by an agreement to do so.[279] However, if it accepts a payment order, it generally must "pay" the beneficiary the amount of such payment order on the payment date.[280] This general obligation to pay has some exceptions. First, the beneficiary's bank may refuse payment if it has "reasonable doubt concerning the right of the beneficiary to payment."[281] Examples of such exception concerns matters such as whether acceptance of the order by the bank has occurred, or whether the person demanding payment is the person identified in the payment order as the beneficiary. It does not cover, for example, dispute over the underlying obligation of transfer. If the beneficiary's bank has doubts on whether

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funds to a given payee. The court found that the bank's failure to transfer funds on time constituted a breach of contract); *Evra Corp. v. Swiss Bank Corp.*, 522 F. Supp. 820 (N.D. Ill. 1981), *rev'd*, 673 F.2d 951 (7th Cir. 1982), *cert. den'd*, 459 U.S. 1017 (1982) (a transferring bank's customer can directly sue an intermediary bank for failure to receive funds on time); *Central Coordinates, Inc., v. Morgan Guar. Trust Co.*, 129 Misc. 2d 804; 494 N.Y.S. 602 (N.Y.Sup., 1985) (a transferring bank's customer was entitled to sue an intermediary bank in contract for its failure to effect payment on time, although no privity of contract did exist between them); and *Gatoil (U.S.A.), Inc. v. Forest Hill State Bank*, 1 U.C.C. Rep. Serv.2d 171 (D.Md. 1986).

[278] The Prefatory Note of Article 4A of the Uniform Commercial Code.

[279] U.C.C. § 4A-212.

[280] U.C.C. § 4A-404(a). See the exceptions under U.C.C. §§ 4A-211(e), 4A-405(e) and 4A-405(e) discussed in the text.

[281] U.C.C. § 4A-404(a).

the sender of the payment order is, in fact, owed the amount of payment to the beneficiary, it has no right to refuse payment. A sender of the payment order may try to prevent the beneficiary's bank from paying the amount of order to the beneficiary by alleging that the beneficiary is not entitled to the amount of the order. The bank should not be involved in any dispute regarding the underlying contract between the originator and the beneficiary. This should be left to these parties to settle between themselves after payment.[282] More importantly, the beneficiary's bank is instructed by the transferring bank or by the intermediary and not by the originator. The payment order sent to it is another order and not the one that the originator has sent to his bank.[283] Another exception for the beneficiary's bank's liability to pay is where the payment order is cancelled by the originator pursuant to § 4A-211(e). Thirdly, the beneficiary's bank is not liable to pay the amount of the transfer to the beneficiary where the payment is made provisional under a funds transfer system rule pursuant to § 405(d). Fourthly, the beneficiary's bank is not liable to pay the beneficiary if the payment order is transmitted over an EFT system which nets obligations multilaterally and has in effect a loss-sharing agreement pursuant to § 4A-405(e) and settlement is not completed.[284]

Apart from these exceptions, beneficiary's bank "pays" the beneficiary by crediting its account by the amount of the payment order and either (i) giving notice of the right to withdraw such credit; (ii) lawfully applies the credit to a debt of the beneficiary; or (iii) otherwise making available the amount of the order to the

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[282] U.C.C. § 4A-406 states when the underlying obligation for the transfer between the originator and the beneficiary is discharged.

[283] Except in the case of book transfer where the receiving bank and the beneficiary's bank is the same bank.

[284] For more detail on banks' insolvency and its effect on settlement obligations, see Nelson N., Settlement Obligations and Bank Insolvency, [1990] 45 The Business Lawyer 1473.

beneficiary.[285] If acceptance of the payment order occurs on the payment date after the close of the "the funds-transfer business day"[286] of the beneficiary's bank, payment is due on the bank's next "funds-transfer business day".[287] This is so, because banks, in practice, normally have a cut-off time after which they stop processing and transmitting payment orders. If no payment date is determined in the payment order received by the beneficiary's bank, payment date is deemed to be "the day the order is received by the beneficiary's bank".[288] If the bank does not credit an account of the beneficiary, the time when payment occurs is determined by the applicable principles of law governing when an obligation is satisfied.[289] For example, if the beneficiary's bank were to pay the amount of payment order by cheque, the time of payment should be determined by the law applicable to cheques.[290]

If the beneficiary's bank refuses to pay the amount of the transfer to the beneficiary without justifiable exception it will breach its obligation to pay. This liability may include not only direct damages caused by such refusal, but also consequential damages. However, consequential damages are recoverable only if the beneficiary demands payment and notifies the bank of the particular circumstances that will give rise to the alleged consequential damages.[291] The beneficiary's right to

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[285] U.C.C. § 4A-405(a). See also the rules of the availability of funds in the Expedited Funds Availability Act, 12 U.S.C. 4001 et. seq. which governs funds availability in general including an electronic funds transfer. It is noticed by the Official Comment 1 of U.C.C.§ 4A-404 that the beneficiary's bank obligation to make the amount of payment orders available to the beneficiary at certain time is subject to the preemption of the Expedited Funds Availability Act, which is a federal law.

[286] See for the definition of this term U.C.C. § 4A-105(a)(4).

[287] U.C.C. § 4A-404(a).

[288] U.C.C. § 4A-401.

[289] U.C.C. § 4A-405(b).

[290] Ballen R. & Diana N., Duties of the Beneficiary's Bank, [1990] 45 The Business Lawyer 1467, 1469. Hereinafter referred to as Ballen & Diana, Duties of the Beneficiary's Bank.

[291] U.C.C. § 4A-404(a).

receive payment and damages is not variable by agreement or a funds-transfer rule.[292]

b- The obligation to notify the beneficiary.

The beneficiary's bank that accepts a payment is required to notify the beneficiary of the receipt of the amount of the order in only two situations.[293] First, whenever the payment order instructs payment to an account of the beneficiary. Second, where notification is required by the terms of the payment order. The bank must notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date.[294] Notification may be given by first class mail, or any other means reasonable in the circumstances. Failing to give the required notification to the beneficiary exposes the beneficiary's bank to liability for payment of interest on the amount of the payment order from the day notification should have been given until the beneficiary learned of receipt of the payment order by the bank.[295]

Unlike the beneficiary's bank obligation to pay the amount of order to the beneficiary, the obligation to notify the receipt of the order is subject to variation by agreement, or by a funds transfer rule provided in the latter case that the beneficiary is given notice of the funds transfer rule before initiation of the funds transfer.[296] For example, the normal practice in ACH[297] transactions is not to give notification to the beneficiary unless it is requested by him. This practice can be continued by adoption

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[292] U.C.C. § 4A-404(c).

[293] U.C.C. § 4A-404(b).

[294] Ibid.

[295] Reasonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim. No other damages are recoverable. See U.C.C. § 4A-404(b).

[296] U.C.C. § 4A-404(c).

[297] The Automated Clearing House.

of a funds transfer system rule.[298]

2.4.2 EFTPOS Transactions.

2.4.2 [a] Under U.K. Law.

The failure to make an EFTPOS might be caused by the retailer, the retailer's bank, or the purchaser's bank, i.e., the card issuer. The liability of the retailer for its failure to accept the purchaser's EFTPOS card falls outside the scope of this thesis.[299] The liability of the two banks involved in the transaction for their failure to effect an EFTPOS is discussed separately.

2.4.2 [a] [i] The Purchaser's Banks.

The purchaser's bank is the bank that issues the EFTPOS card for the purchaser. The issuance of such card is required to be made according to an express written agreement between the card issuer and the card holder. The written terms and conditions of the use of such card should be expressed in a plain language.[300] Normally, such an agreement takes the form of a standard form application for the card in question. By signing such form, the bank's customer binds itself to the terms and conditions of the use of such card. These terms and conditions should provide "a fair and balanced view of the relationship between the customer and the card issuer".[301] In practice, banks retain the right to vary such terms and conditions without the customer's consent. However, banks are required to give customers a

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[298] The Official Comment 4 of U.C.C. § 4A-404.

[299] The retailer is obliged by its agreement with its acquired bank to accept all valid EFTPOS cards issued within an agreed EFTPOS scheme. As regards its liability to the purchaser, one suggests that displaying the customer's card's logo at the retailer's premises indicates the retailer's willingness to accept payment by such method. However, legally speaking, such display does not, probably, amount to an offer to be paid by such card. It could be construed more properly as an invitation for customers to pay by such card, which needs the acceptance of the retailer.

[300] § 14.1 of the Code of Good Banking (1991).

[301] § 14.1 of the Code of Good Banking (1991).

reasonable notice before any variation takes effect.[302]

The fundamental obligation of the purchaser's bank in EFTPOS transactions is to honour its customer EFTPOS transactions, if they satisfy the terms and conditions of the use of such card. The failure of the purchaser's bank to authorise payment by a valid EFTPOS card is a breach of the agreement for the use of such card between the bank and its customer. This might also be seen as a bank's failure to repay its customer's funds in accordance with an agreed method of payment.

The purchaser's bank may completely fail to effect payment by the use of an EFTPOS card by mistakenly including the customer's card number in the "black list" of cards that should not be accepted for reasons of fraud, theft, e.t.c. The communication of such information to retailers means that retailers will not accept the bank's customer's card. If such communication is baseless, a bank would be liable for its complete failure to effect payment by the use of a valid EFTPOS card contrary to its agreement with its customer.

2.4.2 [a] [ii] The Retailer's Banks.

The retailer's bank's liability for failure to make EFTPOS depends on the terms of its agreement with the retailer and the EFTPOS scheme arrangements. In particular, it depends on whether, according to the EFTPOS scheme, retailer's bank guarantees payment for all valid EFTPOS cards, or mere collects funds due to the retailer from the purchaser through the latter's bank.

2.4.2 [a] [ii] [1] Where the Retailer's Bank Guarantees Payment.

A retailer, in this arrangement, looks to the credit of its bank for the

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[302] § 14.2 of the Code of Good Banking (1991). See also § 14.3 of the Code of Good Banking (a possible annual document to be sent to customers consolidating the variations of the terms and conditions of their cards).

satisfaction of his payment. It usually loses such right if it accepts invalid cards. The terms and conditions of acceptance of cards by a retailer and payment to the retailer by its bank are normally agreed upon by the two parties in an express agreement. A retailer may be required to ask for authorisation from the purchaser's bank before accepting payment by EFTPOS cards. Where the purchaser's authorisation of the debit of his account is not made by the use of P.I.N., a retailer must obtain the signature of such purchaser, and further insure that it corresponds to his signature on the card. It must also retain a copy of the signed purchase's receipt.

Failure of the retailer's bank to credit the retailer's account with it by the amount of all valid EFTPOS purchases according to their agreement is a breach of such agreement. The liability is based on contract.

2.4.2 [a] [ii] [2] Where the Retailer's Bank Only Collects Payment.

Although uncommon, a retailer's bank may only undertake to collect the amount of EFTPOS transactions from purchaser's bank without guaranteeing the payment. In this case, its position is analogous to that of the collecting bank in cheques transactions. It may deduct an agreed charge for each collected payment according to its agreement with the retailer. There is also, in addition to the special EFTPOS account agreement, the general banker-customer agreement between the retailer's bank and the retailer as a customer. Under this general agreement, a bank is under a duty to take reasonable care in receiving money and collecting bills for its customer's account. The retailer's bank's failure to make such collection is a breach of such duty.

2.4.2 [b] Under U.S.A. Law.

§ 1693h of EFTA provides that banks are, with some exceptions, liable for

their "failure to make an electronic fund transfer, in accordance with the terms and conditions of an account, in the correct amount or in a timely manner when properly instructed to do so by the customer ...". The term "electronic fund transfer" includes EFTPOS. The breach of such duty by a bank to a consumer customer exposes the bank to liability for "all damages proximately caused" by such breach.[303] Like the case in credit transfer, there is no express provision concerning banks' liability for their complete failure to make an EFTPOS transaction. For the same reasons discussed under banks' liability for their complete failure to make a credit transfer in consumer-based transactions, banks should be also liable for their complete failure to make an EFTPOS transaction.

Retailers are usually bound by an agreement with EFTPOS card issuers to accept EFTPOS cards issued by them provided they are valid cards. It is suggested, however, that a retailer probably does not necessarily agree to be paid by the use of EFTPOS card by mere having an EFTPOS terminal in its store.[304] This can be construed as an invitation to customers to pay by such method. However, if the merchant accepts a debit card and initiates a payment transaction through the terminal, such an agreement would be implied.[305] The liability varies on whether the bank is the purchaser's bank or the retailer's bank.

2.4.2 [b] [i] The Purchaser's Banks.

The banker-customer account agreement usually obliges the bank to honour all its customer's valid EFTPOS transactions. The bank must disclose the terms and

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[303] 15 U.S.C. § 1693h(a).

[304] Summary of comments received by the Board of Governors of the Federal Reserve on proposed regulations interpreting the EFTA. See Memo to Board of Governors (Sept. 6, 1978); reprinted in Summary of Comments Received on Proposed Regulations to Implement EFTA 49 (provisions effective May 1980). Referred to in Baker & Brandel (1988), at para.16.03[2][b], fn.69.

[305] Baker & Brandel (1988), supra, para.16.03[2][b].

conditions of the use of an EFTPOS card at the time the consumer contracts for the service. Such disclosure should be in "readily understandable language".[306] Payment by the card should be honoured as long as it is within the terms and conditions agreed upon. The mere fact of issuing an EFTPOS card to the customer implies that the bank has accepted to honour the customer's EFTPOS transactions, provided that such transaction is made according to the terms and conditions of the account agreement.[307] One common term is that a customer must have sufficient funds in his account to cover his payment order.[308] However, if the insufficiency of funds was caused by the bank's delay in depositing a credit to the consumer's account, a bank is still liable.[309] On the contrary, a bank is excused from such liability if the customer's funds are subject to a legal process or other encumbrance restricting such transfer.[310]

A bank's complete failure to effect payment by EFTPOS card could be intentional, or unintentional as a result of *bona fide* error.[311] A bank which intentionally instructs retailers not to accept a given customer's valid card is liable for "all damages proximately caused" by such act. This liability will be "actual damages proved" if the bank's instructions were not intentional and resulted from a *bona fide* error. It is irrelevant in the latter case whether, or not, the bank has maintained "procedures reasonably adapted to avoid any such error".[312] The rules of transferring

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[306] 15 U.S.C. § 1693c(a).

[307] It is not necessary to issue a PIN since some EFTPOS transactions can be authenticated by customer's signature on a given receipt in conjunction with a debit card.

[308] A customer's account is deemed to have sufficient funds if the customer has an agreed overdraft facilities, or an established credit limit provided that the customer does not exceed the limit of such facilities. See 15 U.S.C. § 1693h(a)(1)(C).

[309] 15 U.S.C. § 1693h(a)(2).

[310] 15 U.S.C. § 1693h(a)(1)(B).

[311] For what is meant by intentional failure and unintentional failure which resulted from a *bona fide* error, see chapter four, para. 4.2.2 [b] [i] [2].

[312] 15 U.S.C. § 1693h(c).

bank's liability in consumer-based credit transfers discussed above are applicable to the purchaser's bank in EFTPOS transactions. That is because both electronic credit transfer and EFTPOS are included in the definition of "electronic fund transfer" under § 1693a(6) of EFTA.

2.4.2 [b] [ii] The Retailer's Banks.

The retailer's bank is liable for its complete failure to collect the amount of EFTPOS purchase from the purchaser's bank.[313] The retailer's bank liability depends on the terms of its agreement with the retailer. The retailer's bank failure to collect from the purchaser's bank would cause him, as direct damages, the amount instructed to be collected and the interest thereon. The failure to collect constitutes a breach of contract. A retailer which is a corporate entity is not a "consumer".[314] Thus, the retailer's bank's liability for complete failure to collect funds from the purchaser's bank and credit the retailer's account is not subject to EFTA. It is governed by special agreement between the retailer and its bank. Under some EFTPOS schemes, a retailer's bank does not collect funds to the retailer from the purchaser's bank, but agrees to guarantee the payment of all valid EFTPOS transactions to its customer, the retailer. Again, in this case, the liability of the bank for failure to credit the retailer's account is not subject to EFTA but to their special contracts.

2.4.3 ATM Transactions.

2.4.3 [a] Under U.K. Law.

A bank that denies a customer a service promised to provide *via* ATMs is probably in breach of such agreement. Although ATMs can be used for other services,

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[313] Assuming that the retailer has an account with a bank other than the purchaser's bank.

[314] § 1693a(5) defines the term "consumer" to mean "a natural person".

cash withdrawal is the common service. Banks' complete failure to make such transaction takes the form of cash denial. In theory, cash denial could be made against all customers from a given ATM when such ATM is out of service. However, a bank may intentionally or unintentionally deny a particular customer or customers access to their funds by the use of ATMs. Although, banks' liability is more likely in the latter case, both cases merit discussion.

2.4.3 [a] [i] Where an ATM is out of Service.

A bank may decide to temporarily withdraw a given ATM from service for operational reasons. In practice, the ATM concerned would show a message for such effect. Banks do not guarantee to customers that all their ATMs would be in operation at all times. Nor they guarantee the use of other banks' shared ATMs. The terms and conditions of the use of cash cards usually contain a term to such effect. Failing to provide so, such effect should be implied. Banks may withdraw a given ATM or ATMs from service because such ATM or ATMs ran out of cash. Since banks would not specify the reason for such withdrawal, customers will not be aware that this inconvenience was caused, for example, by the bank's negligence to supply the ATM or ATMs concerned with the usual amount of cash that the bank reasonably expected to be in demand.

2.4.3 [a] [ii] ATM's Wrongful Denial of Service.

A customer must use his cash card according to terms and conditions of the use of the card. Those terms usually include (i) the customer has sufficient withdrawable funds in his account; (ii) the use of the card in conjunction with its equivalent PIN; (iii) the use of the card to withdraw cash within the allowed daily limit; and (iv) using those ATMs that the customer is allowed to use. However, a

customer may use his card within the terms and conditions of use of his card, but still his request is denied by an ATM. The usual message that a customer would face is "refer to your branch". If such denial of service was wrongfully made by the bank, it is in breach of its account agreement with the customer. This could occur where the bank sends a message to its ATM computer mistakenly instructing the denial of cash to one of its customers. When a customer informs his bank that it has lost his cash card, a bank will send a message through the computer controlling ATM to stop the use of that card. If the bank made a mistake by sending the number of another card, another customer would be denied access to his funds by the use of ATMs. Such denial would be actionable by that customer. The bank will be in breach of its account agreement with that customer.

The breach of funds availability rules may result in the banks' liability for denial of cash through an ATM. A customer who deposits a cheque in his current account expects the bank to make funds available within the limits of the bank's announced policy on availability of funds.[315] Assuming that a given bank's funds availability policy dictates that the amount of a cheque drawn on, and presented to, a Scottish bank would be made available within three business days. Such customer is entitled to have access to his funds (if his cheque was clean) after the expiry of three business days. If, for example, an ATM, which he is entitled to withdraw funds from, denied him cash for insufficiency of funds, one suggests that his bank should be liable for breach of its rules of availability of funds and/or terms and conditions of the use of cash card.

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[315] Banks are required to provide customers with details of "when funds can be withdrawn after a cheque or other payment has been credited to the account". § 10.1 of the Code of Good Banking (1991).

2.4.3 [b] Under U.S.A. Law.

For a bank to be liable for denying its customer a service through an ATM, several conditions must be met.[316] First, there should be an account agreement between the bank and its customer entitles the customer to use ATMs. The terms and conditions of the use of the card should be disclosed to the consumer, in a "readily understandable language", at the time the consumer contracts for such service.[317] The fact that the bank issued to its customer a cash card with a P.I.N. could be taken as a conclusive evidence that the bank agrees that such customer is entitled to ATM service. Second, the customer must use the card issued and its correspondent P.I.N. to withdraw money or access other facilities from those ATMs that he is entitled to use. Third, the customer's account must have sufficient funds in his account, or has an agreed overdraft arrangement with his bank. Fourth, customer must not exceed a specified maximum limit of daily withdrawals. Those conditions, however, are common clauses in most banker-customer agreements for the use of ATMs. To this end, non-compliance with such terms by banks is a breach of contract.

The same exceptions to banks' liability for complete failure to make a credit transfer are applicable to ATM transactions. One important exception under EFTA is that a bank is not liable for its failure to provide a customer with cash from an ATM, if that ATM has insufficient funds to complete the customer's request at the time of that request.[318] This exception has nothing to do with the sufficiency of funds in the customer's account. The rationale behind such exception is probably to cover

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[316] Although ATMs offer bank's customers other services, cash withdrawals are the common service utilised by customers.

[317] 15 U.S.C. § 1693c(a).

[318] 15 U.S.C. § 1693h(a)(1)(D). This exception was different in the House of Representatives' Bill. See Baker & Brandel (1988), supra, at para. 16.03[3][a].

situations where certain ATM is unexpectedly overwhelmed by withdrawal orders. Banks should not be held liable for failure to provide cash through an ATM if such failure was caused by an unexpected demand of cash on a given ATM. It is, however, unclear whether courts would hold banks liable for their failure to supply the failed ATM with a reasonable amount of funds to meet its usual daily cash disbursement. The other important insufficiency of funds exception is the one concerning the customer's account. Banks cannot rely on the latter exception if it was caused by their failure to credit, in accordance with the terms and conditions of the account agreement, a deposit of funds to the customer's account, which would have provided sufficient funds to make the transaction.[319]

A "deny of cash" order by the bank could be intentional, or unintentional. A bank which intentionally denies its customer cash through an ATM is liable for "all damages proximately caused" by such denial. This liability will be "actual damages proved" if the bank's "denial of cash" was not intentional and resulted from a *bona fide* error. It is irrelevant in the latter type of denial that the bank has maintained "procedures reasonably adapted to avoid any such error".[320] The extent of bank's liability for complete failure to honour an ATM transaction is the same as that in EFTPOS transactions.

However, to be actionable, the bank's decision to deny its customer withdrawal of cash through an ATM must be unjustified. A bank, for example, has the right to deny its customer the withdrawal of cash if such denial "is immediately necessary to maintain or restore the security of an electronic fund transfer system or a consumer's

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[319] 15 U.S.C. § 1693h(a)(2).

[320] 15 U.S.C. § 1693h(c).

account."[321] So was held in *Feinman v. Bank of Delaware.*[322] In that case, although the bank denied its customer access to his sufficient funds through ATMs,[323] the court found that the bank has done so because of security reasons. The security reason given by the bank was, *inter alia*, that the plaintiffs had overdrawn their account by the use of ATMs in the past and presented a risk to do so in the future. The court held that since the bank can not reverse an ATM transaction to restore a positive balance; and because of the very real possibility of future attempts by the plaintiffs to overdraw their account by way of ATM withdrawals, the bank has reasonably concluded that there was a security risk at the time it decided to place the "deny cash" restriction on the account.[324]

One of the consumer's concern in ATM transactions is the quick availability of his funds through an ATM. This issue is governed by the Expedited Funds Availability Act.[325] Depositors of cheques, for example, are entitled to withdraw $100 per deposit per day for cheques payable anywhere in the United States, notwithstanding the fact that the paying bank does not know if the item will be honoured. Deposits made at proprietary ATMS are treated in the same manner as deposits at a staffed office.[326] Thus, a customer with a balance less than $100 who

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[321] 15 U.S.C. § 1693c(b). This can be done without prior notice of such change on the terms and conditions of the consumer's account which is required under 15 U.C.C. § 1693c(b). However, subject to certain requirements, subsequent notification is necessary when such change is made permanent.

[322] 728 F. Supp. 1105 (U.S. Dist. 1990). The "deny cash" restriction in that case was not intentional, and resulted from a bona fide error.

[323] This includes an arranged overdraft. However, when the decision to deny the customer the withdrawal of cash through ATMs was made, the plaintiffs' account had previously been overdrawn, at least in part, by ATM withdrawals. The court held that it was irrelevant that the consumer's account had a positive balance when the "deny cash" restriction was keyed into the computer system. The crucial event was that the decision to "deny cash" was based on the information reasonably available at the time and not the physical event of keying the restriction into the bank's computer system. See *Feinman v. Bank of Delaware*, 728 F. Supp. 1105, 1113 (U.S. Dist. 1990).

[324] Ibid, at p.1111.

[325] Codified at 12 U.S.C. §§ 4001-4010. This Act is part of the Competitive Equality Banking Act. See generally Huber, S., "The Competitive Equality Banking Act of 1987: An Analysis and Critical Commentary," [1988] 105 Banking L. J. 284.

[326] Deposits made at nonproprietary ATMs are subject to special provisions. See Huber, Bank officer's Handbook of Government Regulation, (2nd ed. 1989) with 1991 Cumulative Supp. No.2, at para. 19.02.

deposits a $500 check drawn on a distant bank is entitled to withdraw $100 in cash next day from an ATM using his card. A bank may not preclude or delay such customer from obtaining cash from an ATM.[327]

2.5 Special Case; Failure Caused by Malfunction.

Banks' failure to make an EFT, whether credit transfer, EFTPOS or ATM, does not necessarily result from a fault of the bank instructed or its correspondent. It may result from a technical malfunction or an act of God or other circumstances beyond the bank's control. This is discussed separately under British and American jurisdictions.

2.5 [a] Under U.K. Law.

Banks' liability for losses caused by a malfunction is usually governed by established contractual terms or specific express terms.[328] However, banking practice indicates that liability for such losses is usually disclaimed by banks in their contractual agreements with customers.[329] It was argued by the Review Committee that such practice was understandable in the very early days of EFT equipment when "performance was uncertain".[330] The experience of banks and the reliability of most EFT systems used nowadays militate for shifting liability for malfunction to banks. A term in an account agreement disclaiming liability for malfunction by a bank should be construed as an unfair to customers.[331]

Some of the Review Committee recommendations concerning liability for

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[327] Ibid at para.19.02[1].

[328] Goode (ed.), Electronic Banking, The Legal Implications, supra, at 63.

[329] None of the big four banks (Barclays, Lloyds, Midland and Natwest) chosen by the Review Committee to show banking practice in relation to terms and conditions of use of payment cards claims liability for equipment malfunction. See the Review Committee, supra, Appendix F.

[330] The Review Committee, supra, at para. 10.45.

[331] Ibid.

losses due to malfunction have been implemented by the Code of Good Banking.[332] A card issuer is liable for "the full losses incurred" by a customer as a result of "faults" in "the machines, or other systems used".[333] However, a card issuer is not liable if the malfunction "was obvious or advised by a message or notice on display".[334] Presumably an ATM showing a notice of "Out Of Service" satisfies this requirement. The card issuers' liability is "limited to those amounts wrongly charged to customers' accounts and any interest on those amounts."[335]

Since these rules are embodied under Part B of the Code of Good Banking, which is entitled "Customers and their Cards", it is arguably that they are only applicable to malfunction in payment cards. This means that losses caused by malfunction in other EFT transactions (not initiated by payment cards) are not regulated.

2.5 [b] Under U.S.A. Law.

A bank is not liable, in consumer-based transaction, for its failure to make an EFT if it "shows by preponderance of the evidence" that its failure has resulted from "a technical malfunction which was known to the consumer at the time he attempted to initiate an electronic fund transfer or, in the case of a preauthorized transfer, at the time such transfer should have occurred".[336] By negative implication, a bank should be liable for "all damages proximately caused" by technical malfunction if such malfunction was not known to the customer at the time he attempted to initiate the EFT, or in the case of a "preauthorized transfer" at the time such transfer should have

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[332] See the Review Committee recommendation 10(11); and §§ 18.1 and 18.2 of the Code of Good Banking (1991).

[333] § 18.1(c) of the Code of Good Banking (1991).

[334] Ibid.

[335] § 18.2 of the Code of Good Banking (1991).

[336] 15 U.S.C. § 1693h(b)(2).

occurred.[337]

Courts in the United States have examined the results of malfunction in EFT transactions. In *McEvans v. Citibank, N.A.*,[338] a customer deposited $600 *via* an ATM. The ATM accepted the deposit but gave no receipt as the receipt part of the machine was not functioning. The customer tried later to withdraw the funds, but she was denied withdrawal since no deposit had been credited to her account. Since the bank was found negligence in following internal procedures concerning receiving deposits, it was held liable to repay the funds to its customer. The results of EFT malfunction could expose banks to more than returning the funds. In *Stagg v. Bank of Breckenridge*,[339] a customer made a deposit *via* an ATM, which the ATM dated two months later. Having received an overdraft notice, the customer discovered that no money has been credited to his account. He timely informed the bank. The bank's president and vice-president agreed to credit his account, and informed him that an investigation will take place. The customer postponed his vacation a few days. The bank's vice-president, with the president's authorisation, filed a complaint for theft against the customer, who was arrested on vacation and spent two days in jail. The ATM's malfunction was discovered later by the bank, and the bank offered to dismiss the criminal suit if the customer released the bank from civil liability. The customer refused. He was acquitted, and sued the bank for intentional infliction of emotional distress and abuse of process. The parties have settled for $50,521 - $30,000 from the bank, $19,000 from the president, and $1,000 from the vice-president.[340]

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[337] See 15 U.S.C. § 1693a(6) and (9) (definition of "electronic fund transfer" and "preauthorized electronic fund transfer" respectively).

[338] 408 N.Y.S. 2d 870, 96 Misc. 2d 142 (1978).

[339] The parties settled before judgment. Referred to the facts of the case by Graziano & Baharoglu, Automated Teller Machines: Boon or Bane?, [1986] 91 Commercial L. J. 451, at 461-462.

[340] See Graziano & Baharoglu, Automated Teller Machines: Boon or Bane?, [1986] 91 Commercial L. J. 451, at 461-462.

Where the system malfunction prevents the effectuation of an EFT initiated by a consumer to another person, the consumer's obligation to the other person is to be suspended until the malfunction is corrected and the EFT may be completed. This is so, provided that such other person has agreed to accept payment by the EFT system used, and has not subsequently, by written request, demanded payment by means other than EFT.[341] Thus, where a consumer attempts to pay for goods by EFTPOS debit card but before the completion of the transaction a system malfunction occurs, a consumer may take the goods and leave the store.[342] This is true since the consumer has no stop payment right. The consumer's account will presumably be debited when the terminal functions again, and thus he will have neither the money nor the goods. This assumes that the retailer cannot abort the transaction at the time of malfunction.[343]

A bank is also not liable in consumer-based transaction for its failure to make an EFT if it "shows by a preponderance of the evidence" that such failure has resulted from "an act of God or other circumstances beyond its control, that it exercised care to prevent such occurrence, and that it exercised such diligence as the circumstances required".[344]

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[341] 15 U.S.C. § 1693j.

[342] See Baker & Brandel (1988), supra, para. 16.03[2][b].

[343] See for a discussion of this situation and other similar situations, Baker & Brandel (1988), supra, para. 16.03[2][b] and Budnitz, "The Impact of EFT Upon Consumers: Practical Problems Faced by Consumers," [1979] 13 U.S.F.L.Rev. 361, 393.

[344] 15 U.S.C. § 1693h(b)(1).

CHAPTER THREE

FAILURE TO STOP AN ELECTRONIC FUND TRANSFER TRANSACTION

3.1 General.

Since payment orders constitute a mandate, it is capable, in principle, of being countermanded before being carried out. A payer may try to countermand his payment order if a dispute over the payment, for example, arises between him and his debtor, i.e., the payee after the former instructs his bank to transfer a given amount to the latter's bank's account. It was said in the Review Committee Report that:[1]

> "Under the law of agency, the bank acts on the customer's mandate when carrying out a payment instruction on his behalf: Thus if the mandate is withdrawn, the bank could be taken to be under an obligation to stop the payment process if that is still practicable."

Under common law, a customer's mandate is revocable until the instruction is carried out, or until the bank irrevocably commits itself to carry out such mandate, so it would incur liability to a third party if the customer was allowed to revoke his instructions.[2] It was said in *Brind v. Hampshire* that:[3]

> "the directions remains countermandable by the remitter until it is executed, either by the actual delivery of the chattel or money to the remittee, or by some binding engagement entered into between the agent and the remittee, which gives the latter a right of action against the former."

The problem, however, is not the legal justification of such customer's right,[4]

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[1] The Review Committee Report, supra, at para. 12.07.

[2] See e.g., *Williams v. Everett* (1811) 14 East 582.

[3] (1836) 1 M & W 365 as quoted by Wo, Lam Wing "Funds Transfer: A Risk Analysis" [1992] 1 J.I.B.L. 16, 17.

[4] See the Official Comment 1 of U.C.C. § 4-403 where it is stated that "stopping payment ... is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense." Comment 3 of the same section states that "the right to stop payment is not limited to checks, and extends to any item payable by any bank."

but the scope and limits of such right in legal rules and banking practice. Fundamental to the discussion of such issue is to decide up to which stage of the payment process does the initiator (the originator or the payer) of a payment order have the right to countermand (or revoke) it? A general rule of thumb in this area is that the initiator of the payment order cannot unilaterally countermand his payment order after the completion of payment.[5] Thus, it is necessary to determine the time at which payment becomes final. This will proceed the discussion of banks' liability for failure to honour customers' instruction to countermand payment orders in EFT transactions.

3.2 Finality of Payment.

The relationship between countermanding a payment order and completion of payment is that "at whatever point of the payment process a payment instruction becomes irrevocable, it cannot be later than the point of legal completion of payment".[6] But although the two points may, in theory at least, coincide, there is no necessary reason why they should, and in practice they may well not do so.[7] In addition to the fact that payment cannot be countermanded after its completion, the determination of finality of payment is crucial in other aspects. It is important in cases such as attaching creditors, bank failures, determinations of when a taxpayer receives funds for tax purposes, and contracts that stipulate payment by certain date.[8]

Finality of payment here is investigated as between the transferring bank and the payee's bank.[9] That is to determine the time at which the funds are

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[5] See, e.g., Finlayson R., Law Lectures to Bankers, (1939) where it is said, at 49, in relation to cheques that "[t]o be effectual the countermand must, of course, be received before the cheque is actually paid."

[6] The Review Committee Report, supra, at para. 12.03.

[7] Ibid.

[8] See Baker & Brandel (1988), supra, at para. 29.03[3].

[9] See the Review Committee Report, at para. 12.23, where it is said that "there is payment completion as between banks, and there is also payment completion (at a separable moment in time, which according to the system may precede or follow the order) between the payee bank and its customer. Without disputing that there is a tenable point of view here, we find it less confusing

unconditionally transferred to the payee's bank for the benefit of the payee as a matter of right.[10] Finality of payment is a concept that is applicable to transfer of funds made between banks through the banking system. Whether the funds, afterwards, made available to the payee immediately or after some time is another matter, namely, a matter of funds availability.[11] Finality or completion of payment should be also distinguished from irrevocability of the funds transfer. While the former term marks the time at which the funds are unconditionally transferred to the beneficiary's bank for the beneficiary as a matter of right, the latter term marks the time at which the funds transfer cannot be stopped either as a matter of practicality or as a rule of law.

Finality of payment is discussed under credit transfer and EFTPOS transactions. It is not a major concern in ATM withdrawals since no third party is involved. However, payment is final when the properly used ATM dispenses the required cash to the user in case of cash withdrawals. In case of a deposit made through an ATM, it should be considered final when the depositor's bank processes the transaction and decides to accept the deposit on behalf of its customer.

3.2.1 Electronic Credit Transfer Transactions.

3.2.1 [a] Under U.K. Law.

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to use a different terminology for these two events. As we would see it, completion of payment is a concept that applies only to funds transfers made through the banking system, and one that involves only banks. The separable moment when the payee has access to the proceeds of a funds transfer should, for its part, be termed availability of funds. Availability of funds is a concept applying to any funds transfer, including a simple transfer of cash [citation omitted]. It must anyway involve the payee, and, in the case of a funds transfer made through the banking system, it involves his bank as well."

[10] Prof. Goode in Payment Obligations in Commercial and Financial Transactions (1983) emphasised, at 107-109, that finality of payment varies according to the relationship under consideration, therefore, it is important to identify the relationship under consideration before discussing the finality of payment.

[11] See, e.g., *Mardorf Peach & Co. Ltd. v. Attica Sea carriers Corp. of Liberia ("The Laconia")* [1976] 2 All E.R. 249, where Lord Denning M.R., at 255 said:
"'[P]rocessing' was a piece of mechanism inside the bank itself, which worked fast or slow according to the power put behind it. Its speed should not affect the legal position of the parties making or receiving payment."
Although this case was reversed by the House of Lords [1977] A.C. 851, it seems that this point was not affected. Indeed, although Lord Salmon, at 880, inclined to express a view on the point since he thinks it was not necessary to do so, his lordship did however implied its acceptance. He said that "[n]o doubt a certain amount of processing or paper work has to be done even in relation to a cash payment before it finds its way as a credit into the haven of the customer's account."

§ 59 of BEA 1882 provides that a cheque or a negotiable instrument "is discharged by payment in due course". However, it is not only that this section is inapplicable to EFT, but also no definition of what constitutes payment is offered. There are no other relevant statutes. Finality of payment could be defined by contract.[12] The rules of a clearing house and an EFT systems used should be looked at with particular interest to determine the finality of payment of the funds transfer transaction in question. Rule 2(b) of CHAPS Clearing Rules provides that payment carried out through CHAPS is "an irrevocable guaranteed unconditional sterling payment for same-day settlement". This means that a CHAPS payment order is irrevocable once it is sent by the transferring bank. That was the implication made by *R v. King and Others.*[13] In that case, Lord Lane said that the effect of CHAPS payment order is to instruct the transfer of funds "by means of electronic device which would carry out the necessary operations as soon as the staff of the paying bank key the information contained in the document [the paper-based payment order] into the machine and then put the machine into operation."[14] This should be seen as an irrevocability rather than finality of payment. It is, however, uncertain whether such rules are binding on parties who are not settlement members; and indeed banks' customers.[15]

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[12] See The Review Committee Report, supra, at para. 12.16; and Wo, Lam Wing, Funds Transfer: A Risk Analysis [1992] 1 J.I.B.J. 16, at 17.

[13] [1991] 3 All E.R. 705.

[14] Ibid, at 709.

[15] Goode R.M. (ed.), Electronic Banking, The legal Implications, at 79. *C.f.* Cranston R., (ed.), The Single Market and The Law of Banking (1991), at 208, where it is argued that parties to a fund transfer which are not members of the payment or clearing system could be held liable, under certain circumstances, under the rules of such clearing system. The argument continues, at 208, as saying "[c]ertainly it cannot be said that just because the payer and the payee are no parties to a contract, they are not bound by it because of notions of privity. In English law there is clear authority that one can be bound by the custom and usage of a market, irrespective of one's knowledge of them. Indeed a 'man who employs a banker is bound by the usage of bankers' [citing *Hare v. Henty* (1861) 142 ER 374, 379]. The custom or usage becomes binding as an implied term of the payor-bank or payee-bank contract, although where a party is unaware of it the custom or usage can only be implied if it is reasonable [citing *Sweeting v. Pearce* (1861) 142 ER 210]. There is some authority treating a rule comparable to a payment and clearing rule as a custom or usage for the purposes of this principle [citing *Bell Group Ltd v. Herald and Weekly Times Ltd* (1985)

Analogy with common law rules in other methods of payment could be found helpful. In particular, analogy with finality of payment carried out by using such communications as telex messages.[16] This is supported by the view that "what constitutes payment does not depend on the medium".[17]

It was held in the early cases of *Camidge v. Allenby*[18] and *Sibtree v. Tripp*[19] that the moment at which payment, either absolute or conditional, was completed depends on the intention of the parties. Such intention can be ascertained by considering the nature of the transaction, and the surrounding circumstances. Case law indicates that there are two situations. A credit transfer transaction may take place within the walls of the same bank, i.e. in-house transfer, or between different banks, i.e., inter-bank transfer.

3.2.1 [a] [i] In-house Transfers.

If there is one bank acting for both the payer and the payee, the credit transfer will not be made through a clearing system. It is an internal operation. It was held in *The Brimnes*,[20] that payment was complete in in-house credit transfer when the bank has taken the final decision to adjust the appropriate account of the payer and payee by debiting the former's account and crediting the latter's account. The question before the court was whether the owners of a vessel were entitled, under a time

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ACLR 697]".

[16] For the formation of contract by telex, see the decision of the House of Lords in *Brinkibon Ltd v. Stahag Stahl G.m.b.H.* [1983] 2 A.C. 34 where the House declined to formulate a universal rule concerning the time of formation of contract by telex. See also Kasiraja N., Contract by Telex - When it is Formed? [1984] 26 Mal. L.R. 168; and Lewis, The Formation and Repudiation of contracts by International Telex [1980] L.M.C.L.Q. 433.

[17] The Review Committee Report, supra, at para. 12.14. However, it is argued in the Report, at para. 12.15, that "Common law in general does not draw a clear distinction between the concepts of completion of payment and discharge of the underlying obligation ... and so fails to provide a useful definition of the former."

[18] (1827) 16 B. & C. 373.

[19] (1846) 15 M. & W. 23.

[20] *Tenax Steamship Co. Ltd v. Brimnes (Owners of)* [1973] 1 W.L.R. 386; [1973] 1 All E.R. 769, *aff'd* [1975] 1 Q.B. 929 (C.A.).

charterparty contract, to withdraw the vessel for the failure of the charterer to effect payment at an agreed time. The charterer's bank in London had an account with the owners' bank in New York. On instructions from its customers, the charterers, the former bank sent a telex to the owners' bank instructing it to debit their account with the amount of the agreed hire and credit it to the owners' account. Upon the disagreement between the parties on the time at which payment of the hire was made, the Court of Appeal held that "the time of 'decision' has to be regarded as the time of payment".[21] "That 'decision' was signified by the physical act of making the appropriate document by the appropriate member of the [bank's] staff. Until then the owners [i.e. the payees] had no unconditional right to the amount specified in the Telex transfer."[22]

Momm v. Barclays Bank International Ltd,[23] is a direct English authority on finality of payment in EFT transactions. There, the payer instructed its bank, with which the payee also had an account, to transfer £120,000 to the payee's account. An employee of the bank authorised the transfer by setting the appropriate computer process in motion at about mid-day to debit the payer's account and credit the payee's account. The processing of such instructions by the computer would only be done during the night. The payer, a merchant bank, announced that it was going into

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[21] Per Edmund Davies L.J. [1975] 1 Q.B. 929, at 951. His Lordship also said, at p.949, that "payment was effectively made when ... a decision was made to debit [the charterer's bank's account] with the amount instructed and to credit the owner's account with a like amount". See also Cairns L.J. at p.969 (where his lordship said that "the time of tender and of payment was the time when the decision was made to transfer the funds from [the payer's account to the payee's account]".

[22] Ibid, at 950. Consider Megaw L.J., at p.965, where his lordship said: "In my judgment, at any rate after the proper contractual time for payment had passed, instructions to the creditor to pay himself out of an account held by him on behalf of the debtor's agent do not constitute payment until the instructions become known to the creditor and the creditor has had an opportunity, such as would reasonably be required in ordinary course of business in respect of such a transaction, to satisfy himself that the instructions are such as he can properly, in his own interest, accept. That would involve checking, in accordance with ordinary business routine, that the account out of which the creditor is instructed or required to pay himself is an account which is in credit to that extent so that the purported payment of the debt will not be nullified by the creation, as a result of the same transaction, of another debt. It is when that reasonable check has been carried out and the creditor has decided that the instructions can be acted on - then and no sooner - that payment of the debt should be treated as having been made."

[23] [1976] 3 All E.R. 588.

liquidation on the afternoon of that day before the processing by the computer took place. Since the payer was in a net debit position, the bank reversed the entries in the accounts of the payer and the payee next day.[24] The payee, who was notified neither of the credit entry nor of its reversal, discovered the facts through a perusal of his bank's books. Accordingly, an action was brought by the payee against the bank claiming that payment was completed and hence its account was wrongly debited (by the reversal). The court held that payment was complete when the bank unconditionally "decided" to effect the transfer which was signified by setting the appropriate computer processes in motion. In the words of Kerr J.[25]

> "[T]he authorities clearly support the contention that payment in the present case was complete when [the bank] decided to accept [the payer's] instructions to credit the [payee's] account and the computer process for doing so were set in motion."

Thus, in both cases once the payment order had been accepted by the payee's bank, the payment becomes complete and thus the payee acquires the right to the funds transferred. Such instruction being in the nature of a request is recoverable until it had been accepted or acted upon. it is suggested that the "underlying proposition is simple: a request has to be accepted to be effective."[26]

It is not necessary for finality of payment to occur that the payee should be notified of the decision to make the payment. That requirement was first recognised by *Rekstin v. Severo Sibirsko and Bank for Russian Trade.*[27] In that case, notification of the payee was considered a prerequisite for finality of payment.[28] However, doubts

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[24] Although the merchant's account did not have adequate credit balance, the assistant manager of the bank decided to carry out the transfer, apparently by granting an overdraft. This was probably the reason behind the bank's decision to reverse the transfer.

[25] At 598.

[26] Wo, Lam Wing "Funds Transfer: A Risk Analysis" [1992] 1 J.I.B.L. 16, 18.

[27] [1933] 1 K.B. 47.

[28] Ibid, per Talbot J., at 56-57.

on this proposition were cast by later decisions.[29] No such requirement was considered necessary in *The Brimnes*.[30] This indicates that notice to the payee was not necessary for a payment to be completed.[31] Kerr J. in *Momm v. Barclays Bank International*[32] distinguished *Rekstin v. Severo Sibirsko and Bank for Russian Trade,*[33] as confined to its special facts and rejected the interpretation of the case as deciding that "there could not have been any completed payment to the plaintiffs unless and until any advice note recording the credit to their account had been despatched to them or had been received by them."[34]

Thus, payment is final in in-house transfer when the bank unconditionally decides to transfer, according to the payer's instruction, the funds from the payer's account to the payee's account. That is the time when the bank "decides" to irrevocably debit the payer's account and credit the payee's account. On other words, it is the time at which the bank unconditionally decides to adjust the appropriate accounts of the payer and payee. It is not necessary for the completion of payment that the execution of such instructions should appear on the bank's records, nor there

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[29] In fact there was an earlier decision suggests that notification of crediting and debiting the appropriate accounts is not a prerequisite to finality of payment. See *Eyles v. Ellis* (1827) 4 Bing. 112.

[30] [1975] 1 Q.B. 929 (C.A.). See also the decision of Brandon J., the trial judge, [1973] 1 W.L.R. 386; [1973] 1 All E.R. 769 which was affirmed.

[31] See Vroegop J., The Time of Payment in Paper-based and Electronic Funds Transfer Systems, [1990] 1 L.M.C.L.Q. 64, at 81.

[32] [1976] 3 All E.R. 588, at 596-597.

[33] [1933] 1 K.B. 47.

[34] Ibid, at 597. His lordship pointed out that the earlier case of *Eyles v. Ellis* (1827) 4 Bing. 112, has not been referred to by the *Rekstin's* case. Ibid. Moreover, the requirement of notification has not been mentioned by Acton and Selsser JJ. at first instance, nor by Romer in the Court of Appeal in *Rekstin's* case. Talbot's J. remarks on this point should be seen as *obiter dictum*. See Pennington, Hudson, and Mann, supra, at 294., where several reservations have been made against Talbot J.'s view; and Vroegop, J., The Time of Payment in Paper-based and Electronic Funds Transfer Systems, [1990] 1 L.M.C.L.Q. 64, 81. For a critical view of the requirement of notification as a prerequisite for finality of payment, see Arora A., Recent Development in Money Transfer Methods [1980] L.M.C.L.Q. 416 at 426 where she argued that "if this requirement of notification to the payee of the crediting of his account were accepted by the court [commenting on *Momm's* case refusal of such requirement] it would detract from the practicality and reliability of the credit transfer system and would produce a disparity of the rules governimg the effectiveness and irrevocability of the transfer depending on whether it was between accounts held with the same bank or different banks."

should be notice to the payee.[35]

The "decision" test was criticised as "ambiguous".[36] In most cases there will be no credible evidence of the bank's decision to debit and credit the appropriate accounts without looking into the bank's book keeping records and its various "internal accounting processes". What if a decision by one level of the executive is overruled by a supervisor. Is it one decision or two? However, this ambiguity will probably be reduced by the use of new technology. Courts may choose the time of setting the computer that processes the transfer in motion as the exact time of deciding to effect the transfer instructions. This, however, may be seen as the time of a mere execution of an already taken decision to effect the payment instruction. It appears that under the new technology there might be actually no appreciable time lapse between the bank's decision to credit and debit the relevant accounts, and the actual performing of that decision. In practice, banks may affect an instantaneous transfer by instructing a computer in their premises to transfer funds from one account to another by giving the numbers of those accounts, as was in *Momm's* case. The computer will debit the payer's account and at the same time credit the payee's account. The bank's decision to effect the transfer is usually signified by setting the computer that process the transfer in motion.[37]

3.2.1 [a] [ii] Inter-bank Transfers.

Where there are two or more banks involved in an EFT, such transfer is

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[35] The Review Committee Report adopts Prof. Goode's view, that payment in in-house transfers "is complete when the bank has taken the final decision to treat the instructions for transfer as irrevocable. It is not necessary that the bank shall actually have carried out the transfer process by crediting one account and debiting another." See Goode, Payment Obligations in Commercial and Financial Transactions (1983), at 117; and the Review Committee Report, supra, at para. 12.27.

[36] Crawford B., Credit Transfers of Funds In Canada: The Current Law, [1979] 3 Canadian Business L.J. 119, at 142-143.

[37] See for different times at which the decision to make a credit transfer may occur, Goode, Payment Obligations in Commercial and Financial Transactions (1983), at 117.

normally carried out through a banking clearing system. It is suggested that transfer involves "a string of instructions in which each party orders the next party down the line to effect the payment of a given amount and authorizes that party to reimburse itself."[38] Banking practice and common law cases suggest two different categories of credit transfer. First; where the transferring bank, or an intermediary, informs the payee's bank that its account with the transferring bank or with another bank has been credited by the amount of transfer. This is usually coupled with a notification that such credit is made for the benefit of a given customer of the payee's bank; and therefore instructs the payee's bank to credits the payee's account by the same amount. This is called credit notification. Second, the transferring bank, or its intermediary, instructs the payee's bank to credit the payee's account with it by a given amount and meanwhile authorises the debit of its account that is already maintained with the payee's bank by the same amount. This is called credit instructions. The time of completion of payment is discussed in both situations separately.

3.2.1 [a] [ii] [1] Credit Notification.

It was held in *The Effy*[39] that payment was tendered when the payee's bank was informed by the payer's bank that its account with it was credited by the amount of the instructed transfer for the benefit of the payee; and instructed it to credit the payee's account by that amount. It was held in *The Zographia M.*,[40] that the payment was made when the payee's bank received and verified a telex from the transferring bank, i.e. the payer's bank, informing it that its account with it was credited by the

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[38] Ellinger, Banks and Extra-territorial Orders, [1989] L.M.C.L.Q. 363, at 368.

[39] *Zim Israel Navigation Co. Ltd. v. Effy Shipping Corporation* [1972] 1 Lloyd's Rep. 18.

[40] *Astro Amo Compania Naviera S.A. v. ELF Union S.A. and First National City Bank*, [1976] 2 Lloyd's Rep. 382.

amount of the transfer for the benefit of the payee and instructing it to credit that amount to the payee's account. Ackner J., commenting on the telex sent to the owners' bank informing it that its account with it was credited by the amount of the hire and instructing it to credit the owners' account by the like amount, said:[41]

> "[T]his telex was, as between banks, equivalent to the receipt of cash or a payment order, once the telex had been received and had been verified ... the bank had received the money on behalf of the owners, it was the owners' money and accordingly the hire was paid or tendered in a commercially acceptable form to the owners' bank".

In *Royal Products v. Midland Bank,*[42] the plaintiffs wanted to transfer £13,000 from their account with Midland Bank in the United Kingdom to their account with a third party ("National") in Malta. But, since such direct transfer to National would cause them certain charges, they instructed Midland Bank to effect the transfer to their account in another bank in Malta, i.e., Bank of Industry Commerce and Agriculture Ltd ("BICAL"). Thus, Midland instructed its correspondent "National" (the same payee's bank) by telex to pay the sum to BICAL for the benefit of the plaintiffs. National opened an internal suspense account in the name of BICAL and credited it by the amount of the transfer. It notified BICAL that its account with it was credited by £13,000 for the benefit of the plaintiffs. BICAL withdrew the sum and later on the day ceased banking operations. Two days later, the plaintiffs requested Midland Bank to amend the payment instructions by transferring the sum directly to their account in National. Midland passed on that request to National and asked them to "retrieve" the original remittance. National replied that the funds had been paid to BICAL for Royal Products' account and that they were unable to retrieve the funds as BICAL was

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[41] Ibid, at 390.

[42] [1981] 2 Lloyd's Rep. 194.

presently under the control of the Central Bank of Malta.

Webster J. held that the transfer to Royal Products' account in BICAL was complete and thus cannot be reversed when Midland Bank "had carried out Royal Products instructions to draw on or otherwise use the amount of credit transferred, which Royal Products would have been able to do once Midland had, in one way or another and either directly or indirectly, made funds available to BICAL to the extent of £13,000 and had notified BICAL that sum was to be credited to the account of Royal Products."[43] His Lordship found that "from the moment when [BICAL] received in one form or another notification of the credit BICAL were able to draw on National for the amount remitted."[44]

Thus, in credit notification cases it seems that the consent of the payee's bank is not a prerequisite for its receipt of the funds which in turn is to be credited to one of its customers' accounts. Webster J. in *Royal Products Ltd v. Midland Bank Ltd.*, said:

> "I cannot see the necessity, either in practice or in law, for the consent of a bank to be obtained before it is to be treated as having received, in one way or another, money or credit which in turn is to credit to the current account of one of its customers."[45]

Although Ackner J.'s statement in *The Zographia M.* appeared to accept that the receipt of credit notification is, between banks, equivalent to the receipt of cash, one questiones whether the payee's bank is always in a position to assume its customer's consent to such receipt for its benefit. It was held in *The Laconia*[46] that

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[43] [1981] 2 Lloyd's Rep. 194, 198-199.

[44] Ibid, at 203 (where his Lordship found "that BICAL also notified that the amount referred to in it represented a credit to Royal Products's account with them or an amount which according to banking practice they were expected to credit to that account."

[45] [1981] 2 Lloyd's Rep. 194, 201.

[46] *Mardorf Peach & Co. Ltd. v. Attica Sea carriers of Liberia (The Laconia)* [1977] A.C. 850.

even if the payee's bank receives funds as an agent for its customer (the payee) it may have limited authority. In that case, which concerned punctual payment in a time charterparty, the House of Lords held that the payee's bank's authority was construed as being limited to receiving and accepting the punctual payment of the hire.[47] It did not have authority to accept late payments.[48] The House of Lords, however, did not decide whether in the absence of specific instructions from a customer to his bank to reject payment, banks would have authority to bind a customer by accepting late payment.[49]

3.2.1 [a] [ii] [2] Credit Instructions.

In *The Afovos,*[50] Lloyd J. stated that payment was complete "when the telex is received and tested by the receiving bank."[51] Although Lord Roskill, in the appeal of this case to the House of Lords, thinks that the "the correctness or otherwise" of Lloyd J.'s observations on this issue "does not have to be determined in this appeal", his lordship observes that the determination of finality of payment "is likely to depend, at least in most cases, upon proof of the practice of bankers current when the question arises rather than upon any determination of it as a matter of law."[52] Although it was not necessary under the circumstances in *The Laconia*[53] to decide the time of payment, three members of the House of Lords offered an answer.[54] Lord Salmon

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[47] Ibid, at 880.

[48] Ibid, at 871.

[49] Tallackson J.S. & Vallejo N., International Commercial Wire Transfers: The Lack of Standards [1986] 11 North Carolina Journal of International Law and Commercial Regulation 639, 659.

[50] *Afovos Shipping Co. v. Romano Pagnan and Pietro Pagnan* [1980] 2 Lloyd's Rep. 469; [1982] 1 W.L.R. 848 (C.A.), aff'd by the House of Lords [1983] 1 W.L.R. 195.

[51] [1980] 2 Lloyd's Rep. 469, 473.

[52] *The Afovos's* case, supra, [1983] 1 W.L.R. 195, at 204 (H.L.).

[53] *Mardorf Peach & Co. Ltd. v. Attica Sea carriers Corp. of Liberia ("The Laconia")* [1976] 2 All E.R. 249, rev'd by the House of Lords [1977] A.C. 850.

[54] The case has dealt with the right to withdraw vessel failing punctual payment. In particular, whether shipowners' bank's acceptance of unpunctual hire constitutes a waiver of right to withdraw the vessel.

considered the delivery of a payment order to the payee's bank just before the closing time is a punctual payment even if it would take some time before such order would be processed.[55] Lord Russell concurred with this view.[56] Lord Fraser, however, considered that payment did not take place until the payment order is processed and the payee's account credited. His Lordship said that "the charterers [the payer] must pay in sufficient time to allow for the period of processing normally required for the method of payment chosen. They would not, of course, be responsible for abnormal delay in the processing."[57]

Prof. Goode, whose view was adopted by the Review Committee, suggests that it suffices that the payee's bank (or its agent in the clearing), having actual or ostensible authority to accept payment on behalf of the payee, accepts an unconditional transfer of funds from the paying bank (or its agent in the clearing) for the payee's account.[58] It is not a prerequisite that the payee's bank should notify the payee of such decision to accept, or should process such instruction by crediting the payee's account.[59] The payee's acceptance of being paid in his account suggests, *prima facie*, the applicability of the rule that tender is effective if made before midnight at the end of the day fixed for payment.[60] The unconditionality of credit

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[55] Ibid, at 880

[56] Ibid, at 889, Where his lordship said:
"It was said that definitions of payment in 'cash' which are found in the cases would mean that tender of the payment order at, say, 2.30 p.m on the Friday would not have been punctual payment, because the processing would not have been completed until the Monday. I would as at present advised to the view that, a payment order being as between banks the equivalent of cash - meaning I take it irrevocable and 'good' - it should suffice for punctual payment that such cash equivalent be tendered in due time to the nominated bank to be credited to the named account: this was the method of payment laid down: you cannot pay "into" an account, whether you are tendering cash or its equivalent."

[57] Ibid, at 885. This view probably goes beyond mere completion of payment to assure that funds will be available to the payee not just as a right but also for use on or before time of payment.

[58] Goode, Payment Obligations in Commercial and Financial Transactions (1983), at 111. See the Review Committee Report, supra, at para. 12.27.

[59] Goode, Payment Obligations in Commercial and Financial Transactions (1983), at 111.

[60] Ibid, at 64. It is noted that this rule was settled a long time ago in *Startup v. Macdonald* (1843) 6 Mann. & G. 593. This rule has recently been affirmed by the Court of Appeal and the House of Lords in *Afovos Shipping Co. S.A. v. Pagnan* [1982] 3 All E.R. 18 (C.A.), *aff'd* [1983] 1 All E.R. 449; [1983] 1 W.L.R. 195 where Lord Hailsham of St. Marylebone said, at 201,

transfer should not necessarily mean the actual netting of accounts between the payer's and payee's banks either in the Bank of England or with another bank. It should be sufficient that according to banking practice such transfer is considered irrevocable by the payer or the payer's bank, and the transfer of funds to the payee's bank becomes unconditional. The word "unconditional" used here should be seen analogous to that used in *The Brimnes*; and thus be understood in a wide and liberal sense as equivalent to "unfettered or unrestricted". It should not be construed in a narrow sense as meaning that the payee's right to the use of the funds is neither subject to a condition precedent nor a condition subsequent.[61]

This view is compatible with the design of the existing EFT systems. Take for example, funds transfer through CHAPS. A payer instructs his bank, i.e. the transferring bank, to transfer a sum of money from his account to a specific payee, usually to the latter's account in his bank. The transferring bank processes the payment message and releases it, if the transferring bank is a settlement bank, through its gateway to CHAPS central computer. On receipt of this payment message, the transferring bank's gateway will validate, store, and transmit it to the payee's settlement bank through British Telecom's Packet Switching Service "PSS" - unless the payee's settlement bank uses the same gateway that the transferring bank uses. The payee's settlement bank receives the message and sends the payer's settlement bank a "Logical Acknowledgment".[62] If such acknowledgment is not received by the payer's settlement bank, it is assumed that the payee's settlement bank has not

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that:
"I take it to be a general principle of law not requiring authority that where a person under an obligation to do a particular act has to do it on or before a particular date he has the whole of that day to perform his duty." That obviously expires at midnight of the payment date.

[61] Wo, Lam Wing "Funds Transfer: A Risk Analysis" [1992] 1 J.I.B.L. 16, 21-22.

[62] Rule 4(c) of CHAPS Clearing Rules (1985).

received the payment order; and thus no transfer occurs. However, sending a "Logical Acknowledgment" by the payee's settlement bank to the transferring bank binds the payee's bank "to give same day value" to the payee.[63] This is compatible with the common law rule that payment is made when the payee's bank unconditionally accepts the transferring bank's instructions to credit the payee's account by the amount of the transfer. By sending "Logical acknowledgment", the payee's bank decides to accept the transferring bank's instructions to "give same day value" to the payee. "Under the CHAPS rules, the actual transfer is considered payment. It is not merely an advice that payment is to be executed."[64] However, the settlement of the daily balance of any bank involved in CHAPS transfer is effected through the Bank of England which has its own CHAPS gateway. The netting of the transfers undertaken is determined at the close of each business day as every gateway keeps records of amounts received from and amounts paid to each settlement bank operating through that particular gateway. If the records of the gateways involved agree, a message for settlement of the balance is sent to the Bank of England. The finality of payment in the sense of completion between the transferring bank and the payee's bank occurs once the CHAPS order is "acknowledged" by the payee's bank, and not when the netting of the accounts of those banks involved in the transfer occurs in the Bank of England.

In *R. v. King and Others*,[65] the Criminal Division of the Court of Appeal had to decide whether the appellants procured by deception the execution of a "valuable security" contrary to § 20(2) of the Theft Act 1968. The alleged "valuable security" was a CHAPS payment order. Thus, it was necessary for the court to decide whether

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[63] Ibid.

[64] Goode R.M. (ed.), Electronic Banking, The Legal Implications, supra, at 32.

[65] [1991] 3 All E.R. 705.

the execution of CHAPS order constituted a "valuable security". The court held that once the CHAPS order was "processed", the amount of transfer over which the payer had a right before the order was processed "is now available, not to him, but to the payee."[66] The key phrase here was "once the CHAPS order is processed". It appears from the court's decision that what was meant by such phrase was the fact that the payer's bank has "released" the CHAPS order to its CHAPS gateway, which has been "accepted". To prove that, the form of CHAPS payment order used in the transfer was presented to the court. The order was bearing the bank officials' signatures signifying that it has been "processed". That was coupled with "a computer printout headed by the paying bank sorting code number and reading 'Payment released' followed by the outward payment reference from the CHAPS form followed by the time, ... followed by the words 'Payment accepted'".[67] Although the court did not emphasise, or elaborate on, the last fact, namely 'Payment accepted' but did emphasise that the order was "processed", one suggests that the last fact was the decisive factor in the completion of payment. Without receiving the "Logical Acknowledgement" from the payee's bank (or its agent in the clearing house) stating that payment has been accepted, no payment would have ever been made. It will be automatically struck out of CHAPS records like if it had never been made.

The *Momm's* case can be reconciled with this analysis by stating that in *Momm's* case the transfer was in-house one. Thus, in *Momm's* case payment was final when the bank decided to accept the payment instructions to credit the payee's account "and the computer processes for doing so were set in motion."[68] One should

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[66] Per Lord Lane C.J. at 710.

[67] Ibid, at 709.

[68] [1976] 3 All E.R. 688, at 598.

be precise in deciding the moment of finality of payment especially in the age of high-speed computers and instantaneous fund transfers. Setting the computer in motion should not be seen in inter-bank transfers as the moment of finality of payment. This message may not reach its destination. That is why in CHAPS transfers, a payee's bank should acknowledge receipt of the payment order. Rather, the moment of acknowledgement of such transfer should be considered the time of finality of payment between the banks involved in the payment process. This is consistent with the already established case law in credit transfer generally. At that moment, the payee's bank accepts payment for the payee's account, and the title to the transferred funds passes to the payee. The fact that the transfer could be irrevocable at some time earlier should not affect such conclusion. There is no necessary reason for finality of payment to coincide with irrevocability.

The distinction between the time on which the transferring bank releases the payment order by pressing a button to release the payment message and the time on which the payee's bank accepts payment by acknowledging its receipt has a practical consequence. This becomes clear if a defect in the transferring bank's computer or the clearing system prevents the payment message from reaching the payee's bank. In such case, it is hardly possible to contend that there was a credit transfer, save that the title to the funds has passed on to the payee by his bank's acceptance of such transfer.[69] This justifies the precision of choosing the moment of finality of payment in the age of computers. The precision in determining the time of completion of payment is also crucial where on of the banks involved in the payment process becomes insolvent or ceases banking operations. Where the transferring bank ceases

[69] See Wallach E., When is a Transfer Order Finally Performed under German Law? [1988] 6 J.I.B.L 279, 283.

banking operation before the payment is made to the payee's bank, no payment is made to the payee. The payer's obligation to pay the payee remains undischarged.[70] Where an intermediary bank ceases banking, it is suggested that "the payer would still be entitled to revoke its instruction to its bank and recover its money from its bank if the correspondent fails before making payment to the payee's bank, unless the payer has authorised its bank to issue an irrevocable instructions to a sub-agent."[71] That is based on the view that in the absence of express contract or binding practice, the transferring bank may be regarded as mandatory to its correspondent and thus, "would be able to revoke its instructions to the correspondent until the payee's bank (or its agents) has accepted or acted upon the instructions."[72]

3.2.1 [b] Under U.S.A. Law.

3.2.1 [b] [i] The Rule under Article 4A.

Under the United States law, payment is final in wholesale credit transfers when the beneficiary bank unconditionally "accepts" the payment order by its sender.[73] The reason is that the beneficiary's bank, like any other bank in wholesale credit transfers, is under no obligation to "accept" a payment order unless it is bound to do so by agreement. Only at that time the title to the funds transferred passes to the beneficiary. Thus, the question is always this: at what time the beneficiary's bank has unconditionally "accepted" the payment order in question, or deemed to have accepted

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[70] See for the discharge of the payer's payment obligation in credit transfer, *A/S Awilco S.p.A. Di Navigazioni, The Chikuma*, [1979] 1 Lloyd's Rep. 367; [1980] 2 Lloyd's Rep. 409 (C.A.); [1981] 1 Lloyd's Rep. 371 (H.L.) (payment was due on or before 22 January. On that date, the payee's bank received telex from the payer's bank to pay the payee the amount of a hire stating that payment was a 26 value date. Under the Italian law (the proper law) the telex instruction became irrevocable on 22 January but interest would not begin to run in favour of the payee's bank until 26 January. The House of Lords decided no punctual payment was made on 22 January. The test applied was whether the transfer had given the payee the "unfettered or unrestricted" right to the immediate use of the funds on the due date.

[71] Wo, Lam Wing "Funds Transfer: A Risk Analysis" [1992] 1 J.I.B.L. 16, 19-20.

[72] Ibid, at 20.

[73] U.C.C. § 4A-404(a).

it?

Under U.C.C. § 4A-209(b), acceptance of a payment order by a beneficiary's bank occurs at the earliest of the following times. First, when the bank "pays" the beneficiary or "notifies" him of receipt of the order or that his account has been credited by the amount of the order.[74] Paying the beneficiary depends on whether, or not, the bank is crediting an account of the beneficiary. If the bank credits an account of the beneficiary, "payment occurs when and to the extent (i) the beneficiary is notified of the right to withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank".[75] However, if the beneficiary's bank does not credit an account of the beneficiary, the time when payment is made is governed by principles of law that determine when the beneficiary's bank obligation to pay the beneficiary is satisfied.[76] The only restriction on notification of receipt of the order or that the beneficiary's account has been credited is that it must not be accompanied by a statement providing that the funds may not be withdrawn or used until receipt of payment from the sender.[77] Second, when the beneficiary's bank receives payment of the entire amount of the sender's order.[78] The beneficiary's bank receives payment from a sender that is a bank when it "receives final settlement of the obligation through a Federal Reserve Bank or through a funds-transfer system".[79] Where the beneficiary's bank's sender (i) credited an account of the beneficiary's bank with it,

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[74] U.C.C. § 4A-209(b)(1).

[75] U.C.C. § 4A-405(a).

[76] U.C.C. § 4A-405(b).

[77] U.C.C. § 4A-209(b)(1)(ii).

[78] U.C.C. § 4A-209(b)(2). For payment of the sender's obligation, see U.C.C. § 4A-403(a).

[79] U.C.C. § 4A-403(a)(1).

or (ii) caused an account of the beneficiary's bank in another bank to be credited, "payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank [the beneficiary's bank in this case] learns of that fact".[80] Third, "at the opening of the next funds-transfer business day of the [beneficiary's] bank following the payment date of the order if, at that time, the amount of the ... [payment] order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later".[81] In any case, payment cannot occur before the payment order is received by the beneficiary bank;[82] and such order cannot be accepted by the beneficiary's bank until the payment date.[83]

3.2.1 [b] [ii] The Rules under Specific Payment Systems.

FedWire and CHIPS are the most commonly used electronic credit transfer systems in the United States. Finality of payment in both systems is regulated by their clearing rules. Funds transfers through FedWire is regulated by Regulation J., including finality of payment. Regulation J as a federal law preempts Article 4A as a state law. CHIPS Rules, as a private clearing system, may govern completion of payment of those funds effected through such system if the parties agreed to apply such rules. Provisions of Article 4A as to completion of payment may be varied by

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[80] U.C.C. § 4A-403(a)(1)(2).

[81] U.C.C. § 4A-209(b)(3).

[82] U.C.C. § 4A-209(c).

[83] U.C.C. § 4A-209(d).

agreement or a funds-transfer system rule.[84] Thus, completion of payment in these two systems is discussed below.

3.2.1 [b] [ii] [1] FedWire.

Subpart B of Regulation J governs the credit and debit transfer of funds using FedWire. As a federal regulation, it preempts all conflicting state laws and private contract provisions. § 210.62(A) of Regulation J provides that:[85]

> "a transfer item ... finally paid at the time the transfer is sent, or advice of credit for such item is sent or telephoned, to the transferee by a Federal Reserve Bank, whichever occurs first"

Thus, in FedWire transfer, payment is final either when the Federal Reserve Bank sends the payment order to the payee's bank or its agent - if the former is not a clearing bank - or when an advice of credit for such transfer is communicated to the transferee, being the payee's bank or its agent, whichever occurs first. Banks in the United States usually maintain settlement accounts with the Federal Reserve Bank, so they will be able to send and receive payment orders directly from this bank instead of employing another settlement bank. When a payer instructs his bank to transfer certain amount of money to a specific payee, his bank i.e the transferring bank, if it decides to use the FedWire system, will send a payment order to the payee's bank through their Federal Reserve Bank. The payment order will be carried out by debiting the transferring bank's account and crediting the payee's bank's account in the Federal Reserve Bank by the amount of the transfer. After doing so, the Federal Reserve Bank will send messages to both banks informing them of the adjustments of their accounts.

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[84] U.C.C. § 4A-501(a) provides that "[e]xcept as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the effected party". U.C.C. § 4A-501(b) provides, in part, that "[e]xcept as otherwise provided in this Article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effected even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule".

[85] 12 C.F.R. (1980).

Such a message, when sent to the payee's bank or its agent, is called an advice of credit. An advice of debit will also be sent to the transferring bank. However, the Federal Reserve Bank may send the transfer order to the payee's bank or its agent before it makes the adjustments of the accounts. Although this is not a credit or debit advice, banks assume that such funds can be drawn upon by the payee's bank. According to § 210-62(A) of Regulation J the payment is final whenever one of these messages is sent to the payee's bank or its agent. An advice of credit is not necessary to be in writing to produce such effect. It may be communicated by telephone. The time of sending the transfer item, or the advice of credit by the Federal Reserve Bank to the transferee is almost simultaneous with the time of receiving them. Except for the Reserve bank's right to apply the transferred funds to an obligation owed by the transferee, the funds are available for withdrawal by the transferee as of right on final payment.[86]

3.2.1 [b] [ii] [2] CHIPS.

Rule 2 of the CHIPS Rules, which is entitled "Storage and Sending of Payment Messages" provides, in part, that:

> "A payment message once sent by a participant cannot be deleted by such participant and constitutes the unconditional obligation of such participant to make payment in accordance with such payment message and these Rules."

Thus, payment *via* CHIPS is irrevocable and final when payment instruction is "sent" by the transferring bank to CHIPS computer. Irrevocability of payment in CHIPS transfers had its first judicial explanation in *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*[87] The United States Court of Appeals for the Second Circuit,

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[86] 12 C.F.R. § 210.36 (1985).

[87] 464 F. Supp. 989 (S.D.N.Y. 1979), aff'd, 609 F.2d 1047 (2nd Cir. 1979).

affirming the District Court for Southern District of New York, held that fund transfer *via* CHIPS was irrevocable and final when the payment message was "released" by the transferring bank. The Court of Appeals has reproduced Broderick J.'s (the trial judge) description of how the transfer took place, and at which moment it became final. His lordship said:[88]

> "Once the programming of the computer has been completed, the send form is sent to the appropriate area at the sending bank for approval. When a determination is made at the sending bank (Manufacturers) to make the payment, the form is returned to one of the computer terminal operators, reinserted in the computer and the release key is depressed. At that moment, the central computer at the Clearing House causes a credit ticket to be printed automatically at the terminal of the receiving bank (Chase) and a debit ticket to be printed at the terminal of the sending bank (Manufacturers). Further, the central computer automatically makes a permanent record of the transaction and debits the Clearing House account of the sending bank and credits the Clearing House account of the receiving bank. ... At the end of the day, the central computer correlates all of the day's transactions, nets out the debits and credits, and print out reports showing which banks owe money and which have money due them. That information is delivered to the New York Federal Reserve Bank the next business day and adjustments are made on the appropriate books of account."

Moore J. in the Appeal Court's decision noticed that the payment instructions carried out through CHIPS system reached the payee's bank almost as soon as they were released by the transferring bank's computer. The court relied, *inter alia*, on the banking practice that all the participant banks in CHIPS understood that funds transferred through this system could be drawn upon by the payee as soon as the electronic message was received by the payee's bank. It is irrelevant whether, or not, the payee's bank makes the required book keeping. The "final settling of the accounts" at the end of the day is "mere bookkeeping".[89] Book keeping is an internal

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[88] As quoted, in fn.1, by Moore J. in the Appeal Court's decision.

[89] The Appeal Court in *Delbrueck's* case, supra, at 1051.

administrative banking mechanism which should not affect the finality of payment.[90]

The same court has considered very recently the same question again. Citing *Delbrueck's* case, the court in *Banque Worms v. Bank of America International*,[91] found that the CHIPS transaction was final and irrevocable once the transfer had taken place.[92]

However, Rule 2 is subject to the provisions of paragraph B of Rule 13. Rule 13, which is entitled "Settlement" provides that in certain uncommon circumstances payment messages can be retained. This mainly occurs in cases of a failure of one of the participants in the payment process. A transferring bank may instruct the transfer of a large sum of money to a given payee relying that the payer will make funds available before settlement. If such payer fails to provide the required funds, the bank may accordingly fail to meet its obligations under CHIPS settlement rules. This means that other banks will not receive expected funds at the end of the netting process on a particular day. Rule 13 solves this problem by removing from the system all transactions carried out by the failed bank. Settlement, therefore, takes place without that bank. The CHIPS Committee is permitted to reset all payment in the system to a storage mode, at which time each participant would be given the opportunity to reconsider payments it made. Authority to such a step would rest exclusively with the CHIPS committee.[93]

Rule 13(B) reaffirms the general rule of finality of payment as quoted above in Rule 2. It also sets forth the finality of payment rule in those exceptional

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[90] See for an analysis of the case, Katz D., Irrevocability of Interbank Electronic Fund Transfers: Delbrueck & Co. v. Manufacturers Hanover Trust Co., [1984] Annual Review of Banking Law 263.

[91] 726 F. Supp. 940 (S.D.N.Y. 1989).

[92] Ibid, at 943.

[93] See Baker & Brandel (1988), supra, at para. 19.04[1].

circumstances of bank's failure. It provides that if the transactions of a given bank are removed from the system as a result of its failure, "such deletion will not relieve such participant of its unconditional obligation to make payment in accordance with its payment messages and these Rules".

3.2.2 EFTPOS Transactions.

Finality of payment in EFTPOS transactions depends mainly on two factors. First, whether the purchaser and the retailer bank in one bank or different banks. Second, whether the EFTPOS scheme used was an Off-Line or an On-Line one.

3.2.2 [a] On-Line EFTPOS Schemes.

In such schemes, the basic concept is the use of electronic communications to make a simultaneous unconditional transfer of funds from a purchaser's account to a retailer's account at the time of purchasing goods or services.[94] The retailer will, through its Optical Character Recognition scanner, identify the objects purchased, price them, total the price and request a transfer of funds from the purchaser's account to its account. This will be done by activating a communication connection between the retailer and its bank and the purchaser's bank. The purchaser, using an access device, e.g., debit card with P.I.N., will authorise the transfer from his account to the retailer's account.

Under these schemes, payment is made instantaneously. So payment is irrevocable at the time the purchaser encodes in his P.I.N authorising the transfer. This entry automatically debits the purchaser's bank account and credits the retailer's bank account.[95] If the purchaser has insufficient available funds in his account, the retailer

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[94] See Hawkland's UCC Series (1991), § 4-101:21.

[95] Baker & Brandel (1988), supra, at para. 1.03[5]

will be notified; and the embarrassed purchaser will be denied purchase. Finality of payment here does not differ from that in credit transfer cases. It is the purchaser's bank's decision to pay the retailer, and the retailer's bank's decision to accept the payment (which are taken simultaneously) that marks the finality of payment. Whether the purchaser and the retailer bank in one bank or different banks is irrelevant, since those banks are usually connected by an electronic switch which facilitates the communication and the transfer of funds between the banks.

3.2.2 [b] Off-Line EFTPOS Schemes.

In Off-Line EFTPOS schemes, the transfer of funds from the purchaser's account to the retailer's account is not immediate. The purchaser is issued with an access device, normally a debit card, by his bank. Participant retailers keep a card reader fixed in their premises. The purchaser hands his card to a cashier who must check its validity, e.g., expiry date e.t.c. The card will be "swiped" through the card reader attached to the retailer's terminal. The purchase details, including the price, will be entered. A duplicate receipt will be issued detailing the retailer outlet, date, time and amount of the transaction. The purchaser will sign the receipt with the cashier verifying the signature against the specimen on the card. The receipt will be handed over to the customer with a copy being retained. The details of the sale will be stored in the terminal memory. The stored details of the transaction are subsequently passed on either on tape or *via* telecommunications links to the bank concerned for processing.

Where the purchaser and the retailer maintain accounts with the same bank, one suggests that payment should be final at the time the bank decides to adjust such accounts by the appropriate debiting and crediting. Book-keeping should be seen as

an internal operation. This is an in-house transfer and the same rules under credit transfer should be applied. Where the purchaser and the retailer bank with different banks, payment is complete when the purchaser's bank accepts the retailer's bank's demand for payment or reimbursement for the purchaser's valid EFTPOS transactions. In particular, the processing of the stored sales' details by the retailer's bank should not be considered as a completion of payment. Where the retailer's bank guarantee payment to its customer, i.e. the retailer, payment to the retailer is completed when the bank decides to honour such obligation. However, payment is completed between the purchaser's bank and the retailer's bank when the purchaser's bank accepts the demand for reimbursement. The latter time should probably be considered the time of payment between the purchaser and the retailer since payment to the retailer under its bank's guarantee is a separate payment made under a separate arrangement. The guarantee of payment is a contractual obligation between the retailer and its bank, and is not binding on the purchaser or his bank unless agreed to. This stems from the separate bi-contractual relationships between the parties to EFTPOS transactions.

3.3 The Scope of Banks' Liability for Failure to Stop an EFT.

Banks' liability for failure to stop an EFT will be discussed under credit transfer and EFTPOS transactions. Stop payment issue does not arise in ATM cash withdrawal transactions since there is no third party beneficiary from whom payment is to be withheld. Moreover, cash withdrawal transactions initiated at ATM's are instantaneous. However, a customer may cancel his instructions to withdraw cash from an ATM by pressing the "cancel" transaction button to abort the transaction. Up to that moment, a customer may stop the transaction. In the case of a deposit made through an ATM, stop payment is not of a major concern since a depositor may

withdraw the credit shortly after it has been made to the account.[96]

3.3.1 Electronic Credit Transfer Transactions.

3.3.1 [a] Under U.K. Law.

Since an EFT order is a mandate to a bank to debit, credit, or authorise the debit or credit of an account, it is, in principle, open to be countermanded. This right was traditionally given to a customer who draws a cheque on his bank. Section 75 of BEA 1882 provides that:

> "The duty and authority of a banker to pay a cheque drawn on him by his customer are determined by (1) countermand of payment ...".

Although this section is inapplicable to EFT orders, customers under EFT transaction are entitled to countermand their payment orders on the same reasoning. That is because EFT orders are, like cheques, an authorisation or a mandate to banks to pay a sum of money to a third party. However, the introduction of technology in EFT payment systems makes it impractical (or some times impossible) to countermand a payment order.[97]

To be effective, countermand instruction must be brought to the conscious knowledge of the banker; constructive countermand is not sufficient in such commercial matter.[98] It probably should be served on the branch where the payment order is originally given.[99] Stop payment order should not be ambiguous.[100] It must

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[96] Subject to funds availability rules. In U.K., see § 10.0 of the Code of Good Banking (1992). In U.S.A., see Expedited Funds Availability Act, 12 U.S.C. §§ 4001-4010; and Regulation CC, 12 C.F.R. Part 229. See Norris R.H., Expedited Funds Availability and ATMs [1989] 44 The Business Lawyer 1120 in Goldstein D.B. (ed.), Consumer Financial Services Survey: Electronic Fund Transfers [1989] The Business Lawyer 1081. See generally, Huber S., The Competitive Equality Banking Act of 1987: An Analysis and Critical Commentary, [1988] 105 Banking L.J. 284; and for the same author, Bank Officer's Handbook of Government Regulation (2nd ed. 1989), supra, at para. 19.02.

[97] See the Review Committee Report, supra, at para. 12.07.

[98] By analogy to countermand of cheques. See in case of cheques, *Curtice v. London City and Midland Bank Ltd* [1908] 1 K.B. 293.

[99] By analogy with cheques. A stop payment delivered to one branch of a bank is not an effective stop on a cheque drawn on another branch of the same bank. See *London Provincial and South-Western Bank Ltd v. Buszard* (1918) 35 T.L.R. 142. See also Wallace and McNeil's Banking Law, (9th ed. 1986), at 134. However, since all branches of the same bank are usually connected by a computer network, there should be no need to compel a customer to serve his stop transfer instruction on his

contain sufficient information to help the bank identify the payment order to be stopped.

Under common law, a mandate given by a customer to his bank is revocable until the bank carries out such mandate or irrevocably enters into a commitment to carry out such mandate, so that it would incur liability to a third party if the mandate is revoked.[101] However, banks are entitled to a reasonable time to act upon customer's instruction to stop payment from being made.[102] Such reasonable time is determined by banking practice, and the facts of each case. However, one assumes that in the light of the use of modern technology, this time would be a short one. In certain payment system, stop payment right is affected by the complication posed by sophisticated technology used in EFT systems. The stop payment time period may be totally eliminated by the mechanics of the EFT systems. In On-Line payment systems, for example, no attempt is made to affirmatively eliminate the stop payment right, but that result is merely a by-product of the system efficiency and design.[103]

For example, payment is final in CHAPS transfer when CHAPS order is "processed" and a "logical Acknowledgement" of receiving the order is sent back by the payee's bank. The transferring bank must be given reasonable time to act upon the stop payment order. Thus, although payment is not made until the payment instruction

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branch. Any branch receiving such instruction may pass it to the central computer and place a hold on such transfer if not executed. Alternativelly, it may pass such instruction after identifying the instructor to the branch concerned.

[100] Generally, if the customer's instructions are ambiguous, e.g., to the amount to be transferred, the name of the payee, or the account to which payment is to be made, the bank is protected if it carries out the instructions in good faith and on a reasonable interpretation of such instructions. In *Westminster Bank Ltd. v. Hilton* (1926) 43 T.L.R. 124, it was said that if principal gives an order to an agent in such uncertain terms as to be susceptible of two different meanings and the agent, bona fide adopts one of them and acts upon it, the principal cannot repudiate the act as unauthorised because he in fact meant something different. See also Finlayson R., Law Lectures to Bankers, (1939), where it is said as to cheques, at 49, that "[s]o far as the paying banker's is concerned, he must obey his customer's instructions, provided they be clear and definite."

[101] e.g., *Williams v. Everett* (1811) 14 East 582; *Morrell v. Wootton* (1852) 16 Beav 197; and *The Laconia* [1976] Q.B. 835.

[102] See Mittelsteadt, Thomas, "The Stop Payment Right in an Electronic Payment Environment: An Analysis of the Transition Problems Involved when Integrating a Traditional Right into New Value Transfer Systems", [1982] 17 New England L. Rev. 355, 408.

[103] Mittelsteadt, supra, at 408.

is transmitted through the payer's bank's CHAPS gateway and acknowledged by the payee's bank, the payer's bank cannot amend or countermand the payment once the payment order is transmitted through the gateway.[104] It is, thus, misleading to say that the bank's customer is entitled to stop his payment order up to the time of payment in CHAPS transfers.[105] There is probably one case whereby the transferring bank may stop the payment order even after its release to the CHAPS computer. That is when the payee's bank fails to acknowledge the payment order sent to it *via* the system. Such failure by the payee's bank to give acknowledgement by the end of the day results in the payment automatically being cancelled by CHAPS computer. Unless the transferring bank sends another payment order which should be acknowledged by the payee's bank no payment will be made. As such the transferring bank by refraining from issuing new payment order is practically stoping the payment which is originally intended to be made by the first payment order.

What is, then, the liability of a bank that fails to act upon a properly given instruction to stop an electronic credit transfer? There is no special rule regarding banks liability for failure to make an EFT in comparison with other payment systems. A bank that overlooks or ignores a stop payment order by carrying out the transfer does so without mandate from its customer.[106] Hence, it cannot debit its customer's account unless the customer ratifies such transfer.[107] However, if such transfer confers a benefit on the transferring bank's customer, the bank should be subrogated to the payee's rights against its customer, the payer. It should be entitled to rely on

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[104] Penn G.A., Shea A.M., & Arora A., The Law Relating to Domestic Banking, 1987, at 297; and Arora A., Electronic Fund Transfers and the Law [1986] 7 The Company Lawyer 195, at 201.

[105] See Goode R. (ed.), Electronic Banking, The Legal Implication, supra, at 78 where it is said that CHAPS order may be revoked up to the time of its release to the transferring bank's CHAPS gateway.

[106] See in relation to CHAPS transfers, Goode R. (ed.), Electronic Banking, The Legal Implications, supra, at 78-79.

[107] Encyclopedia of Banking Law, Vol.I, at para. 256.

these rights when the customer disputes the payment involved to the extent of the benefit conferred by the transfer.[108] If a bank by mistake overlooks a stop payment order and transfers funds to the payee despite such order, it can recover such funds as money paid under a mistake of fact, unless the payee has changed its position in good faith to its detriment.[109]

3.3.1 [b] Under U.S.A. Law.

3.3.1 [b] [i] Common Law Rules.

The right to stop payment made its appearance in the United States in 1888 in *German National Bank v. Farmers' Deposit Bank*[110] and has been, since then, a settled common law rule.[111] The court stated its opinion on the right to stop a payment of a cheque and the effect of the bank's failure to honour such order without citing an authority by saying:[112]

> "[N]o one to this day questions the right of the drawer of a check to stop the payment thereof. This is usually done by notice to the bank upon which the check is drawn. If the bank pays after such notice it does so at its peril ... The right of payment ceases of course with actual payment."[113]

It was, however, common banking practice to exclude liability for paying over

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[108] By analogy with the paying bank's position in cheque cases. See Wright J. in *Liggett B. (Liverpool) Ltd. v. Barclays Bank Ltd.* [1928] 1 K.B. 48, at 60 where his lordship said:
"[T]he general principle of equity, that those who pay legitimate demands which they are in some way or other bound to meet, and have had the benefit of other people's money advanced to them for that purpose, shall not retain that benefit so as, in substance, to make those other people pay their debts."
See also generally, Ryder F.R., Forgery on a Drawer's Cheque, Gilbart Lectures (1972), at 23-24; and Ellinger, Modern Banking Law, at 300-301.

[109] See in Scotland, *Credit Lyonnais v. Stevenson* (1901) 9 S.L.T. 93 (repetition) and in England, *Barclays Bank Ltd. v. W.J. Simms, Son and Cooke (Southern) Ltd.*, [1979] 3 All E.R. 522 (money paid by mistake of fact). See for more discussion on recovery of money paid under a mistake of fact, chapter four, para. 4.2.2. [a] [iii].

[110] 118 Pa. St. 294, 12 A. 303 (1888).

[111] See Pape Ch., Stop Payment in The Uniform Commercial Code, [1983] 9 Rutgers Computer & Technology Law Journal 535, at 357.

[112] As quoted by Pape, ibid, at 313.

[113] See also *Universal C.I.T. Credit Corp. v. Guaranty Bank & Trust Co.*, 161 F. Supp. 790, 791 (D.Mass. 1958) ("Since a check is merely an order to a bank to make a payment in the manner set forth, the customer has the right to revoke such order before it is carried out.").

a stop payment order by inadvertence or oversight.[114] This practice ceased to exist now. Although Article 4's provisions are variable be agreement, "no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care".[115] Courts have interpreted that as barring the traditional exclusion clauses.[116] Banks, however, were given the right of subrogation.[117] The common law rule of stop payment was recognised by the Uniform Commercial Code. Under U.C.C. § 4-403 a bank must honour its customer's instructions, if timely received,[118] to stop payment on a cheque not yet certified or paid.[119] Oral and written stop payment orders are valid.[120] However, since the direct application of Article 3 and Article 4 of the U.C.C. to EFT transactions has been ruled out by courts,[121] stop payment rules under these Articles are not applicable.

Nevertheless, American Courts have recognised the right to stop or reverse a payment in EFT transactions. In *Mellon Bank, N.A., v. Securities Settlement Corp.*,[122] the defendants instructed the plaintiff to wire transfer $113,080.50 to a given payee. Within several hours after Mellon Bank had sent the wire, the defendant instructed it

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[114] Baker & Brandel (1988), supra, para.12.02[3][c]. See Note, Exculpation Contracts in Stop-Payment Orders [1952] 6 Rutgers L. Rev. 577, at 578-79 (discussing the effectiveness of release clauses to eliminate bank liability for failure to honour stop payment under pre-UCC law).

[115] U.C.C. § 4-103(1).

[116] Baker & Brandel (1988), supra, at para. 12.02[3][c] citing Utah Op. Att'y Gen., No. 66-011; 3 U.C.C. Rep. 115 (1966).

[117] U.C.C. § 4-407 (The right of subrogation on payment over a stop payment order is given to banks to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank involved by reason of its payment of the item).

[118] The customer's order to stop payment must be received at such a time and in such a manner as to afford the bank reasonable opportunity to act.

[119] See U.C.C. § 4-303 (stop payment of a cheque is terminated if one of the following occurs: (i)certification; (ii)paying the item in cash; (iii)making final settlement for the item; and (iv)completion of the process of posting).

[120] Oral stop payment orders are valid for 14 days unless confirmed in writing within that period. Written stop payment orders are valid for six months unless renewed in writing.

[121] See *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 609 F.2d 1047, 1051 (2nd Cir. 1979); *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982) (the language of Article 4A could be stretched to include EFT, but EFT was not in the contemplation of the draftmen); *Control Coordinators, Inc. v. Morgan Guarantee Trust Co.*, 629 Misc. 2d 804, 494 N.Y.S.2d 602 (N.Y. Sup. Ct. 1985); *Walker v. Texas Commerce Bank, N.A.*, 635 F. Supp. 678 (S.D. Tex. 1986); and *Bradford Trust Co. v. Texas American Bank*, 790 F.2d 407 (5th Cir. 1986).

[122] 710 F.Supp. 991; 8 U.C.C. Rep. Serv. 2d 597 (D.N.J., 1989).

to stop the transfer. The funds went through, however, to the payee's account. Since the defendant had not paid for the transfer in advance, and later refused to pay arguing that it instructed the plaintiff to stop the transfer, Mellon Bank filed a suit seeking reimbursement for the funds that it had transferred. The court held that Mellon Bank was in breach of its contract of transfer since it did not use ordinary care to stop the payment. The defendant had a right to stop the wire transfer upon instructions, and Mellon Bank "was under a corresponding duty to use ordinary care in handling [the defendants'] request [of stop payment]".[123] The court held that Mellon Bank was given sufficient time to act upon the stop payment order, but it negligently sent an order to its correspondent to cancel the payment which contains error in identifying the original order. The court concluded that "[n]o reasonable fact finder could conclude that Mellon acted with ordinary care regarding the cancellation."[124] It added that "Mellon's error easily ranks with those considered sufficient to constitute a breach of a bank's duty of ordinary care. The record demonstrates that Mellon inaccurately carried out [the defendants'] instructions and that, even though it was twice given notice of [the correspondent's] corresponding inability to cancel the wire, Mellon failed to take prompt remedial action."[125] One of the reasons for holding Mellon Bank in breach of its ordinary care was its failure to follow its own internal guidelines.[126] The failure to carry out a valid stop payment order deprives the bank of the right to debit its customer by the amount transferred contrary to the stop payment order.

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[123] *Melon Bank, N.A., v. Securities Settlement Corp.*, 710 F.Supp. 991, 994 (D.N.J., 1989) (where the court identified the lack of ordinary care with negligence).

[124] Ibid, at 996.

[125] Ibid, at 997.

[126] Ibid, at 996

Banks' liability for failure to countermand an electronic credit transfer ceases when such transfer becomes final. It was held in *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*,[127] that a transferring bank was not liable for failure to stop a CHIPS transfer after it became final. This is because the title to funds has passed at that time from the transferring bank's customer to the beneficiary's bank's customer. The transferring bank has no longer a power over the funds. In *Shawmut Worcester County Bank v. First American Bank & Trust*,[128] a transferring bank brought an action against the beneficiary's bank, challenging beneficiary's bank's failure to "reverse" an electronic funds transfer made *via* FedWire. The United States District Court of Massachusetts decided that the beneficiary's bank was not liable for such failure since the instructions to reverse the transfer were given to it after the completion of payment. In explaining the procedure and the time limits for stoping a transfer *via* FedWire the court said:

> "Under Regulation J, the transferor bank, in making a request for a transfer, authorizes its Reserve Bank to debit its account for the amount of funds to be transferred and further authorizes the transferee institution's Reserve Bank to credit the same amount to the transferee bank. Any request by a transferor to interrupt the carrying out of a funds transfer must be made to the transferee's Reserve Bank, not to the transferee. Even then, that Reserve Bank is not obliged to accommodate the transferor, but may do so if the request is made in time to give the Reserve Bank a reasonable opportunity to comply ... that is, before it makes final payment to the transferee receiving bank."[129]

3.3.1 [b] [i] Statutory Law Rules.

3.3.1 [b] [i] [1] Consumer-based Transactions.

The EFTA provides consumers with the right to stop payment of a

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[127] 609 F.2d 1047 (2nd Cir. 1979).

[128] 731 F.Supp. 57, 11 U.C.C. Rep. Serv. 2d 417 (D.Mass. 1990).

[129] Ibid, at 60-61. See also 12 C.F.R. § 210.35(a).

"preauthorized electronic fund transfer".[130] The term "preauthorized electronic fund transfer" means "an electronic fund transfer authorized in advance to recur at substantially regular intervals".[131] Thus a consumer who arranged with his bank a preauthorised credit transfer has the right under § 1693e(a) of EFTA to instruct his bank to stop such credit transfer. The stop payment order must meet certain requirements. First; the credit transfer that the customer intends to stop must be a "preauthorized" electronic credit transfer. That is an electronic credit transfer[132] which was "authorized in advance to recur at substantially regular intervals".[133] It was held in *Kashanchi v. Texas Commerce Medical Bank, N.A.*,[134] that a credit transfer initiated by a telephone conversation between an employee of the bank and another person, which was not pre-arranged in advance to recur at a substantially regular intervals, did not satisfy the requirements of the definition of "preauthorized electronic fund transfer". This means that since such transfer is not governed by EFTA, the rules of stop payment, and banks' liability for failure to effect such an order, are not applicable. *Kashanchi* case was followed recently by *Abyaneh v. Merchant Bank, North.*[135] Second, an oral or a written stop payment order should be notified to the bank at any time up to three business days preceding the scheduled

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[130] 15 U.S.C. § 1693e(a).

[131] 15 U.S.C. § 1693a(9).

[132] The electronic credit transfer as an electronic fund transfer must meet the definition of the term "electronic fund transfer" under § 1693a(6). See *Wachter v. Denver National Bank*, 751 F.Supp. 906, 908 (D.C. Col. 1990) ("two requirements must be met to qualify a transaction as an electronic fund transfer: (1) it must be initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape, and (2) it must order, instruct or authorize a financial institution to debit or credit an account."); *Inez Spain v. Union Trust*, 674 F.Supp. 1496, at 1500 (D.Conn. 1987) ("the essential difference between an electronic fund transfer and [a non-electronic fund transfer is that the] former requires no personal contact, no personal decision making; [while] the latter require[s] a personal determination as to the propriety of the action to be taken and a personal effort to execute such action. Stated another way, the difference is between an electronic terminal which takes the place of a face-to-face personal banking transaction and the electronic terminal of a computer which merely assisted the financial institution in its internal processing of the transaction."). It must be noted, however, that it is the transfer that should be electronic but not the preauthorisation to the bank. On the contrary, the preauthorisation of the transfer must be in writing. See 15 U.S.C. § 1693e(a).

[133] 15 U.S.C. § 1693a(9).

[134] 703 F.2d 936 (5th Cir. 1983).

[135] 670 F. Supp. 1298 (M.D. Pa. 1987)

date of such transfer.[136] Where the notification was made orally, the bank may require written confirmation to be provided to it within fourteen days of the oral notification. The bank should have advised the consumer, at the time when oral notification was made, that it must confirm such notification in writing and provided him with the address to which such confirmation should be sent.[137] If written confirmation is required by the bank, the oral stop payment order ceases to be binding on the bank fourteen days after it has been made.[138] This means that such failure by the consumer will release the bank from any obligation to continue to refuse payment on the transfer that the consumer asked the bank to cancel.[139] Identifying a resubmitted payment order is almost an impossible task in electronic fund transfer transactions. This is solved by allowing the consumer the option either of suspending all payments to the designated payee until further notice from the consumer, or stopping a given specific payment order. Electing the second option permits the bank to debit the consumer's account for any subsequently received payment orders submitted by the same payee without fear of liability.[140]

A bank that fails to act on a consumer's stop payment order as described above is liable for "all damages proximately caused" by such failure if such failure was not a result of a *bona fide* error.[141] This include intentional bank's failure to act upon such stop payment orders. If such failure was not intentional and which resulted from a *bona fide* error, the bank will be liable for "actual damages proved".[142] In the latter

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[136] 15 U.S.C. § 1693e(a).

[137] Ibid.

[138] Regulation E, 12 C.F.R. § 205.10(c).

[139] See the Federal Reserve Board Comment on 12 C.F.R. § 205.10(c) at 44 Fed. Reg. 59,467 (1979).

[140] 45 Fed. Reg. 66,349 et seq. (1980) at Question 10-22. See Brandel R. & Geary A., Electronic Fund Transfers [1981] 36 The Business Lawyer 1219, 1227.

[141] 15 U.S.C. § 1693h(a)(3).

[142] 15 U.S.C. § 1693h(c).

case, the bank is still liable for "actual damages proved" notwithstanding the maintenance of procedures reasonably adapted to avoid such *bona fide* failure to stop the payment order.[143] EFTA is silent where the bank's failure to stop a preauthorised credit transfer was a result of an act of God or other circumstances beyond the bank's control. Nor it provides for what liability the bank should incur if it exercised reasonable care to stop the transfer, but nevertheless failed. Moreover, there is no provision on bank's liability if its failure to stop the credit transfer was caused by a technical malfunction known to the consumer at the time such transfer was initiated. EFTA, however, provides that where a bank completely fails to make a credit transfer, or fails to make a timeous transfer, it is relieved from liability if such failure was caused by an act of God or other circumstances beyond its control, or by a technical malfunction under certain circumstances.[144]

One suggests that since the Congress did not excuse banks from liability for their failure to stop a "preauthorized" credit transfer if such failure was a result of an act of God or technical malfunction, banks should be liable for such failure. If the Congress intended so, it could have done so expressly as in the case of banks' failure to make an EFT in the correct amount and in the timely manner.[145] This is clear from the language of § 1693h. This section is divided into three subsections. Subsection (a) provides for banks' liability for their "action or failure to act proximately causing damages". That is for intentional failure. Subsection (a) is divided into another three subsections. Subsection (a)(1) and (2) deal with banks' liability for failure

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[143] 15 U.S.C. § 1693h(c).

[144] 15 U.S.C. § 1693h(b).

[145] 15 U.S.C. § 1693h(a)(1) and (2).

to stop payment of a "preauthorized" EFT. An intentional banks' failure under any subsection of subsection (a) exposes the bank involved to the payment of "all damages proximately caused" by such failure. However, when such failure is caused by an act of God or malfunction, Subsection (b) provides that banks are relieved from liability only for failures under subsection (a)(1) and (2); that is intentional failure to make an EFT. Subsection (a)(3) which deals with failure to stop a "preauthorized" EFT is omitted. One suggests that such omission was deliberate. The Congress did not exclude banks' failure to stop a "preauthorized" EFT from subsection (c). Under that subsection, if the banks' failure to make an EFT or to stop a "preauthorized" EFT was not intentional and resulted from a bona fide error, the bank involved is liable for "actual damages proved" rather than "all damages proximately caused". Thus, the construction of § 1693h supports the argument that a bank that fails to stop a "preauthorized" EFT which caused by an act of God or other circumstances beyond the bank's control, or by a technical malfunction, is not relieved from liability. Courts have supported such statutory construction. It was held in *Kashanchi v. Texas Commerce Medical Bank*,[146] that "[i]t is well-established principle of statutory construction that where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."[147] Thus, banks are not exempted from liability for failure to stop payment of a

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[146] 703 F.2d 936 (5th Cir. 1983).

[147] Ibid, at 939. The court cited and quoted from *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972) (where it was said, at 722, that "words in statutes should not be discarded as 'meaningless' and 'surplusage' when Congress specifically and expressly included them, particularly where the words are excluded in other sections of the same act." *Kashanchi* case was affirmed on this point by *Abyaneh v. Merchant Bank, North*, 670 F.Supp. 1298, at 1300 (M.D. Pa. 1987); *Inez Spain v. Union Trust*, 674 F.Supp 1496, at 1499 (D.Conn. 1987). The above cases have adopted such principle of statutory construction in interpreting some of EFTA's terms. Moreover, courts have adopted this principle in other statutes. See *Tricia v. Edwin Meese*, 755 F.Supp. 1375, at 1385-1386 (E.D. Louisiana 1991) following the statutory construction approach adopted in *Kashanchi* case.

"preauthorized" credit transfer if such failure was caused by an act of God or other circumstances beyond the banks' control, nor it is exempted if such failure was caused by a technical malfunction. Since no such exemption is found, a bank is generally liable for "all damages proximately caused" by such failure.[148]

The EFTA includes no subrogation provision as does U.C.C. § 4-407. It is suggested that to permit subrogation in the cheque collection process and not provide for it in the context of electronic funds transfers is unreasonable.[149] A bank that transfers funds contrary to a stop payment order and does not debit its customer's account by the transferred amount should be subrogated to the rights of the payee.

Banks are not only liable for their failure to stop a "preauthorized" credit transfer, but also under an obligation to disclose to its customers, "in readily understandable language", the fact that they have the right to stop payment of a "preauthorized" electronic transfer, and the procedure to initiate such stop payment order.[150] Their failure to do so exposes them to civil liability, under which a bank is liable to "actual damages sustained", statutory damages, the costs of the successful action together with a reasonable attorney's fee as determined by the court.[151]

The rules of stop payment in consumer-based transactions as discussed above are not only limited to preauthorised credit transfer transactions but also include preauthorised debit transfer transactions.[152] like any debit transfer, it is the payee who initiates the demand to transfer funds from his debtor's (the payer's) account to

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[148] 15 U.S.C. § 1693h(a). See also Baker & Brandel (1988), para. 16.03[3][a].

[149] Alces, P.A., Toward a Jurisprudence of Bank-Customer Relations, [1986] 32 The Wayne L. Rev. 1279, at 1294-1295.

[150] 15 U.S.C. § 1693c(5). See also Regulation E, 12 C.F.R. § 205.7(a)(7) and § 205.10(c).

[151] 15 U.S.C. § 1693m.

[152] See also Baker & Brandel (1988), supra, para. 16.02[2].

his account.[153] The Federal Reserve Board has amended the Official Staff Commentary to Regulation E to address the consumer's right to stop a preauthorised debit initiated by the payee, who has authority to do so by the consumer. The amendment states that whenever the consumer instructs his bank that he is revoking his authorisation to a given payee to debit his account electronically, the bank must comply with the instructions and stop accepting all future debits transmitted by that payee. The bank must not, in particular, wait for the payee to cease the initiation of preauthorised debits.[154] However, the three business days notification under preauthorised credit transfer is also applicable in this case.[155]

3.3.1 [b] [ii] [2] Commercially-based Transactions.

Article 4A knows what is called "cancellation and amendment of payment order" rather than the traditional terminology of "stop payment". Cancellation of a payment order means in fact stopping the payment from getting through to the payee. Amendment of a payment order under the provisions of Article 4A means "cancellation of the original payment order at the time of amendment and issue of a new payment order in the amended form at the same time".[156] This also means stopping the original payment order, and issue a new payment order at the same time.

Cancellations and amendments of payment orders may be transmitted to a receiving bank orally, electronically, or in writing.[157] If a "security procedure"[158]

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[153] The consumer's authorisation to his creditor, the payee, should be in "writing". The Federal Reserve Board ruled that a tape recording of a telephone conversation between the consumer and the payee does not meet the written requirement of authorisation under EFTA, even if the payee, relying on such authorisation, signed a written authorisation to the bank, on behalf of the consumer. See 51 Fed. Reg. 13,484 (1986); 12 C.F.R. § 205 Supp. II, Ques.10-18.6(1986); 12 C.F.R. § 205.10(b)(1986).

[154] 55 Fed. Reg. 12,635 (1990); Regulation E, 12 C.F.R. § 205 Supp. II, Ques. 10-19.5 (1991). See Baker & Brandel (1988), Supp.2 (1991), para. 16.02[2][c].

[155] 15 U.S.C. § 1693e(a).

[156] U.C.C. § 4A-211(e).

[157] U.C.C. § 4A-211(a).

[158] See for the definition of such term, U.C.C. § 4A-201.

is used to verify payment orders between a bank and its sender, any order to cancel or amend a payment order is not effective unless it is verified pursuant to that security procedure or the bank agrees to the cancellation or amendment order.[159]

Article 4A distinguishes between a sender's right to cancel or amend the transfer before and after acceptance of the payment order. These two situations are discussed separately.

i. Cancellation or Amendment Before Acceptance.

The general rule adopted by § 4A-211(b) is that a sender of a payment order has a unilateral right to cancel or amend its payment order as long as a communication or notice of cancellation or amendment "is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order." Thus, acceptance of a payment order is the end point at which a sender of a payment order can no longer unilaterally cancel or amend its payment order. A payment order is accepted by a receiving bank that is not a beneficiary's bank when it "executes" the order.[160] U.C.C. § 4A-209(b) setforth the rules of acceptance of a payment order by a beneficiary's bank. It is the bank's acceptance of the payment order that triggers parties' obligations under the funds transfer transaction. But when a sender effectively cancels a payment order prior to acceptance, the payment order can no longer be accepted,[161] and the sender will not be liable to pay the payment order.[162]

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[159] U.C.C. § 4A-211(a). See for a detailed discussion of the effect of the use of a "security procedure" on liability of banks, chapter five, para. 5.4 [b] [ii] [2].

[160] U.C.C. § 4A-301 (Execution and Execution Date).

[161] U.C.C. § 4A-211(e) ("A cancelled payment order cannot be accepted").

[162] Cowie R., (Note), Cancellation of Wire Transfers Under Article 4A of the Uniform Commercial Code: *Delbrueck & Co. v. Manufacturers Hanover Trust Co.* Revisited, [1992] 70 Tex. L. Rev. 739, at 749 (where it is argued that although Article 4A does not expressly state that a sender is not obligated to pay for a payment order that has not been accepted, this result must follow from the negative implication of § 4A-402(c), which states that "acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order." Further support to this argument can be found in the Official

According to U.C.C. § 4A-106, the time which is accepted as affording the bank a reasonable opportunity to act on a cancellation or amendment order is determined by the rules applicable to receipt of a notice stated in U.C.C. § 1-201(27).[163] However, a receiving bank may fix a cut-off time on a particular category of cancellation or amendment orders. Such cut-off times may apply to a certain category of senders.[164] Cancellation or amendment orders received after the close of a funds-transfer business day[165] or after the appropriate cut-off time on a funds-transfer business day may be treated by the receiving bank as received at the opening of the next funds-transfer business day.[166] The traditional "mailbox" rule is not applicable in this case, since under Article 4A provisions such cancellation or amendment order must be "received" by the receiving bank within the allowed time.[167]

However, just as a drawee bank will sometimes pay despite a valid stop payment order on a cheque, an originator's bank may sometimes carry out a payment order even though the originator effectively cancelled the order. The originator is entitled in such a case to recover the amount of the transfer from the originator's

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Comment of § 4A-402 which states that "[a] payment order is not like a negotiable instrument on which the drawer or maker has liability. Acceptance of the order by the receiving bank creates an obligation of the sender to pay the receiving bank the amount of the order. That is the extent of the sender's liability to the receiving bank and no other person has any rights against the sender with respect to the sender's order."

[163] U.C.C. § 1-201(27) provides:
"Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information."

[164] U.C.C. § 4A-106(a).

[165] Defined in U.C.C. § 4A-105(4).

[166] U.C.C. § 4A-106(a). See also U.C.C. § 4A-106(b).

[167] Ibid.

bank.[168] Interest is also payable on the refundable amount.[169] The originator's bank may recover from the beneficiary to the extent allowed by the law of mistake and restitution.[170]

Cancellation of payment orders before acceptance may occur by operation of law. § 4A-211(d) considers that all stale payment orders are cancelled. Payment orders are normally expected to be accepted by the receiving bank at the execution or payment date. Unaccepted payment order is cancelled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution or the payment date of the order.[171] This will prevent an unexpected delayed acceptance.[172]

ii. Cancellation and Amendment After Acceptance.

Article 4A allows cancellation or amendment of a payment order after acceptance of such order only if the receiving bank agrees to the cancellation or amendment, or a funds-transfer system rule allows that without the agreement of the bank.[173] However, even if the receiving bank agrees to such cancellation or amendment, it is only effective in certain circumstances. This depends on whether, or not, the receiving bank involved is a beneficiary's bank. First, If the payment order is accepted by a receiving bank that is not a beneficiary's bank, cancellation or amendment of such order is not effective unless a conforming cancellation or

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[168] U.C.C. § 4A-402(d) ("If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay.")

[169] Ibid.

[170] Although not expressly stated in § 4A-211, this can be concluded by drawing an analogy with the case of erroneous transfer of a greater amount (§ 4A-303(a)). The New York Court of Appeals in *Banque Worms v. Bank America International*, 570 N.E.2d 189, 196 (N.Y. 1991) recently cited § 4A-303(a) as its basis for limiting an originator's bank's recovery to the amount allowed by the law of mistake and restitution when the originator's bank erroneously executed a payment order that the originator had effectively cancelled.

[171] U.C.C. § 4A-211(d).

[172] The Official Comment 7 of U.C.C. § 4A-211.

[173] U.C.C. § 4A-211(c).

amendment of the payment order issued by the receiving bank is also made.[174] Second, if a payment order is accepted by a beneficiary's bank, cancellation or amendment is not effective unless the order sought to be cancelled or amended was issued in execution of an unauthorised payment order,[175] or because of a mistake by a sender in the funds transfer.[176] To be effective, such mistake must result in the issuance of a payment order that (i) is a duplicate of a payment order previously issued order by the sender; (ii) instructs payment to a beneficiary not entitled to receive payment from the originator; or (iii) instructs payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. Although a fund transfer system rule allows cancellation or amendment of a payment order without the acceptance of the receiving bank involved,[177] this rule is not effective if it conflicts with the beneficiary's bank rule[178] under the circumstances discussed above.[179]

U.C.C. § 4A-211(e) provides that "[i]f an accepted payment order is cancelled, the acceptance is nullified and no person has any right or obligation based on the acceptance." That means if a properly cancelled payment order is, nevertheless, carried out contrary to the cancellation instruction, each receiving bank must repay its sender the amount of the transfer paid. The beneficiary's bank, at the end of the payment process, "is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution."[180] However,

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[174] U.C.C. § 4A-211(c)(1).

[175] See U.C.C. § 4A-202 (Authorised and Verified Payment Orders).

[176] U.C.C. § 4A-211(c)(2).

[177] U.C.C. § 4A-211(c).

[178] U.C.C. § 4A-211(c)(2).

[179] U.C.C. § 4A-211(h).

[180] U.C.C. § 4A-211(c)(2).

since a bank that accepts a cancellation or amendment instructions after acceptance of a payment order does so as an accommodation to the sender it should not incur any loss and expenses in doing so.[181]

Article 4A failed to address the issue of subrogation. It is unclear, for example, whether an originator's bank that executes a properly cancelled payment order would be subrogated to the rights of the beneficiary against the originator. One argument is that since Article 4A is a deliberate "closed system" of assigning loss, resort to principles of law and equity is not appropriate to create rights, duties and liabilities.[182] The drafters of Article 4A would have included a provision similar to § 4-407 rather than rely on broadly stated common law principles if they had believed that it was necessary to include subrogation rights in the loss allocation system of Article 4A.[183] However, another argument in favour of subrogation is the provisions of the Uniform Commercial Code itself. § 1-103 states that the general principles of law and equity supplement the U.C.C. provisions "unless displaced by particular provisions". No particular provisions of Article 4A displace common law subrogation principles. It is argued that the provision implying that an originator is not obligated to pay the originator's bank if the order is properly cancelled[184] affects only the originator's liability on the payment order, not its liability on the underlying debt.[185] Article 4A does not govern the parties' rights and obligations with respect to the underlying debt, while the common law rules do. The rights of the parties with respect

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[181] U.C.C. § 4A-211(f).

[182] See the Official Comment of U.C.C. § 4A-102; and Cowie R., Note, Cancellation of Wire Transfers Under Article 4A of the Uniform Commercial Code: Delbrueck & Co. v. Manufacturers Hanover Trust Co. Revisited, [1992] 70 Tex. L. Rev. 739 at 762.

[183] U.C.C. § 4-407 expressly subrogates a bank that pays over a countermand cheque to the rights of the payee or holder.

[184] The negative implication of U.C.C. § 4A-402(c).

[185] Cowie R., Note, supra, at 763.

to the funds transfer transaction, which are governed by Article 4A, are not affected by subrogation; rather subrogation relates to the underlying debt only. From the originator's standpoint, cancellation of the transfer is just as effective with or without subrogation. The only difference is to whom the underlying debt is owed. Thus, Article 4A should not be read to displace the common law right of subrogation. The right of subrogation should not be limited to the case in which an originator's bank executes a properly cancelled payment order, but also extends to any other provision of Article 4A in which a party pays debt that it was not otherwise obligated to pay.[186]

In practice, however, it is difficult to cancel or amend a payment order. Unless the execution of payment order is deferred by agreement, the payment order will normally be executed shortly after receipt. Thus, as a practical matter, senders will have very short time in which to instruct cancellation or amendment.[187] In addition banks normally do not accept cancellation or amendment orders after the cut-off time. By accepting the payment order and sending it to the next bank, the receiving bank would be obliged to pay the next bank unless no payment is made. As such it is argued that it is "unreasonable to impose on the receiving bank a risk of loss with respect to a cancellation request without the consent of the receiving bank."[188] That is because under Article 4A's provisions, cancellation or amendment of the first payment order, for example, requires the cancellation or amendment of all subsequent

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[186] For example, where the beneficiary's bank pays the beneficiary contrary to a properly cancelled transfer. See Cowie R., Note, supra, at 763.

[187] U.C.C. § 4A-211, Official Comment 3.

[188] Ibid.

accepted and executed payment orders.[189]

3.3.2 EFTPOS Transactions.

3.3.2 [a] Under U.K. Law

Theoretically, stop payment is possible in Off-Line EFTPOS schemes. Although most of British EFTPOS schemes are Off-Line ones, customers are deprived from such right by a disclaimer clause. There is normally a term in those EFTPOS agreements that a customer irrevocably authorises his bank to debit his account with all valid EFTPOS transactions. It is impossible to stop a payment order under an On-Line EFTPOS transaction after instructions is passed through the system to the purchaser's bank. There is, too, no EFTPOS reversibility rules under British Law, nor banks provide that in practice. Thus, one concludes that there is no stop payment right in EFTPOS transactions under the British Law. However, banks usually reach an agreement with retailers to adopt the same refund's policy in EFTPOS transactions as that in other methods of payment.[190]

3.3.2 [b] Under U.S.A. Law.

Stop payment and reversibility of EFTPOS transactions proved to be the most controversial issue during the drafting process of EFTA.[191] The National Commission on Electronic Fund Transfers (NCEFT) considered whether the right to stop payment should be given to consumers in EFTPOS transactions since such right affords consumers "a degree of protection against merchants who would sell defective

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[189] It is said in the Official Comment 3 of U.C.C. § 4A-211 that "[i]t makes no sense to allow cancellation of a payment order unless all subsequent payment orders in the funds transfer that were issued because of the cancelled payment order are also cancelled."

[190] e.g., Clause 4.6 of The Royal Bank of Scotland SWITCH Card Retailer Agreement provides that "[t]he Retailer agrees that in all circumstances where it would normally provide a refund to a customer a SWITCH refund must be available to a Cardholder."

[191] American Banker, Apr. 11, 1978, at 1; American Banker, June 2, 1978, at 1.

goods or others whose goods or service are less than the consumer feels he was promised in the bargain."[192] Although NCEFT acknowledged that the use of such right by consumers is minimal,[193] the existence of the right to stop payment to consumers may have some deterrent effect on retailers. Since it is technologically impracticable to stop an EFTPOS payment before it becomes final,[194] it was suggested that EFTPOS transactions should be reversible instead. This argument, which derives support from the fact that EFTPOS is analogous to cheque transactions, has been rejected by NCEFT. NCEFT argued that the marketplace should determine how consumers will see the importance of stop payment or reversibility right. Consumers who think that such right is important to them may choose to pay by cheques. Thus, NCEFT concluded that "no legislation be passed at this time that specifies rights or procedures for stop payment or reversibility in customer-initiated EFT transaction."[195]

Congress rejected reversibility in EFTPOS transactions. Allowing reversibility would expose retailers to nonpayment for some time.[196] Conversely, the refusal of reversibility would leave consumers vulnerable to uncooperative retailers. However, allowing reversibility would mean that all consumers would be entitled to reverse an EFTPOS payment for any reason.[197] This means the retailer's goods would be in the hands of the consumer without payment. It is cumbersome for retailers to pursue their

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[192] National Commission on Electronic Fund Transfers, EFT in the United States 50 (1977) (Final Report). Hereinafter cited NCEFT Final Report.

[193] Constituting 0.029 percent of all cheques written in 1973. See Baker & Brandel (1988), supra, para.16.01[1].

[194] Indeed it may be impossible in the case of On-Line EFTPOS schemes. However, in Off-Line systems, there is a time period during which payment can be cancelled before it reaches the retailer's account.

[195] NCEFT Final Report, at 52.

[196] See the submission of The Illinois Retail Merchants Association to Illinois Electronic Fund Transfer Systems Study Commissions concerning EFTs and the Consumer on reversibility issue, reproduced in Feldman A. (ed.) Electronic Funds Transfer, Commercial Law and Practice, Course Handbook Series, Number 199, Practising Law Institute, New York City.

[197] If not restricted by legislation.

claim for either a payment or a return of their goods in good condition.[198] Moreover, consumers who reverse EFTPOS payment would be, practically speaking, difficult to locate.

Since allowing reversibility of EFTPOS transactions by a State law would afford consumers greater protection, such a law would not be inconsistent with EFTA, and thus would not be preempted.[199]

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[198] See Nimmer R.T., Consumer Payment Systems: Leverage Effects within an Electronic Funds Transfer System [1980] 17 Houston L. Rev. 487, 533-534 (where it is argued that "[i]n comparing the desirability of placing the loss on the bank or on the consumer, the most obvious rational for loss distribution focuses on the bank's greater ability to estimate and bear the resultant losses ... Appropriately, one can conclude that in the smaller dollar amount purchases, any reverse credit risk should be borne by the individual consumer. The degree of loss in such purchases does not justify the system cost and administrative difficulty of shifting the burden to the bank.")

[199] 15 U.S.C. § 1693q.

CHAPTER FOUR

ERRONEOUS ELECTRONIC FUND TRANSFER TRANSACTIONS

4.1 General.

Errors in banking transactions are not uncommon. Both a bank and its customer may commit an error in EFT transactions. A bank's customer may err in his payment order to his bank. Banks may commit an error in executing customer's instructions. The most common errors in banking transactions occur in the amount of the payment order and the identity of the beneficiary. Banks' liability for such errors in EFT is discussed under the three commonly used EFT systems; credit transfer, EFTPOS and ATMs.

4.2 Electronic Credit Transfer Transactions.

A distinction must be drawn between an error committed by the sender of a payment order himself in making or sending such an order to its bank, and an error committed by the banks involved in the payment process during the execution of the sender's payment order. The former is called an erroneous payment order since the error is in the payment order when it is received by the bank. The latter is called an erroneous execution of the payment order since the error is committed during the execution process of a correctly delivered payment order. According to this distinction, an erroneous payment order and an erroneous execution of payment order may occur in one EFT transaction. That may occur when the transferring bank, for example, errs in carrying out its customer's payment order, which originally contains different error. Whether there is an erroneous payment order or an erroneous execution of that order

depends on the relationship between the parties to the dispute. A correct payment order may be communicated to a transferring bank, which carries it out erroneously to its correspondent. In such case, there is an erroneous execution of the payment order by the transferring bank as far as the payer is concerned. The same error is considered an erroneous payment order as far as the correspondent bank is concerned. The scope and extent of banks' liability is affected by such distinction. This liability is discussed separately under both types of errors.

4.2.1 Erroneous Payment Orders.

4.2.1 [a] Under U.K. Law.

A customer may instruct his bank to make a credit transfer while he is under some misunderstanding or misapprehension either as to his obligation to the payee or to the terms of the payment order, e.g., the amount to be transferred. A customer may sign, send or authorise releasing a payment order by mistake, believing it to be an entirely different kind of instrument. The question is whether an alleged error is essential. Bell's definition of essential error includes error "[i]n relation to the subject of the contract or obligation; ... the person ... to whom it is supposed to be undertaken, wherever personal identity is essential; ...[and] [i]n relation to the nature of the contract itself supposed to be entered into."[1] Bell's definition of error in substantials, has been mentioned, with approval, by Lord Watson in *Stewart v. Kennedy*.[2] Later, it seems that Lord Watson in *Menzies v. Menzies*,[3] has adopted a "but for" test. His Lordship stated that "[e]rror becomes essential whenever it is shown that but for it one

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[1] Bell's Principles of the Law of Scotland, (4th ed.), s.11.

[2] (1889) 16 R. 857; (1890) 17 R.(H.L.) 25, at 29.

[3] (1893) 20 R. (H.L.) 108.

of the parties would have declined to contract."[4] This later view is criticised as "capable of being read as destroying the law on unilateral essential error. What happened was that Lord Watson changed the meaning of essential error."[5] The effect of such an error is that "[a]n error in an essential matter excluded consent; an error in a collateral matter did not."[6] Stair suggests that if the error is in the substantials, "there is no true consent, and the deed is null."[7] Erskine thinks that consent is excluded by error in the essentials.[8] However, the recent trend of the effect of essential error after *Menzies* case is that essential error is not relevant unless induced or mutual.[9]

One suggests that applying the common law principle that those who err in the substantials do not contract would hinder the efficiency of EFT transactions and shoulder banks with a great risk. Banks are not in a position to ascertain customers' intention when they receive payment orders to transfer funds from customers' accounts. Parties must be bound by what they say not by what they think. It is argued that a subjective view of consensus is "logical but dangerous. The plea that, 'I wrote X but meant Y,' if generally allowed, would lead to havoc in a mercantile community."[10] Banks should be entitled to rely on payment orders as received from customers regardless of their intention. The intention of the sender of a payment order

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[4] Ibid, at 143.

[5] McBryde, The Law of Contract in Scotland, 1987, at para. 9-26. See the illustration given by McBryde, ibid, at para. 9-27, showing the difference between the essential error according to Bell's definition (and "Stair's sense of error in *substantialibus*", Stair, Inst., I,ix,9;IV,xl,24) and Lord Watson's later view in *Menzies* case.

[6] McBryde, The Law of Contract in Scotland, 1987, at para. 9-12.

[7] Stair, Inst., I,ix,9; IV,xl,24.

[8] Ersk., Inst., III,i,16.

[9] See McBryde, The Law of Contract in Scotland, 1987, at paras. 9-29 to 9-39 and the cases cited therein.

[10] McBryde, the Law of Contract in Scotland, 1987, at para. 9-23.

must be inferred from his words and conduct as interpreted by a "reasonable man".[11] Any reasonable bank is entitled to assume in the normal circumstances that the customer meant to instruct the transfer of funds as stated in the payment order. This applies to customer's errors in making and/or transmitting payment orders to the bank. When the court is construing a payment order made in a written form, the actual intention of the bank's customer as to the meaning of such form is irrelevant, and "perhaps even inadmissible in evidence".[12] Although a person who makes an erroneous payment order has no real subjective intention to accept the risk that stems from such an order, such risk is caused by his error which misled the bank to make the erroneous transfer. It follows that he should stand by his erroneous order and bear the risk of recovering the erroneous payment from the beneficiary. It is, however, unlikely that a bank would induce a customer to make payment to other person. Errors in payment orders usually occur in the amount to be transferred or in the beneficiary's name or account number. Although such errors would entitle the customer to recover an erroneous payment from the beneficiary, it is unlikely that a bank would not be entitled to debit its customer's account by such amount. The question will become a question of allocation of the risk of recovery of erroneous payment from the beneficiary or his bank. Clerical error in making and/or transmitting a payment order to a bank does not prevent the bank from debiting the customer's account by the erroneous transfer if the bank is not aware of the error and carried out the payment order according to its terms as communicated to it. A customer may instruct his bank to transfer money to a given payee believing that he is legally liable to pay the

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[11] *Smith v. Hughes* (1871), L.R. 6 Q.B. 597, in particular, per Blackburn J., at 607; and *Stewart v. Kennedy* (1889) 16 R. 857; (1890) 17 R.(H.L.) 25.

[12] Atiyah P.S., An Introduction to the law of Contract, (4th ed. 1989), at 88 citing *Prenn v. Simonds* [1971] 1 W.L.R. 1381.

amount transferred to such payee, while he is in fact not. A customer may also instruct his bank to make payment to a given payee while making an error in the identity of such payee.[13] It is suggested that in these circumstances the customer assents to the issue of the mandate according to which the bank made the payment and, thus, the bank "would therefore undoubtedly be entitled to debit the payer's account unless it actually knew of the mistake which vitiated the payment."[14]

The underlying transaction between the payer and the payee, subject to the payment order, could be vitiated by an error as to its validity, or its factual basis on the part of the payer. An example is an error in the identity of the payee, or the existence of the subject matter of the transaction. It is suggested that such an error does not affect the validity of the payment order to the bank; and the bank is protected if it carries out the payment order to the payee's bank without knowledge of the vitiating factor.[15] The effect of the bank's customer's error as to a fundamental matter affecting the underlying transaction may make that transaction void at common law, even if the total invalidity of the transaction may result in third parties who have acted in good faith losing rights which they have acquired and incurring liabilities.[16] However, an error which invalidates the underlying transaction does not necessarily avoids derivative or consequential transactions.[17] That is so, if the derivative transaction alone would not itself be avoided by one of the parties making an error of the kind which invalidates the underlying transaction. The derivative transaction was upheld at the instance of the party who neither made the error or knew that it had

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[13] *Cundy v. Lindsay* (1878) 3 App. Cas. 459.

[14] Penn G.A., Shea A.M. & Arora A. The Law Relating to Domestic Banking, 1987, at para. 18.171.

[15] Goode, R.M. (ed.), Electronic Banking, The Legal Implications, supra, at 68-69.

[16] Ibid, at 69 citing *Hardman v. Booth* (1853) 1 H & C 803; and *Cundy v. Lindsay* (1878) 3 App. Cas. 459.

[17] Ibid.

been made.[18] Thus the payment order or the payment itself when made may not be invalidated even if the underlying transaction, under which such an order is made, is as a result of the sender's error is void.[19] It is submitted that banks are under no duty to discover errors in their customer's payment orders.[20] However, it is submitted that where a bank's customer signs a payment order by mistake, believing it to be an entirely diferent kind of document, he "will then be able to recover the amount paid if he can successfully plead *non est factum.*"[21] Thus, it "would appear the paying bank has no effective mandate from the payer to debit his account and must seek recovery from the collecting bank or the payee by suing for money paid under a mistake of fact."[22]

A bank that receives an erroneous payment order from a customer cannot rely on the objective interpretation of the customer's intention if the bank is aware of the error in the payment order. This proposition is derived from the rule that where one party is aware that the offer or the acceptance of other party does not represent his true intentions, he will normally be bound by the real intentions of the other party.[23] It is suggested that "[t]here is no justification for permitting X to assume that Y meant one thing, when in fact X knows very well that Y meant something quite different."[24]

In EFT transactions, there is usually an agreed arrangement between the bank and its customers. Such arrangement is expected to describe the necessary steps that

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[18] *Aiken v. Short* (1856) 1 H & N 210.

[19] See Goode, R.M. (ed.), Electronic Banking, The legal Implications, supra, at 69-70 citing *Chambers v. Miller* (1862) 13 C.B.N.S. 125; *Pollard v. Bank of England* (1871) L.R. 6 Q.B. 623; and *Deutsche Bank v. Beriro & Co.* (1895) 73 L.T. 669.

[20] Goode, R. M. (ed.), Electronic Banking, The Legal Implications, supra, at 89-90.

[21] Arora A., Recent Developments in Money Transfer Methods [1980] L.M.C.L.Q. 416, at 428 citing *Saunders v. Anglia Building Society* [1971] A.C. 1004.

[22] Ibid.

[23] *Cundy v. Lindsay* (1878) 3 App. Cas. 459. See also, Atiyah, P.S., An Introduction to the Law of Contract, (4th ed. 1989), at 90.

[24] ibid, at 90.

a customer and the bank should follow to send and receive payment orders. Security precautions are also expected to be taken by both the bank and its customers. In practice, banks usually shoulder customers with liability for such errors if resulted from senders' failure to follow such arrangement. Thus, an error by the sender, or its employees, in encoding its payment order into a computer message to its bank causing a greater amount to be transferred would result in no liability on the bank. This is so, provided that the bank that received the message, has no knowledge of such error. The allocation of loss caused by such matters is not governed by any legislation in U.K. Moreover, it seems that there is no case law on the issue. The Code of Good Banking is silent on this matter. The only regulations would be the private contracts between banks and their customers, and rules of the electronic fund transfer system used in the transaction. It seems that CHAPS rules contain no provision dealing with such an issue.[25] It is probably assumed that a bank is entitled to carry out its customer's payment order according to its terms as described in such an order.

The risk resulting from the uncertainty surrounding this issue is mitigated, to certain extent, by the fact that erroneous payment is generally recoverable under equitable doctrines such as repetition in Scots law and money paid under a mistake of fact in English law. The question is always: who bears the risk of recovery, the bank or its customer? A suggested solution is that a bank should not bear the risk of erroneous payment order unless it is aware of such error before it executes the payment order. A bank that discovers such an error should take the necessary steps to contact its customer asking for further directions. Shouldering the bank with the risk

[25] Rule 7 of CHAPS Clearing Rules (1985) deals with wrongly delivered payments as between settlement banks and not with errors in payment orders.

of recovering the erroneous payment from the paid beneficiary, in such a case, is probably justified on the ground that the bank has the last clear chance to prevent the erroneous payment occurring. It is not an unfair rule since banks are under no duty to discover such errors. However, where the bank knows nothing about the error, the customer should blame no body but himself for the consequences of his error. The bank is in no better position to prevent the occurrence of the erroneous payment. The burden of recovering the erroneous payment under common law and equity principles from the paid beneficiary is on the customer.

The party who bears the risk of loss resulting from payment under an error of fact is entitled to recover from the paid beneficiary or, to certain extent, from the beneficiary's bank under common law. Repetition is the appropriate action under Scots law. Under English law, the action could be recovery of money paid under a mistake of fact. The action of recovery against the beneficiary's bank is limited. This is because the beneficiary's bank is in the same position as an agent who has received money on behalf of his principal to which the principal is not entitled. If the agent has paid the money to his principal, he is no longer liable to restore it to the person from whom it was received.[26] Where the beneficiary's bank has paid part of the erroneous payment to its principal, the bank is only liable to return the remaining part of the sum which it still holds for the unentitled beneficiary when a demand is made on it by the transferring bank or its customer.[27] It is argued that § 4(1) of the Cheques Act 1957 "clearly seems to extend to credit transfers, and so provide protection for the collecting bank if it is sued by the payer under a credit transfer or by the paying

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[26] *Kleinwort Sons & Co. v. Dunlop Rubber Co.* [1907] 97 L.T. 263, 265.

[27] *National Westminster Bank Ltd v. Barclays Bank International Ltd* [1975] Q.B. 654.

bank."[28] That section protects a collecting bank that collects, in good faith and without negligence, an instrument to a customer who has no title or a defective title to the instrument from being liable to the true owner of that instrument.

4.2.1 [b] Under U.S.A. Law.

4.2.1 [b] [i] Consumer-based Transactions.

Under common law, the position in the American law is the same as that of the British law. A bank is under no duty to question the correctness of its customer's instructions. Thus, if the bank acts on a payment order which contains a greater amount than what the customer intends to transfer, it incurs no liability so long as it is not aware of such error.

The EFTA is silent on this matter. EFTA regulates banks' liability for erroneous execution of consumers' payment orders, but not for erroneous payment orders. Consumers usually enter into an account agreement with their banks, which may regulate banks' liability in erroneous payment errors. In the absence of specific rules, a bank is not liable if it acted on its customer's instructions which include an error provided that the bank has acted in good faith and without knowledge of such error. If the bank has certain rules on such issue in its account agreement forms, it is liable under § 1693c of EFTA to disclose such rules in "readily understandable language" to its customers.

4.2.1 [b] [ii] Commercially-based Transactions.

An erroneous payment order is commonly but not always committed by the originator of the payment order. An erroneous payment order does not only include errors committed during the initiation of a payment order, but also extends to the

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[28] Penn G.A., Shea A.M., & Arora A., The Law Relating to Domestic Banking, 1987, at para. 18.171.

amendments of such order.[29] The allocation of loss in this case depends on whether, or not, the parties to the transfer have agreed on a "security procedure"[30] for the detection of error. If no "security procedure" for the detection of error has been agreed upon; and an error has occurred in the initiation or amendment of the payment order the sender bears the risk of loss, provided that the transfer is completed.[31] It is the sender's responsibility to describe exactly the beneficiary or the beneficiary's bank, to mention a smaller or larger amount than its debt, or to delay the issuance of its payment order. If its instructions are inaccurate, it bears the risk of loss.[32] Thus, if the sender, who did not agree on any kind of "security procedure" for the detection of error with his bank, erred by sending a payment order of $1,000,000 to his bank instead of the intended amount of $100,000 he is bound to pay his bank $1,000,000 if the transfer is completed by paying the intended beneficiary the mistaken amount. The erroneous payment order is not restricted to an error in sending a greater amount. It also covers cases of erroneous duplicate orders and error in the identification of a beneficiary.[33] However, the sender that erroneously issued a payment order, which accepted by the beneficiary's bank, is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing payment under mistake and restitution.[34]

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[29] U.C.C. § 4A-205(c).

[30] U.C.C. § 4A-201 defines "security procedure", in relation to error, as "a procedure established by agreement of a customer and a receiving bank for the purpose of ... detecting error in the transmission or the content of the payment order or communication."

[31] U.C.C. § 4A-402(c).

[32] See Thevenoz L., Error and Fraud in Wholesale Funds Transfers: U.C.C. Article 4A and the UNCITRAL Harmonization Process, [1991] 42 Alabama L. Rev. 881.

[33] See U.C.C. § 4A.205(a) and its Official Comment 1. It seems from the language of § 4A-205(a) that other types of errors, such as an erroneous payment order of less than the amount intended, falls outside the scope the section. See French, J.K., "Unauthorised and Erroneous Payment Orders", [1990] 45 The Business Lawyer, 1425, at 1443, fn.60. One suggests that the erroneous payment orders with lesser amount than intended causes no principal loss to the sender, so the draftsmen were justified in excluding them from the scope of § 4A-205.

[34] U.C.C. § 4A-205(a)(3).

A sender of a payment order may agree with its receiving bank on a specific "security procedure" to detect errors in its payment orders. If such an agreement is reached, the parties must apply the agreed upon "security procedure" in detecting errors in payment orders communicated between them. Since a "security procedure" arrangements should be established by agreement between the bank and its sender, using a "security procedure" to detect error in absence of an agreement does not qualify as a "security procedure" under the provisions of Article 4A.[35] Nor, the use of another "security procedure" different from the one agreed upon. However, the agreement on a "security procedure" need not be express or written.[36]

Banks' liability for erroneous payment orders tested according to an agreed upon "security procedure" is governed by § 4A-205. A sender of an erroneous payment order that passes the agreed upon "security procedure" for the detection of error would be excused from liability for its own error if certain requirements are met. Provided that such payment order is accepted by the beneficiary's bank, those requirements are:

(A) The sender, or any person acting on its behalf, has complied with the agreed upon "security procedure";

(B) The receiving bank has failed to comply with the agreed upon "security procedure"; and

(C) The error in the payment order would have been detected had the receiving bank complied with the agreed upon "security procedure";

(D) The error committed must be either (i) a transfer of a greater amount; (ii) a

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[35] French, J.K., "Unauthorized and Erroneous Payment Orders", [1990] 45 The Business Lawyer, 1425, at 1427.

[36] Baker & Brandel (1988), 1991 supp., supra, para. 12A.07[4].

transfer of a duplicate amount; or (iii) a transfer to an unintended beneficiary.

The burden of proof is on the sender.[37] To succeed in its action in shifting the risk of loss resulting from its error to its receiving bank, the sender must "prove"[38] that it or a person acting on its behalf[39] has complied with the "security procedure" agreed upon, its receiving bank has not complied with that procedure and that the error would have been detected had the bank complied with that procedure.[40] If the sender successfully met the burden of proof, it is not obliged to pay the order to the extent of the error committed. Thus, where the error committed was an overpayment (greater amount or duplicate order) the sender is not obligated to make such overpayment to its bank. Where the error committed has caused payment to an unintended beneficiary, the sender of such order is not obligated to pay the order to its receiving bank. However, in both cases the receiving bank is entitled to recover the overpayment in the first case and the whole amount in the second case from the payee to the extent allowed by the law governing mistake and restitution.[41]

Since loss allocation rules can be created either by contract, or by statute,[42] the drafters of Article 4A were looking for rules that do not unduly hinder the quick, efficient handling of funds transfers. The primary object seems to be the prevention of loss in the first place. Thus, Article 4A provisions, generally, allocate error's losses

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[37] U.C.C. § 4A-205(a)(1). See French, J.K. "Unauthorized and Erroneous Payment Orders", [1990] 45 The Business Lawyer, 1425, at 1443-1445.

[38] U.C.C. § 4A-105(a)(7) defines "prove" with respect to a fact to mean: "to meet the burden of establishing the fact". U.C.C. § 1-201(8) defines "burden of establishing" a fact as "the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence."

[39] Pursuant to U.C.C. § 4A-206.

[40] U.C.C. § 4A-205(a)(1).

[41] U.C.C. § 4A-205(a)(1), (2) and (3).

[42] Dole, Richard F., "A Japanese Insight with Respect to the Finality of Wholesale Wire Transfers", [1991] 12 University of Pennsylvania Journal of International Business Law, 661, at 681.

to the cheapest-cost loss avoider rather than loss spreading,[43] or loss imposition.[44] That object explains the preference for introducing security procedures for the detection of error. A party to a transfer who does not agree on a security procedure, or agrees but fails to comply with it, bears, as a general rule, the loss for such failure or non compliance. Moreover, Article 4A adopts procedures to minimise losses on a last-clear-chance basis.[45] That is evidenced where the sender proves that it, or its agent, did comply with the agreed security procedure, but the receiving bank failed to comply with it causing the non detection of an erroneous payment order. In this case, although the sender may have been negligent in transmitting its erroneous payment order, the risk of loss is put on the bank on a last-clear-chance theory. U.C.C. § 4A-205(b) provides for the circumstances under which the risk of loss could be shifted back to the sender on a last-clear-chance theory. Under that subsection, where the sender is not liable to pay its receiving bank all or part of its erroneous payment order, the receiving bank may reshift the risk of loss back to the sender if it can "prove" that the sender, after documentation showing the erroneous payment order is sent to it, has failed (i) to exercise ordinary care to discover the error with respect to the order; and (ii) to advise the bank of the relevant facts within a reasonable time not exceeding ninety days after the sender received such documentation.

The burden of proving the sender's failure to exercise ordinary care to discover the error and supply the bank with the relevant facts within the mentioned time is on

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[43] Ibid, at 681.

[44] See for a proposed theory based on economic efficiency, Cooter & Robin, "A Theory of Loss Allocation for Consumer Payments", [1987] 66 Tex. L. Rev. 63. See also Luc Thevenoz, "Error and Fraud in Wholesale Funds Transfers: U.C.C. Article 4A and the UNCITRAL Harmonization Process", [1991] 42 Ala. L. R. 881.

[45] See the Official Comment 2 of U.C.C. § 4A-205. The last clear chance theory means that "if the defendant has the last clear opportunity to avoid the harm, the plaintiff's negligence is not a 'proximate cause' of the result'. See W. Prosser, Handbook of the Law of Torts, (4th ed. 1971), § 66, at 427.

the receiving bank. If the bank failed to prove that, the sender assumed no liability. If the bank succeeded in meeting this burden, the sender is obliged under U.C.C. § 4A-205(b) to reimburse the bank for the loss the bank proves it has incurred as a result of that failure. However, the maximum liability of the sender in this case is the amount of sender's erroneous payment order. This, in practice, puts the sender in no worse position than if it had not reached an agreement with its bank on a "security procedure" to detect the error. However, it is clear that with a "security procedure" for the detection of error the sender could be, in certain circumstances, in a better position.

U.C.C. § 4A-205(b) puts a careful and a clever receiving bank in a relatively good position to throw the risk of loss of an erroneous payment order back on the shoulders of its sender, even if the bank has failed to comply with the agreed upon "security procedure". Assume that a sender succeeded in shifting the risk of loss to its receiving bank by meeting the requirements discussed above, what the bank needs to do, to reshift the risk of loss back to its sender, is (i) a notification to the sender that the *order was accepted by the bank* or that *the sender's account was debited* with respect to the order; and (ii) a proof that the sender has failed to exercise a reasonable care to discover, and notify the bank of, the error *on the basis of information available* to it *within a "reasonable time" not exceeding ninety days* after the above notification was received by the sender. A notification that the *order was accepted*, or that the *sender's account was debited* need not be more than an ordinary statement.[46] A receiving bank may use the second requirement to its benefit. The ninety days is the

[46] A periodical statement would satisfy such requirement. See Smart W., New Article 4.5 of the UCC: Funds Transfers, [1991] 20 Colorado Lawyer 457.

maximum period and not the period for discovering the error and reporting it to the bank. The period is a "reasonable time" not exceeding ninety days. The more information about the order the bank gives its sender the higher the standard of care the sender would be subjected to. This may include a shorter period for reporting the error. Conversely, a bank which supply lesser information about the transfer may reduce the standard of care required by its sender. This is because, the discovery and notification of the error by the sender will be *on the basis of information available* to the sender.[47] Such information is usually become available through the receiving bank. For example, a receiving bank which does not mention the name of the beneficiary in its communication with its sender would probably reduce its sender's standard of care to discover and report an error in the identity of the beneficiary where a payment order is paid to an unintended beneficiary.

However, a receiving bank should not heavily rely on U.C.C. § 4A-205(b) because, in certain circumstances, even if the bank succeeds in shifting the risk of loss back to the sender, it may not be entitled to recover all its loss from the defaulting sender. That is because a receiving bank's loss should be *incurred as a result* of the sender's breach of its duty to discover and report the error within the mentioned period. The ability of the bank to recover depends on a causal connection between the loss and the sender's failure to discover the error and notify the bank on time.[48] If the bank could not have recovered from the beneficiary that received the erroneous payment even if the sender had timely discovered and notified the bank of the error, no causal connection exists between the bank's loss and the sender's failure.

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[47] U.C.C. § 4A-205(b).

[48] The Official Comment 2 of U.C.C. § 4A-205.

Accordingly, the bank is not entitled to compensation for such loss from the sender. A loss resulted from the receiving bank's failure to recover an erroneous amount from a bankrupt unintended beneficiary is *not incurred as a result* of the sender's failure to discover and report such erroneous order.

Finally, the receiving bank's liability for erroneous payment orders is subject to variation by agreement with its sender under U.C.C § 4A-501.[49] Thus, a receiving bank may agree different liability with its senders for its failure to detect errors if they agreed upon a certain "security procedure".

4.2.2 Erroneous Execution of Payment Orders.

The two common errors during the execution of payment orders are that in the amount of the payment order, and that in the identity of the beneficiary. Those are discussed under U.K. and U.S.A. jurisdictions.

4.2.2 [a] Under U.K. Law.

4.2.2 [a] [i] Erroneous Amount.

Banks are under a duty to conform to customer's mandate and to obey the customer's instructions in making payments out of his account. Since payment orders constitute a mandate from the customer, as principal, to his bank, as agent, the bank is under a duty to conform to such payment orders when performing them.[50] This conformity requirement reflects itself, *inter alia*, in the amount of the payment order.[51] A bank that deviates therefrom does so at its peril.[52]

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[49] Official Comment 3 of s.4A-205 of the U.C.C.

[50] *Royal Products Ltd. v. Midland Bank Ltd.* [1981] 2 Lloyd's Rep. 194, 198.

[51] The bank must also conform with other terms of the payment order such as the beneficiary, his account number and the time of payment if specified.

[52] *Midland Bank Ltd. v. Seymour* [1955] 2 Lloyd's Rep. 147, 168 per Devlin J. "[i]t is a hard law sometimes which deprives an agent of the right to reimbursement if he has exceeded his authority, even though the excess does not damage his principal's interests." Devlin J. followed the House of Lords' decision in *Ireland v. Livingston* (1872) L.R. 5 H.L. 395. *C.f. European Asian Bank AG v. Punjab and Sind Bank (No.2)* [1983] 1 W.L.R. 642, 656 (suggesting certain limitations to Devlin J.'s dicta). See Ellinger, Modern Banking Law, supra, at 285.

The result of the bank's failure to conform to the customer's mandate is that it cannot debit the customer's account by the amount wrongfully paid.[53] This is true in case of exceeding bank's mandate by transferring an amount greater than the one contained in the payment order. A bank may instruct the transfer of an amount greater than that in the payment order, or wrongfully carry out the payment order twice. In the former case, the bank cannot debit the customer's account by the overpayment. In the latter case, the bank also cannot debit the customer's account by the amount of the duplicate order. In *Chase Manhattan Bank N A v. Israel-British Bank (London)*,[54] the plaintiff through a clerical error made a duplicate payment to the defendant. It was held that the plaintiff was entitled to recover the erroneous duplicate payment.

The fact that the bank cannot debit its customer's account by the amount that it is not authorised to transfer is an application to the negative aspect of the bank's absolute duty to conform to its mandate.[55] This is because the amount deposited by the customer in his bank's account ceases, upon deposit, to be the customer's money. The bank can use the money as it pleases. It has an authority to be reimbursed by the customer for money paid upon the customer's instructions or authorisation. But, it has no authority to reimburse itself from the customer's account for any amount paid away without the customer's authorisation. Lord Cottenham L.C. in *Foley v. Hill* summarised this point by saying:[56]

"Money, when paid into a bank, ceases altogether to be the money of the

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[53] See in the case of wrongful payment of cheques, e.g *Greenwood v. Martins Bank Ltd.* [1933] A.C. 51; *Orr v. Union Bank of Scotland* (1854), 1 Macq. (H.L.) 512 (bank has no authority to debit its customer's account when it pays a bill of exchange or a cheque bearing forged signature); and *Liggett (Liverpool) Ltd. v. Barclays Bank Ltd.* [1928] 1 K.B. 48 (bank fails to conform to customer's mandate if it pays a cheque drawn on a company's account signed by only one director when the company instructed the bank to honour cheques only if signed by two directors).

[54] [1981] 3 All E.R. 1025.

[55] Pennington, Hudson and Mann, Commercial Banking Law, at 35-36; and Goode, R.M. (ed.), Electronic Banking, The Legal Implications, supra, at 75.

[56] (1848) 2 H.L.C. 28; 9 E.R. 1002, 1005.

> principal; it is the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profits of it he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers in some places, or the principal and a small rate of interest, according to the custom of bankers in other places. The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it, or deal with it, as the property of his principal, but he is of course answerable for the amount, because he has contracted, having received the money, to repay to the principal, when demanded, a sum equivalent to that paid into his hands."[57]

This duty is imposed on banks regardless the method of payment employed. Whether the bank disburses its customer's money by electronic or traditional means is not relevant as far as the bank's duty not to debit its customer's account without authority is concerned. In particular, the payer authorises his bank to make a payment through CHAPS "only of a specified amount to a specified bank for the account of a specified payee."[58] Thus, if the payment message passed through the CHAPS gateway differs from the payer's instructions to his bank in respect of any of these three matters, the transferring bank acts without the payer's mandate; and whether it or any of its employees or agents has been guilty of negligence or not, it cannot debit the amount wrongfully paid to his account.[59]

4.2.2 [a] [ii] Unintended Beneficiary.

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[57] *C.f., Agip (Africa) Ltd. v. Jackson* [1991] 3 W.L.R. 116 (C.A.). There, the defendants argued that the plaintiffs did not have a title to sue because the money wrongly transferred was the plaintiffs' bank. The Court of Appeal, adopting a pragmatic approach, rejected this argument. It was held that "in practical terms" the bank had paid the payees with the plaintiffs' money and that the "substance of the matter" was that the money deposited with the bank is plaintiffs' money. This decision was criticised on this point "because it is a fundamental principle of banking law that a banker who pays money without a mandate cannot debit the customer's account. And, if the bank cannot debit the customer's account, then it must be the bank's money and not the customer's money which is paid out." See McKendrick E., "Tracing Misdirected Funds" [1991] L.M.C.L.Q. 378, 379-380.

[58] Goode, R.M. Electronic Banking, The Legal Implications, supra, at 75.

[59] Ibid. See Arora, A "Electronic Banking and the Law", supra, at 136.

Payment to an unintended beneficiary or payee contrary to the customer's payment order is a breach of the customer's mandate. Accordingly, as the case in the erroneous amount, a bank is not entitled to debit its customer's account by the amount transferred to the wrong beneficiary. The bank's duty to conform to its customer's mandate discussed under the erroneous amount is applicable to the case of paying an unintended beneficiary. A bank that transfers the instructed amount to a different beneficiary from that specified by the customer in his instructions is not entitled to debit its customer's account by such amount.[60] That bank has transferred funds from its own money. It is, thus, not entitled to reimburse itself from its customer's account without his authorisation.

A sender of a payment order may instruct its bank to transfer funds to a given beneficiary, who is identified by name and account number. Clearly, there is no problem if both name and account number refer to one person. Payment to other than that person is breach of mandate with the result that the bank is not entitled to debit the sender's account by the amount of transfer. Moreover, there is probably no problem if the bank discovers the discrepancy before sending the message to the beneficiary's bank. Good banking practice suggests that the bank should decline to carry out such payment order and seek further clarifications from its customer. If the bank, nevertheless, did proceed in the transfer process either to the beneficiary's name or to the beneficiary's account number only, with the result that payment was made to the wrong beneficiary, the bank should be liable. This bank is in the best position to avoid the loss, since it is aware of the discrepancy between the beneficiary's name

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[60] See Chitty on Contracts, (26th ed. 1989), at para. 2955 where it is argued that a bank in Giro transfer is "precluded from debiting the customer's account with a wrongfully made payment".

and the beneficiary's account number before it released the payment message. A reasonable banker would expect that payment to a wrong beneficiary is likely in such situation. That bank, being transferring or intermediary bank, may, however, argue that the beneficiary's bank should discover the discrepancy, and return the payment order. This argument is based on the last clear chance theory to avoid the loss. It is difficult, in absence of clear authority, to conclude which rule is applicable. Unfortunately, this will add more uncertainty to the law of electronic funds transfer in the United Kingdom.

A suggestion would be that banks should be allowed, where they are ignorant of the discrepancy, to rely on account numbers rather than beneficiary's names in this type of fund transfer. Allowing banks to rely on account numbers alone is more efficient than comparing the beneficiary name and its account number. It is also more reliable than examining only the beneficiary's name. This suggestion takes into account that banks in EFT transactions rely heavily on numbers when sorting and routing out funds to and from customers' accounts. In addition, a fast, reliable and inexpensive EFT system would clearly be furthered by allowing banks to rely entirely on account numbers in handling EFT transactions.

Under CHAPS Clearing Rules, where a CHAPS payment order is addressed to "a non-existent or invalid Sorting Code Number", the payee settlement bank must treat such order as if it is sent to "the Repair Sorting Code Number" of that bank.[61] This "Repair Sorting Code Number" is a unique number allocated by each settlement bank participant in CHAPS "to which a Payer Settlement Bank may direct CHAPS payments when insufficient information is available to the Payer Settlement Bank to

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[61] Rule 7(a) of the CHAPS Clearing Rules (1985).

determine the Sorting Code Number of the Payee Settlement Bank Office".[62] The effect of sending a CHAPS order to such special Sorting Code Number is provided for in Rule 6(c) of CHAPS Clearing Rules. This Rule provides in full:

> "A Payee Settlement Bank receiving a CHAPS payment message addressed to its Repair Sorting Code Number must use its best endeavours to re-direct that payment to the correct destination. In any circumstances in which the correct destination cannot be ascertained with reasonable certainty, as soon as practicable, but in any case no later than the next business day, in which case there will be no interest penalty, the value must be repaid to the Repair Sorting Code Number of the originating Settlement Bank Office by means of a CHAPS payment message or such alternative method as may be agreed between the respective offices. The refund payment must contain the following information:
> A. The date and SPN (Senders Payment Number).
> B. The Payer Sorting Code Number."

Where a CHAPS order cannot be sorted by the office indicated in the order, but by another office of the same payee settlement bank, this bank must re-direct the order to the correct destination within the bank. The payee settlement bank must either re-direct the order that contains insufficient information to the correct destination within the same bank, or repaid to the Repair Sorting Code Number of such bank as soon as practicable, but in any case no later than 12.00 on the next business day.[63] If the bank satisfies such requirements, no interest is paid on the principal sum of the payment order in question.[64]

4.2.2 [a] [iii] Recoverability of Erroneous Payment from the Payee.

A bank that finds itself obliged to recredit its customer's account as a result of its erroneous execution of its customer payment order, may still recover such payment from the beneficiary under common law and equity rules. This is equally applicable to a customer who bears the risk of such recovery such as in the case of

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[62] Rule 6(a) of the CHAPS Clearing Rules (1985).

[63] Rule 7(b) of the CHAPS Clearing Rules (1985).

[64] Ibid.

an erroneous payment order that has been executed by the bank without its knowledge of such an error. Since the law differs, to certain extent, between Scotland and England, separate discussion of the two jurisdictions follows.

4.2.2 [a] [iii] [1] Under the Scots Law.

Under Scots law, "repetition" is the appropriate remedy for the recovery of erroneous payment.[65] This is based on the equitable remedy of *condictio indebiti*. The error relied on by the bank must be a basic one.[66] The erroneous payment must be caused by an error in fact; "it must be ignorantia faci, for ignorantia juris availeth no Man."[67] Until the beginning of nineteenth century, Scots law allowed recovery of erroneous payment made under an error of law.[68] It was Lord Chancellor Brougham in *Wilson & McLellan v. Sinclair*[69] and *Dixon v. Monkland Canal Co.*[70] who brought the Scots law into the line with English law on this point.[71] In *Wilson*'s case, *albeit obiter*, Lord Chancellor Brougham invoked the English rule that payment made under a mistake of law is irrevocable. His Lordship again, fully aware that he might be seen as altering the Scots law on *error juris*, took the view that English doctrine

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[65] For a general accounts of Scots law in this area, see, e.g., Wilson & Wilkinson (eds.) Gloag and Henderson's Introduction to the Law of Scotland (9th ed. 1987) at 159-65; Walker D.M., The Law of Contract and Related Obligations in Scotland (2nd ed. 1985), at 583-594; Wilson, The Scottish Law of Debt, (2nd ed. 1991), at para. 1.6; Birks, P. "Restitution: A View of the Scots Law", [1985] 38 Current Legal Problems 57, at 68-70; MacDonald, D. R. "Mistaken Payments in Scots Law", [1989] 34 Juridical Review 49, 53; and Marshal E.A., General Principles of Scots Law, (5th ed. 1991), at 467.

[66] Per Lord Wright in *Norwich Union Fire Insurance Society v. William H. Price Ltd.*, [1934] A.C. 455 ("It is essential that the mistake relied on should be of such a nature that it can properly be described as a mistake in respect of the underlying assumption of the contract or transaction or as being fundamental or basic.").

[67] Mackenzie, Works, II.310. C.f. Stair, Inst., I, vii,9 where he allows recovery "when any party through error, delivered or payeth that which he supposeth due, or belongeth to another".

[68] Erskine, An Institute of the Law of Scotland, 2, 3, 54. Stair, Inst. I, 7. 9, was less explicit. See MacDonald D.R., Mistaken Payments in Scots Law, [1989] 34 Juridical Review 49, at 57-58.

[69] (1830) 4 W. & S. 398, at 409.

[70] (1831) 5 W. & S. 445, at 452.

[71] In English law, see per Lord Abinger in *Kelly v. Solari* (1841) 9 M & W 54, where his lordship said that:
"[t]he safest rule however is that if the party makes the payment with full knowledge of the facts, although under ignorance of the law, there being no fraud on the other side, he cannot recover it back."

to apply in Scotland.[72] Although reluctantly, subsequent Scottish decisions mostly reflect the rule that payment is irrecoverable if made under an error of law.[73]

The pursuer's claim should not fail because the beneficiary was not *lucratus*. In *Royal Bank of Scotland v. Watt*,[74] a rogue convinced the defender to put a forged cheque (£18,631) in his account with the pursuer. After the clearance of the cheque, the defender withdrew £18,000 in cash and gave it to the rogue. The Court of Session allowed the pursuer to recover £18,631 from the defender in an action of repetition. The Court held that since it was not necessary for the beneficiary to be *lucratus* in a repetition case, the pursuer should succeed in the action.[75]

Thus, where a bank transfers funds to a wrong beneficiary's account because of an error in encoding customer's instructions, it is entitled to recover such funds under "repetition" in Scots law. This applies for overpayment or duplicate payment order provided that the error was in *facti*. Where the risk of recovery falls on the bank's customer, he is entitled too to recover from the beneficiary.

However, since condictio indebiti is an equitable remedy, the bank that erroneously transfers funds may not recover where repayment would cause the beneficiary injustice. It is noted that "[t]hree closely related aspects of this general principle can be seen from the reported cases: the fact that the payer knew, or should have known, the true position; the effect generally of careless payment and the parties' conduct; and the case of the payee who changed his position in reliance on the

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[72] Arguing that the earlier Scottish authorities on the recoverability of payment under an error in law could be disregarded. His Lordship argued that *Stirling of Northwoodside v. Earl of Lauderdale* (1733) Mor. 2930 could not be relied on. *Carrick v. Carse* (1778) Mor. 2931; (1778) Hailes Dec. 783 was obiter on this point. Finally, his Lordship disregarded Erskine's view, Inst., III, iii, 54.

[73] e.g. *Glasgow Corporation v. Lord Advocate*, 1959 S.C. 203; and *Taylor v. Wilson's Trustees* [1974] S.L.T. 298. See Evans-Jones R. "Payments in Mistake of Law - Full Circle", [1992] Journal of the Law Society of Scotland, 92.

[74] [1991] S.L.T. 138.

[75] See for comments on the case, Gretton G.L., Unjust Enrichment in Scotland, [1992] J.B.L. 108; and MacQueen H.L, Unjustified Enrichment in Scots Law, [1992] J.B.L. 333.

payment."[76]

4.2.2 [a] [iii] [2] Under the English Law.

Erroneous transfer of funds can be recovered in England in an action for money paid under a mistake of fact.[77] The authorities on the issue was reviewed by the House of Lords recently in *Barclays Bank Ltd. v. W. J. Simms, Son & Cooke (Southern) Ltd,*[78] and *Woolwich Equitable Building Society v. Inland Revenue Commissioners*.[79] For a bank to recover money erroneously transferred, three conditions must be satisfied. These are:

(i) The mistake must be one of fact, not of law.

The mistake that caused the erroneous fund transfer must be one of fact. Payment to a wrong beneficiary was held to be an mistake of fact.[80] It was held in England that payment made under a mistaken construction of statute[81] or in reliance on a judicial decision which is subsequently overruled[82] is a mistake in law and thus

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[76] MacDonald D.R., Mistaken Payments in Scots Law, [1989] 34 Juridical Review 49, at 62. See ibid, at 62-68 and the cases cited thereon. See, in particular, for the defence of bona fide change of position by the beneficiary, *Credit Lyonnais v. George Stevenson & Co. Ltd.*, (1901) 9 S.L.T. 93 where Lord Kyllachy, said, at 195, that:
"The money in question was paid in error under a mistake in fact. It was therefore reclaimable, unless (the pursuers' remedy being equitable) there was an equitable defence to repetition. In my opinion the defenders, in order to establish such defence, would require to show (1) that they had reasonable grounds for believing that the money was theirs; (2) that having that reasonable belief, they acted upon it so as to alter their position in such manner as to make repetition unjust."

[77] See generally Lord Goff & Jones G., The Law of Restitution, (3rd ed. 1986), chap.3; and Birks, P. An Introduction to the Law of Restitution (1985). As to banking law see, Paget's Law of Banking, (10th ed. 1989), chap.25; and Ellinger, Modern Banking Law, supra, chap.11.

[78] [1980] Q.B. 677, [1979] 3 All E.R. 522 (bank pays a cheque regardless a stop payment order). Hereinafter referred to as *Simms* case.

[79] [1992] 3 W.L.R. 366 (where a building society paid tax under an unlawful demand to avoid economic and social consequences. This payment unjustly enriched the State. Accordingly, and since this payment was not made under a mistake of fact (the building society was aware of the unlawfulness of the demand), nor filled under the statutory framework governing repayment of overpaid tax, the House of Lords found it was necessary to reformulate the law of restitution so as to recognise a *prima facie* right of recovery based solely on payment of money pursuant to an *ultra vires* demand by a public authority.

[80] See *Kleinwort, Sons & Co. v. Dunlop Rubber Co.*, (1907) 97 L.T. 263. See a criticism of this case on another point, Ellinger, Modern Banking Law, at 323-324 and the cases cited thereon. See for other examples of mistake of fact, *National Westminster Bank v. Barclays Bank International Ltd* [1975] Q.B. 654, [1974] 3 All E.R. 834 (payment on a forged cheque), *Simms* case, supra, (payment of a cheque contrary to a countermand instructions).

[81] See e.g *Whiteley v. R.* (1909) 26 T.L.R. 19.

[82] See e.g *Henderson v. Folkestone Waterworks Co.* (1885) 1 T.L.R. 329.

irrecoverable.[83] English courts held that payment under a mistake in the construction of private contracts is irrevocable. They allowed recovery of payments made under a mistake in law in exceptional cases. Those cases include, payments of public funds without legal authority,[84] payment made pursuant to a court order which is reversed on appeal,[85] payment made to an officer of the court,[86] payment induced by the payee's fraud, oppression, undue influence or breach of fiduciary duty, or received in bad faith.[87]

In *Woolwich Equitable Building Society v. Inland Revenue Commissioners*,[88] Lord Goff suggested that a citizen who pays a tax under a mistake of law should be allowed to recover such payment. His claim should not fail simply because he has paid under a mistake of law. Although the decision was not based on this ground, Lord Goff's view, however, may indicate that English law is probably in a move to accept recovery of money paid under a mistake of law.[89]

(ii) The mistake must have caused the payment.[90]

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[83] *e.g., Holt v. Markham* [1923] 1 K.B. 504. See Paget's Law of Banking, (10th ed. 1989), at 406 on the distinction between misconstruction of a contract (mistake of law) and a reliance on misrepresentation as to the contents of a contract (mistake of fact) and the criticism to such distinction thereon.

[84] *Aukland Harbour Board v. R.* [1924] A.C. 318.

[85] *Re Birkbeck Permananet Benefit Building Society* [1915] 1 Ch. 91.

[86] *Re Carnac, ex p Simmonds* (1885) 16 O.B.D. 308.

[87] *Rogers v. Ingham* (1876) 3 Ch. 351. See also *Kiriri Cotton Co. Ltd v. Dewant* [1960] A.C. 192, [1960] 1 All E.R. 177 (P.C.) (recovery by a tenant of an illegal premium). The latter case was followed by the Court of Appeal in *Shelley v. Paddock* [1980] Q.B. 348, [1980] 1 All E.R. 1009.

[88] [1992] 3 W.L.R. 366.

[89] Interestingly enough that the two Scottish Lords in that case (Lord Keith of Kinkel and Lord Jauncey of Tullichettle) have dissented.

[90] Lord Goff in *Simms* case, supra, at 536 decided that there is no requirement "more than that the mistake have caused the payment." His Lordship was responding to the view that for a mistake to be operative as to the recovery of money paid under it, it must be essential to the liability. The latter view stemmed from a frequently cited *dictum* of Bramwell B. in *Atken v. Short* (1856) 1 H & N 210; [1843-60] All E.R. 425. That *dictum* reads, at 215, 427 respectively:
"In order to entitle a person to recover back money paid under a mistake of fact, the mistake must be as to a fact which, if true, would make the person paying liable to pay the money; not where, if true, it would merely make it desirable that he should pay the money."
This *dictum* purports to exclude recovery of payment made under a mistake that does not lead the bank to believe that it was liable to pay the funds to the payee.

Lord Goff in *Simms* case, relying on three cases of the House of Lords concluded that the proposition that recovery will only be allowed if the mistake is a mistake as to liability does not represent the law.[91] In his Lordship's judgement, there is no requirement "more than that the mistake have caused the payment."[92] In particular, the suggestion that the mistake must be "fundamental", it is submitted, is inconsistent with the Privy Council's decision in *Colonial Bank v. Exchange Bank of Yarmouth, Nova Scotia*,[93] and with the three cases of the House of Lords referred to above.[94] Even if there is a requirement that the payer's mistake must be "vital" or "material", Lord Goff in *Simms* case suggests that this means that the mistake caused the payer to pay the money.[95]

(iii) The mistake must be that of the payer but not necessarily that of the payee.[96]

The House of Lords in *Kleinwort, Sons, & Co. v. Dunlop Rubber Co*,[97] allowed recovery of payment made to a wrongful payee since the mistake, which concerned the relationship of payer and payee, was the sole cause of payment involved.[98] However, doubts on the conclusiveness of this proposition were raised by Barwick C.J. in *Porter v. Latec Finance (Queensland) Pty. Ltd.*[99] His lordship

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[91] *Simms* case [1979] 3 All E.R. 522, at 529. The three cases of the House of Lords that Lord Goff has relied on to justify his decision were *Kleinwort, Sons & Co v. Dunlop Rubber Co.*, (1907) 97 L.T. 263; *Kerrison v. Glyn, Mills, Currie & Co.*, (1911) 81 L.J.K.B. 465, [1911-13] All E.R. 417; and *Jones (R.E.) Ltd. v. Waring & Gillow Ltd.*, [1926] A.C. 670, [1926] All E.R. 36. His Lordship was responding to Bramwell B.'s dictum in *Atken v. Short*, (1856) 1 H & N 210; 215 [1843-60] Eng. Rep. 425, 427, quoted above.

[92] Per Lord Goff in *Simms* case, supra, at 536.

[93] (1885) 11 App. Cas. 84.

[94] See Paget's Law of Banking, (10th ed. 1989), supra, at 408; and Goff & Jones, The Law of Restitution (3rd ed. 1986), supra, at 87-90. *C.f.* Ellinger, Modern Banking Law, supra, at 323-325.

[95] *Simms* case, supra, at 532.

[96] Paget's Law of Banking, (10th ed. 1989), at 405.

[97] (1907) 97 L.T. 263.

[98] See also *Rogers v. Kelly* (1809) 2 Camp 123; *Chambers v. Miller* (1862) 13 C.B.N.S. 125; *Weld-Blundell v. Synott* [1940] 2 K.B. 107; and *Porter v. Latec Finance (Queensland) Pty. Ltd.* (1964) 111 C.L.R. 177, 204 per Windeyer J. See per Kerr J. in *National Westminster Bank Ltd v. Barclays Bank Ltd*, [1974] 3 All E.R. 834, 841; [1975] Q.B. 654, 662 (albeit obiter).

[99] (1964) 111 C.L.R. 177, 178.

suggested that for a mistake to be operative, it had to be between the payer and the payee and recovery would be ruled out unless the mistake was common to both parties. Such requirement would, if strictly applied, preclude, for example, a bank from recovering payment made over a stop payment order. Moreover, this proposition is irreconcilable with cases where recovery was allowed, although the mistake was between the payer and a third party.[100]

Goff J. in *Simms* case has rejected this last proposition. Commenting on the decision of the House of Lords in *Jones (R.E.) Ltd. v. Waring & Gillow Ltd*,[101] Goff J. said:[102]

> "[T]he House of Lords must have rejected the view ... that to ground recovery the mistake must have been 'as between' payer and payee, in the sense of having been a mistake shared by both parties."

His lordship concluded that for a mistake to be operative, it does not have to be between the payer and the payee. Thus, in banking transactions, it is sufficient for a mistake to ground recovery that it is between the bank and its customer, the payer, and not as between the bank and the payee.[103]

Prima facie, a bank that satisfies these requirement is entitled to recover any mistaken transfer of funds. However, as the case under Scottish law, a beneficiary who received the payment may have a defence against such claim. Lord Goff in *Simms* case summarised these defenses as follows:[104]

"[A] claim may however fail if (a) the payer intends that the payee shall have

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[100] *Kerrison v. Glyn, Mills, Currie & Co.*, (1911) 17 Com. Cas. 465; and *Jones (R.E.) Ltd. v. Waring & Gillow Ltd* [1926] A.C. 670.

[101] [1926] A.C. 670.

[102] *Simms* case, [1979} 3 All E.R. 522, at 534.

[103] Ellinger, Modern Banking Law, supra, at 323. See also *Kelly v. Solari* (1841) 9 M & W 54, per Lord Abinger at 68. Paget's Law of Banking, (10th ed. 1989), at 410, suggests, however, that "[i]t would therefore be unsafe to assume that the *Simms* case has settled the law on this issue."

[104] Ibid, at 695 and 535 respectively.

> the money at all events, whether the fact be true or failse, or is deemed in law so to intend; or (b) the payment is made for good consideration, in particular if the money is paid to discharge, and does discharge, a debt owed to the payee (or a principal on whose behalf he is authorised to receive the payment) by the payer or by a third party by whom he is authorised to discharge the debt; or (c) the payee has changed his position in good faith, or is deemed in law to have done so."

The acceptance of the *bona fide* change of position is a new development in English law.[105] Although it is argued that such recognition may possibly be treated as confined to negotiable instrument cases,[106] there is no ground for such proposition. The method of making the erroneous payment, whether by negotiable instrument or by EFT should not change the equitable ground of such defence.

The other common defence is where payment is made for good consideration. In such case, the payee is entitled to retain the sum remitted so long as he furnished a good consideration for it. The common example is where such payment discharged an obligation owed to the payee. Where the obligation discharged by the erroneous payment was between the transferring bank and the payee, the payee is clearly entitled to retain the erroneous payment. Where the obligation discharged was between the payer (the transferring bank's customer) and the payee, payment may be described as one effected in discharge of a contract made tacitly between the bank and the payee.[107] Although the money is paid by the transferring bank, the payee is entitled to retain it as money paid to discharge a debt owed to him by the payer who discharged this debt by authorising his bank to discharge the debt.

A banker who is, *prima facie,* entitled to recover money paid under a mistake of fact will be estopped from doing so if:

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[105] See Hudson A.H., (case and comment) Bankers' Drafts and Mistakes, [1991] L.M.C.L.Q. 291, 295-296.

[106] Ellinger, Modern Banking Law, supra, at 327.

[107] Ellinger, Modern Banking Law, supra, at 328.

> "i. he made a representation of fact which led the [payee] to believe that he was entitled to treat the money as his own; ii. relying on this representation the [payee] changed his position and in so doing acted to his detriment; iii. the [payee] was not at fault either in relation to the mistake being made or in subsequently acting to his detriment."[108]

If such an estoppel operates, it defeats the whole claim, even if the payee spent part of the mistaken payment.[109] The erroneous transfer of funds without negligence on the part of the bank should not be considered as a representation by the transferring bank that such transfer was a genuine one, which entitle the payee to rely on estoppel.[110] The mere spending of money by the payee is not sufficient to meet such requirement. In *Larner v. London County Council*[111] Denning L.J. said:[112]

> "Speaking generally the fact that a recipient has spent the money beyond recall is no defence unless there was some fault - as, for instance, breach of duty - on the part of the paymaster and none on the part of the recipient."

However, it was held in *Skyring v. Greenwood*[113] that having the money paid under a mistake of fact for a considerable time and spending it in such a manner as to have altered the payee's mode of living constituted a change of position. It is submitted that it is not an easy task for the payee to convince the court that he has altered his mode of living.[114] The payee cannot succeed in his estoppel claim if there has been a fault, misrepresentation or concealment of relevant facts on his part at any

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[108] Paget's Law of Banking, (10th ed. 1989), at 417. See for the same three requirements, *United Overseas Bank v. Jiwani* [1977] 1 All E.R. 733, per MacKenna J., at 737.

[109] Paget's Law of Banking, (10th ed. 1989), at 417-418 citing *Avon County Council v. Howlett* [1983] 1 All E.R. 1073, [1983] 1 W.L.R. 605 (C.A.).

[110] By analogy with *Kerr J.'s dictum in National Westminster Bank Ltd v. Barclays International Ltd* [1975] Q.B. 654, 672; [1974] 3 All E.R. 834, 849 (where it was held that payment of a forged cheque without negligence on the part of the bank did not impliedly represent to the payee that the signature was genuine as to bar any right of recovery from him).

[111] [1949] 2 K.B. 683.

[112] Ibid, at 688.

[113] (1825) 4 B & C. 281.

[114] See *Avon County Council v. Howlett* [1983] 1 All E.R. 1073; [1983] 1 W.L.R. 605 (C.A.). See for judicial examples of change of position cases cited by Paget's Law of Banking, (10th ed. 1989), at 421.

time from the original transaction to the payer's request of repayment.[115]

A mistaken transfer of funds may be traced under English law into the hands of the payee, and if the circumstances allow, recovered. Generally, both common law and equity accepted the right of the true owner to trace his property into the hands of others while it was in an identifiable form. The common law treated property as identified if it had not been mixed with other property.[116] It is, however, not a prerequisite condition for tracing a fund in equity to have such fund identified. In equity, funds can be followed even if they are mingled or mixed with other funds. However, it is prerequisite to the operation of the remedy in equity that there must be a fiduciary relationship which calls the equitable jurisdiction into being. Applying this to electronic credit transfer suggests that tracing funds in common law is almost impossible, since funds transferred in EFT systems are unidentifiable. It is, however, possible in equity law.

4.2.2 [b] Under U.S.A. Law.

4.2.2 [b] [i] Consumer-based Transactions.

Banks are bound under EFTA to investigate errors reported by their consumer customers. The mandatory error resolution procedures will save consumers the costs of litigation. However, if a consumer is not satisfied with such investigation, he may take the case to courts. Both procedures of solving an erroneous execution of an EFT transaction are discussed separately.

4.2.2 [b] [i] [1] Error Resolution Procedures.

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[115] *George Whitechurch Ltd v. Cavanagh* (1825) 4 B & C 281. This requirement as formulated by Lord Brampton in *Cavanagh's* case was relied on by Kerr J. in *National Westminster Ltd v. Barclays Bank International Ltd* [1983] 1 All E.R. 1073, [1983] 1 W.L.R. 605 (C.A.).

[116] See, e.g., *Agip (Africa) Ltd. v. Jackson* [1991] 3 W.L.R. 116 (C.A.). For a comment on the case, see Hudson A.H., Bankers' Drafts and Mistakes [1991] L.M.C.L.Q. 291.

Consumers who assert an error in their fund transfer transaction are entitled to have their complaint investigated by their banks according to certain error resolution procedures. Errors in EFT transactions were in the contemplation of EFTA draftsmen; and thus, a mandatory error resolution procedures were designed to ensure that consumers will have a fairly reasonable investigation of allegations of errors without the need to recourse to judicial litigation.[117] However, an unsatisfied customer with the result of his bank's error investigation, may take the matter to courts.

i. The Bank's Duty to Notify Consumers of Error Resolution Procedures.

A bank is under a duty to disclose to its consumer customer in "readily understandable language" a summary of the provisions of the mandatory error resolution procedures as adopted by the bank; and the consumer's rights thereunder.[118] In addition, the bank should thereafter transmit such information to the consumer at least once per calendar year.[119]

ii. The Consumer's Duty to Notify Errors.

The application of the bank's error resolution procedure is usually initiated by the consumer concerned. To utilise such procedure, the consumer must notify his bank that an error has occurred. This notification should be made within sixty days of the date on which the bank transmitted the documentation showing such error.[120] A consumer who fails to notify his bank that an error occurred does not waive his substantive rights, such as the right to compel the return of funds wrongfully removed

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[117] For a discussion of the history of such procedure and the policies behind it, see Taffer L.M., The Making of the Electronic Fund Transfer Act: A Look at Consumer Liability and Error Resolution, [1979] 13 University of San Francisco L. Rev. 231.

[118] 15 U.S.C § 1693c(a)(7).

[119] 15 U.S.C. § 1693c(a)(7).

[120] 15 U.S.C. § 1693f(a); Regulation E, 12 CFR § 205.11(b)(1)(i) (1986). The bank is bound to make available to its customer a written documentation of each EFT transfer. This documentation must clearly show the amount transferred, the date of transfer and the name of the payee. 15 U.S.C. § 1693d(a).

from his account. He merely waives access to the error resolution procedures. The error resolution procedures were adopted to give consumers additional rights, not to limit existing ones.[121]

In practice, the consumer will know about such error from his periodic statement.[122] Accordingly, the sixty-day period begins to run from the date of the transmittal of such statement.[123] No specific form in which notice of error given to the bank is required.[124] Oral as well as written notification is accepted. However, a bank may, by agreement, require written notification, or written confirmation of the oral notification within a specified period.[125] Written confirmation, if required, must be requested at the time the bank receives oral notice; and an address on which such confirmation is to be received must be given to the customer. A bank may insist that the consumer should use a specific phone number or address when giving a notice of error.[126]

The consumer must provide the bank with information regarding his identity and the account affected by the error. He must also provide the bank with information about the error. This includes, but is not limited to, a statement indicating his "belief, and reasons for that belief, that an error exists in [his] account ... and to the extent

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[121] Huber, S. "Bank Officer's Handbook of Government Regulation", (2nd ed. 1989), at para. 22.05[1]; and Baker & Brandel (1988), supra, at para. 15.02[2] (where it is said that the customer's failure to notify his bank of the erroneous transfer does not, by itself, "defeat such customer's rights with respect to any claims for monies wrongfully paid or withheld, for damages arising from the [bank's] breach of duty owed to the customer").

[122] 15 U.S.C. § 1693d(a) obliges banks to provide consumers with a vast range of written documentation of their transfers. This, for example, includes (i) the amount involved and date the transfer is initiated; (ii) the type of transfer; (iii) the identity of the consumer's account with the bank from which or to which funds are transferred; the identity of any third party to whom or from whom funds are transferred; and the location or identification of the electronic terminal involved.

[123] See for a detailed discussion of error resolution generally, Baker & Brandal (2nd ed., 1988), chap. 15.

[124] 15 U.S.C. 1693f(a); and Regulation E, 12 CFR, § 205.11(b)(1)(i) (1986).

[125] Regulation E, 12 CFR § 205.11(b)(2) (1986).

[126] Regulation E, 12 CFR § 205.11(b)(1)(i) n.10 (1986). However, in order to do so, the bank must maintain reasonable procedure for referring those customers who contact other bank's phone numbers or addresses to the proper phone number or address. See 45 Fed. Reg. 8255 (1980).

possible the type, the date, and the amount of the error".[127] Informing the bank of the account number that has been erroneously debited, and the amount of debit and type of error would be sufficient for such notification requirement. Where a consumer's notification is somewhat vague or imprecise, a bank is expected to make a good faith effort to identify and resolve the alleged error.[128]

iii. Acts Constituting Errors.

For the purpose of error resolution procedures, a broad range of acts constitute errors. Those include the following:[129]

(a) An incorrect electronic funds transfer from or to the consumer's account;

(b) Computation errors by the bank concerning an electronic funds transfer;

(c) Consumer's inadequate funds from an electronic terminal;

(d) An unauthorised electronic fund transfer;

(e) Erroneous omissions of an electronic fund transfer from a consumer's periodic statement; and

(f) Improper documentation of electronic fund transfers.

The Board of Governors of the Federal Reserve System can, by way of regulations, add other acts.[130]

iv. The Investigation of the Alleged Error.

A bank must promptly act to resolve the alleged error upon receipt of a proper notice from the consumer concerned.[131] Its investigation must reach a conclusion as

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[127] Regulation E, 12 CFR § 205.11(b)(i)(iii) (1986).

[128] 44 Fed. Reg. 59, 481 (1979).

[129] 15 U.S.C. § 1693f(f).

[130] 15 U.S.C. § 1693f(f)(7).

[131] See Beutel F.K. & Schroeder M.R., Bank Officer's Handbook of Commercial Banking Law (5th ed.), at § 26-65.

to the presence or absence of the alleged error.[132] The bank may utilise two methods for resolving the alleged error; a ten-business-day procedure, or a forty-five business day procedure. Whichever procedure the bank chooses, it should completes its investigation and send the results to the consumer within the time limit of the procedure used.

If the bank chooses the shorter investigation period, it must investigate the alleged error, determine whether an error has occurred, and notify its consumer of the result of its investigation within ten business days.[133] A bank may require written confirmation to be provided to it within ten days of an oral notification of error. This does not waive the bank's duty to commence its investigation immediately.[134] Indeed, this may work for the interest of the bank, since it must meet certain requirements if it chooses to enter into the other procedure.

Choosing the longer investigation period procedure requires the bank to provisionally recredit its consumer's account with the amount of the alleged error within ten business days after receiving notice of such an error;[135] and allow him full use of the provisionally recredited funds during the investigation period.[136] The bank must notify the consumer of such steps within two business days after the recrediting occurs. Oral notification is allowed, but the bank must keep proof of such fact.[137]

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[132] 15 U.S.C. § 1693f(a).

[133] 15 U.S.C. § 1693f(a).

[134] Regulation E, 12 CFR, §§ 205.11(c)(1), 205.11(c)(1) and 205.11(c)(3). See also Baker & Brandel (1988), supra, para. 15.02[4].

[135] Regulation E, 12 CFR §§ 205.11(c)(2)(i), 205.11(c)(2)(ii) and 205.11(c)(2)(iii) (1986). However, the bank is entitled to withhold up to $50 from the amount recredited if it has reasonable grounds to believe that an unauthorised EFT may have occurred and that it has satisfied the requirements imposed by § 205.6(a) concerning the liability of the consumer for unauthorised EFT. See Regulation E, 12 CFR § 205.11(c)(2)(i) (1986).

[136] 15 U.S.C. § 1693f(c).

[137] See Huber, S. "Bank Officer's Handbook of Government Regulation", (2nd ed. 1989), at para. 22.05[1][a].

Banks can combine the two procedures together.[138] This means that the ten business-day and the forty five business-day periods represent the maximum time available for error investigation. A bank may start with the ten-business-day procedure for two reasons. First, to limit consumer dissatisfaction with longer period; and second, to avoid the withdrawal of the recredited funds by a fraudulent consumer. If, however, the bank needs more than ten-business-days, the bank can start the forty-five business-day procedure by recrediting the disputed sum to the consumer's account and sending him an appropriate notification letter. Banks may adopt the last procedure by programming a computer to recredit disputed amounts and generate notification letters on the tenth business day after an error notice is received, subject to a countermanding instructions if the error investigation is completed earlier.[139]

The bank is under no duty to investigate beyond its own records. Thus, where there is an error in the amount of payment transferred to a specific payee, the bank is under no duty to investigate the records of the payee if there is no agreement between the bank and the payee.[140] This so-called "four walls investigation rule" leaves consumers with the burden of providing external evidence.[141]

The error resolution procedure can be disregarded by the bank if (i) the bank chooses to credit the consumers' account permanently with the amount of the alleged error or to take whatever other action the consumer is requesting in connection with the error;[142] or (ii) the consumer voluntarily withdraws the notice of error after

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[138] Ibid.

[139] Ibid.

[140] Regulation E, 12 CFR § 205.11(d)(2) (1986). A bank is expected to have an agreement, for example, with retailers that accept the bank's EFTPOS debit cards. Thus, in error resolution case, a bank can be compelled to review the relevant retailer's records.

[141] Baker & Brandel (1988), supra, para.15.02[4][b].

[142] Regulation E, 12 CFR § 205.11(d)(3) (1986).

concluding that no error has actually occurred.[143]

v. The Implementation of the Investigation's Result.

Since the bank is obliged to conclude whether, or not, the alleged error did occur, three possible results can be reached. Those are: (i) the alleged error did occur; (ii) the alleged error did not occur; and/or (iii) a different error from that alleged was found by the bank during the investigations. Different steps are required by the bank involved depending on which result is reached.

a- Existence of the Alleged Error.

If the bank determines that the alleged error did occur, it should promptly correct the error within one business day of such finding.[144] If such determination occurs on the tenth business day after the error was reported, the bank can recredit the consumer's account on the eleventh day, even though it is required to send the result of the investigation to the consumer by the end of the tenth day.

Where correcting the error requires the bank to recredit a consumer's account, interest on the wrongfully debited amount must be included if such amount was originally held in an interest-bearing account.[145] Fees and charges imposed as a result of the error must be refunded, but not those that would have been incurred even if the error had not occurred.[146] The bank must notify the consumer that an error did occur within the ten days or forty five days time limit, whichever is applicable. Such notification can be given in the periodic statement, if such statement is mailed within the time limit and according to the appropriate notification requirements.[147]

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[143] Regulation E, 12 CFR § 205.11(g).

[144] 15 U.S.C. § 1693f(b); Regulation E, 12 CFR § 205.11(e).

[145] Ibid.

[146] Huber, S. "Bank Officer's Handbook of Government Regulation", (2nd ed. 1989), at para. 22.05[1][b].

[147] Official Staff commentary to Regulation E, § 205.11-20.

The recrediting of the consumer's account is subject to consumer's liability for unauthorised electronic fund transfers according to the provisions of § 1693g of EFTA. This may result in deducting a $50 from the recredited amount in certain circumstances.

b- Absence of the Alleged Error.

If the bank determines after the completion of its investigation that the alleged error has not occurred, it should send the consumer concerned an explanation of its finding. This must be coupled with a notice of the consumer's right to request reproductions of the documents that the bank has relied on its investigations.[148] However, a bank is allowed to excise parts of the documents that it relied on in its investigation to protect the privacy of other customers.

The notification must be made at the end of the tenth business day if the bank uses such procedure. Alternatively, the bank is allowed three business days after the conclusion of its investigation if it uses the longer procedure, even if the bank uses all the forty five business-days. The rationale behind this distinction is that the notification in the longer procedure is less urgent since the amount in dispute is available to the consumer.[149]

The bank is entitled, if it concluded that no error was found, to debit the consumer's account with the provisionally recredited amount. It must notify the consumer of this action. Thereafter, the bank must continue to honour paper instruments payable to third parties and preauthorised transfers for five business days after the transmittal of the notice of debit.[150] No ATM or other cash withdrawal is

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[148] 15 U.S.C. § 1693f(d); and Regulation E, 12 CFR § 205.11(f)(1) and (3).

[149] Huber, S. "Bank Officer's Handbook of Government Regulation", (2nd ed. 1989), at para. 22.05[1][c].

[150] Regulation E, 12 CFR § 205.11(f)(2)(ii) (1986).

allowed regarding the debited amount. This right should be mentioned in the notice. This, of course, does not mean that the bank must honour all items presented during the five business-days following the transmittal of the debit notice. It must honour only those items that would have been paid during those five days had the consumer's account not been debited.[151] No charge may be imposed for overdraft items honoured because of the five business day rule, but normal item or transaction charges may be imposed.[152] For example, if a consumer's balance is $500 and an additional $100 is in dispute, a bank may not refuse to honour a cheque of $550, presented within five business days of the bank's finding that no error has occurred, even if such finding concludes that the consumer's true balance is only $500. No overdraft charge may even be imposed. However, a bank may refuse to honour a cheque of $650. That is because, such cheque would have been dishonoured for insufficient funds even if there had been no error.[153]

c- Existence of a Different Error.

An investigation of an alleged error may reveal another error. For instance, the bank may find that the amount of the error is different from the amount alleged by the consumer. If the bank found that the amount is greater than that asserted by the consumer, the bank must rectify the error as described in the existence of an alleged error. However, if the amount is lesser than the one alleged, the bank must follow both procedures; the one relates to the existence of the alleged error regarding the lesser amount and the one relates to the absence of the alleged of error regarding the

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[151] Baker & Brandel (1988), supra, para. 15.02[5][b].

[152] Huber, S. "Bank officer's Handbook of Government Regulation", (2nd ed. 1989), at para. 22.05[1][c].

[153] See for other examples, Baker & Brandel (1988), supra, para. 15.02[5][b]; and Huber, S. "Bank Officer's Handbook of Government Regulation", (2nd ed. 1989), at para. 22.05[1][c].

remaining alleged amount.[154]

A bank may, however, found an entirely different error from that alleged. The bank, in this case, is not obliged to follow the error resolution procedures adopted by EFTA. That is because those procedures are inapplicable to errors found by banks without consumer's compliant.[155] But, if the suspected error is under investigation when an allegation that such an error exists in a consumer's account is made, the bank must follow error resolution procedures, as it has not yet discovered the alleged error.

vi. Liability for Noncompliance with the Error Resolution Procedures.

a- Failure to Disclose Error Resolution Provisions.

A bank's failure to disclose to its consumer customers a summary of the error resolution provisions, and their rights thereunder in "readily understandable language" at the time of entering into the transaction involved in the error, is liable for damages. Those damages include "any actual damages sustained" by the consumer concerned as a result of the lack of such disclosure, in addition to a prescribed statutory damages. This is coupled with the costs incurred and a reasonable attorney's fee in the case of a successful action.[156]

b- *Mala fide* Noncompliance with the Investigation.

A consumer who thinks that his bank did not take his allegation seriously, may take the matter to courts. There, a bank may face an action for "treble" "any actual damages sustained" by such customer for the bank's failure to comply with certain requirements of the error resolution procedures. Under § 1693f(e) of EFTA this action arises in two situations: First; where the bank uses the longer procedure but fails to

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[154] See Huber, S. "Bank Officer's Handbook of Government Regulation", (2nd ed. 1989), at 22.05[1][d].

[155] Ibid.

[156] For the measure of such damages see 15 U.S.C. § 1693m.

provisionally recredit a consumer's account within ten business day after receiving notification of error provided that such failure is coupled with either (i) the bank's failure to make a good faith investigation for the alleged error, or (ii) the non existence of a reasonable justification for the bank's belief that the consumer's account was in error. Second; where the bank knowingly and wilfully concluded that the consumer's account was not in error when such conclusion could not reasonably have been drawn from the evidence available to the financial institution at the time of its investigation.

c- *Bona fide* Noncompliance with the Investigation.

A bank that does not resolve an alleged error could face liability even if it followed the error resolution procedure. The consumer still has his substantive rights to recover any amount wrongfully removed from his account. Assuming that the bank wrongfully transferred a given amount to a different beneficiary, it is not entitled to debit its customer's account for lack of mandate. This is also the case in overpayment.

4.2.2 [b] [i] [2] Post-Error Resolution Procedures.

A consumer that is not satisfied with the result of its bank's error investigation, may sue its bank for damages resulting from the alleged error. No provision in EFTA prevents such consumer from raising the same dispute again in courts. However, a consumer cannot obtain damages under both procedures. A consumer may only sue the bank when he rejects the finding of the bank's investigation concerning the alleged error.

In dealing with banks' liability for their failure to make an EFT "in accordance with the terms and conditions of an account, in the correct amount or in a timely manner", EFTA adopts different standard of liability if such failure has resulted from

"a bona fide error".[157] A bank in this case is liable to its consumer for the "actual damages proved" to have been caused by such error. It is irrelevant whether the bank causing the error has maintained "procedures reasonably adapted to avoid any such error".[158] However, if the bank's failure to make an EFT, generally, was not caused by a bona fide error, that bank would be liable for "all damages proximately caused" by such failure.[159] Since banks' liability for failure to make an EFT was discussed earlier, the analysis here will concentrate on banks liability for bona fide erroneous transfers.

Although it is said that § 1693h of EFTA "would set the same standards of liability for financial institutions in EFT that now apply to checking under the Uniform Commercial Code",[160] it did not adopt the traditional distinction made by U.C.C. § 4-402 between "mistaken" wrongful dishonour and "nonmistaken" wrongful dishonour of cheques. Rather, § 1693h of EFTA made a distinction between "a bona fide error" and other causes of banks' failure to make an EFT generally. The term "a bona fide error" is not defined by EFTA, or Regulation E. However, it was used by other titles of the Consumer Credit Protection Act.[161] The Fair Debt Collection Practices Act[162] provides in a very similar language to EFTA that the defendant will be relieved of all liability if it shows by "a preponderance of evidence" that the violation of the provisions of FDCPA was "not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid

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[157] 15 U.S.C. § 1693h(c).

[158] Ibid.

[159] 15 U.S.C. § 1693h(a).

[160] The Sen. Rep. No.915, supra, at 9417, 9409.

[161] 15 U.S.C. § 1601 et seq. Hereinafter cited as CCPA.

[162] 15 U.S.C. § 1692 et seq. Hereinafter cited as FDCPA.

any error."[163] The Truth-in-Lending Act[164] also provides in the same language for "a bona fide error" defence.[165]

Thus, an analogy should be drawn with other titles of the Consumer Credit Protection Act (CCPA) rather than with U.C.C.§ 4-402. That is because of the similarity of the language used in those titles and § 1693h of EFTA. Further, EFTA and those mentioned statutes are titles of one Act, namely Consumer Credit Protection Act.[166] Thus, one suggests that courts should interpret the term "a bona fide error" as they did in other titles of CCPA.

Under both Acts the term "a bona fide error" has been narrowly construed by courts. The defendant must show that the violation of the Act was not intentional and was the result of a "*bona fide* error".[167] It was mainly restricted in practice to unintentional clerical errors.[168] It does not include mistakes in interpretation of the requirements of law.[169] Moreover, errors in printed forms are not, usually, viewed as clerical errors.[170] Banks' failure to provide any of the required information has been held not to be a bona fide or inadvertent error.[171] Courts did not consider a mistake in legal judgment, even on advice of counsel, a "bona fide error".[172] A

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[163] 15 U.S.C. § 1692k(c) (1982).

[164] 15 U.S.C. § 1601 et seq.

[165] 15 U.S.C. § 1640(c) (1982).

[166] 15 U.S.C. § 1601 *et seq.*

[167] See *Bingham v. Collection Bureau, Inc.*, 505 F.Supp 864, 874 (D.N.D. 1981) (FDCPA). It was held in *Baker v. G.C. Services Corp.*, 677 F.2d 775 (9th Cir. 1982) that reliance on advice of counsel does not establish a bona fide error.

[168] See e.g. *Bizier v.Globe Fin. Services Inc.*, 654 F.2d 1 (1st Cir. 1981); *McGowan v. King Inc.*, 569 F.2d 849 (5th Cir. 1978); *Haynes v. Logan Furniture Mart, Inc.*, 503 F.2d 1161, (7th Cir. 1974); *Aldrich v. Upstate Auto Wholesale*, 564 F. Supp. 390 (N.D.N.Y. 1982); *Pearson v. Easy Living, Inc.*, 534 F. Supp. 884 (S.D. Ohio 1981); *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303 (E.D. Va. 1981); *French v. Wilson*, 446 F. Supp. 216 (D.R.I. 1978); and *Housten v. Atlanta Fed. Sav. & Loan Ass.*, 414 F. Supp. 851 (N.D.Ga. 1976).

[169] See Matthew Bender's Banking Law, Vol. 8, supra, para. 164.05[4][a].

[170] *Simbolin v. Kline Sales Co.*, 422 F.Supp. 625 (S.D.N.Y. 1976).

[171] *Hinkel v. Rock Springs Nat'l Bank*, 538 F.2d 295 (10th Cir. 1976).

[172] See e.g. *In re Shariff*, 23 Banker, 519, 521 (N.D. Ga. 1982) and cases cited thereon. See Matthew Bender's Banking Law, Vol. 8, supra, para. 164.05[4][a] (where it is argued that "[e]rrors in legal judgment will, under no circumstances, be considered a *bona fide* error").

bank's refusal to make a credit transfer in reliance on an unjustifiable set-off, for example, which left insufficient funds in the customer's account should not be construed as "a bona fide error".

Thus, a "bona fide error" should be restricted by courts to clerical and other bookkeeping errors.[173] It should, for example, exclude intentional acts based on a misunderstanding of the legal rights of the bank, the customer and third parties. Moreover, courts should require banks to show that they had maintained procedures reasonably adopted to avoid bona fide errors.[174] It was held in *Mirable v. General Motors Acceptance Corp.*,[175] that the insufficient training of staff was a lack of maintaining necessary procedures. It is clear that this issue is a possible area for conflicting interpretation.

4.2.2 [b] [i] [3] Exceptions; Errors Caused by Act of God or Technical Malfunction.

§ 1693h(b) of EFTA provides for two exceptions to bank's liability for its failure to make an EFT in "the correct amount". A bank is exempted from liability for "all damages proximately caused" by its failure to make an EFT in "the correct amount" if it shows by a "a preponderance of the evidence" that its action or failure

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[173] See e.g. *Bizier v. Globe Fin. Services Inc.*, 654 F.2d 1 (1st Cir. 1981); *McGowan v. King Inc.*, 569 F.2d 849 (5th Cir. 1978); *Haynes v. Logan Furniture Mart, Inc.*, 503 F.2d 1161, (7th Cir. 1974); *Aldrich v. Upstate Auto Wholesale*, 564 F. Supp. 390 (N.D.N.Y. 1982); *Pearson v. Easy Living, Inc.*, 534 F. Supp. 884 (S.D. Ohio 1981); *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303 (E.D. Va. 1981); *French v. Wilson*, 446 F. Supp. 216 (D.R.I. 1978); and *Housten v. Atlanta Fed. Sav. & Loan Ass.*, 414 F. Supp. 851 (N.D.Ga. 1976). In addition to these cases, one may also find some support in the interpretation of the concept of mistake in wrongful dishonour of cheques by the leading case of *Wildenberger v. Ridgewood National Bank*, 230 N.Y. 425, 130 N.E. 600 (1921). Such dishonour was restricted by that court to clerical errors. This case has been constantly followed by later decisions. See for example, *Morse v. Matual Fed. Sav. & Loan Ass.*, 536 F.Supp. 1271 (D.Mass. 1982); *Yacht Club Sales & Service, Inc. v. First Nat'l Bank*, 101 Idaho 852, 623 P.2d 464 (1980); *Allison v. First Nat'l Bank*, 85 N.M.283, 511 P.2d 769 (N.M. Ct. App., rev'd on other grounds, 85 N.M. 511, 514 P.2d 30 (1973); *Farmers & Merchants State Bank v. Ferguson*, 617 S.W.2d 918 (Tex. 1981). Contrast *Continental Bank v. Fitting*, 559 P.2d 218 (Ariz. Ct. App. 1977); *American Fletcher Nat'l Bank & Trust Co. v. Flick*, 146 Ind. App. 122, 252 N.E.2d 839 (1970); *First Nat'l Bank v. Hubbs*, 566 S.W. 2d 375 (Tex. Civ. App. 1978). It is argued that since EFTA "appears to be modelled after the original Truth-in-Lending Act ... an expansive definition of *bona fide* error may not be appropriate for the EFTA". Matthew Bender's Banking Law, Vol.8, supra, para. 164.05[4][a]. However, it should be noted that in the Truth-in-Lending Simplification Act, the concept of clerical error has been expanded to include other types of errors such as miscalculation, computer malfunction and programming errors, and printing errors.

[174] This has been the case under the FDCPA which has the same wording as EFTA as far as this point is concerned. See *Carrigan v. Central Adjustment Bereau*, 494 F.Supp. 824 (N.D. Ga. 1980).

[175] 537 F.2d 871 (7th Cir. 1976).

to act which caused the "incorrect amount" to be made has resulted from:

> "(1) an act of God or other circumstances beyond its control, that it exercised reasonable care to prevent such an occurrence, and that it exercised such diligence as the circumstances required; or
> (2) a technical malfunction which was known to the consumer at the time he attempted to initiate an electronic fund transfer or, in the case of a preauthorized transfer, at the time such transfer should have occurred."

4.2.2 [b] [ii] Commercially-based Transactions.

4.2.2 [b] [ii] [1] Erroneous Amount.

As a general rule, a sender is obliged to pay its receiving bank only the amount designated in its payment order.[176] The receiving bank that erroneously executed its sender's payment order as to the amount, is entitled either to the amount of the sender's payment order or the actual amount transferred, whichever is lesser. The bank is entitled, however, to recover the excess payment from the paid beneficiary to the extent allowed by the law governing mistake and restitution.[177]

U.C.C. § 4A-303(a) states that a bank that erroneously executes a payment order by transferring an amount greater than the amount of its sender's payment order is entitled to recover from that sender only the amount of the sender's payment order. This includes the case of duplicate orders. Thus, if a receiving bank, for example, receives an order by a customer to transfer $10,000 to a given beneficary in the latter's bank; and the bank erroneously instructed the beneficiary's bank to credit the beneficary's account with it by $100,000 it must bear the loss. If the beneficiary's bank accepts the receiving bank's payment order of $100,000 by crediting this amount to the beneficiary's account, it is entitled to be reimbursed for the whole amount by

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[176] U.C.C. § 4A-303(a). This assumes that the sender is obliged under § 4A-402(c) to pay the receiving bank, i.e. no application of the money back guarantee rule. It assumes too that money is paid to the right beneficiary, but the amount is wrong.

[177] U.C.C. § 4A-303(a).

the receiving bank. The receiving bank, however, cannot debit its sender by more than $10,000. The receiving bank has a mandate to debit its sender's account only by the amount that appears in the sender's payment order. The risk of loss resulting from the overpayment is to be borne by the receiving bank. That is $90,000. The receiving bank is entitled, however, to recover such amount from the paid beneficiary to the extent allowed by the law of mistake and restitution.[178] This does not necessarily mean that the receiving bank will be able to recover all the overpaid amount from the beneficiary. The beneficiary may, under certain circustances, keep either all, or part, of the overpayment. For example, if the receiving bank's customer, in the above example, owes the beneficiary $30,000. The beneficiary, provided receiving the erroneous amount of $100,000 in good faith from its debtor, is entitled to keep the intended amount of transfer, that is $10,000, plus $20,000 its extra unpaid debt which the receiving bank's customer owes it. It is entitled to consider such debt as discharged as against the receiving bank's customer. However, the receiving bank that has paid a debt of its customer would be subrogated to the beneficiary's rights against its customer on the debt paid by it.[179] The same rule applies to duplicate orders.[180]

The other possible case is the execution of the sender's payment order with underpayment. In this case, unless the bank corrects the situation by issuing an additional payment order, it is not entitled to more than the actual amount transferred.[181] However, if the supplement payment is received later than the payment date, a sender may consider that as a late payment which may entitle him to

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[178] U.C.C. § 4A-303(a).

[179] See the Official Comment 2 of U.C.C. § 4A-303.

[180] U.C.C. § 4A-303(a).

[181] U.C.C. § 4A-303(b).

damages.[182]

The amount of the sender's payment order could be reduced by the amount of the bank's charges for services and expenses in connection with the execution of the order. This will result in an execution of the sender's payment order in an amount less than its original intended amount. Such deduction needs express authorisation by the sender.[183] If a bank, however, obtains such authorisation, it escapes liability for underpayment where it results from the deduction of the bank's charges for services.[184]

The sender of a payment order is under a duty to exercise ordinary care to determine, on the basis of information available to it, that the order was erroneously executed. The sender should notify its receiving bank of the relevant facts within a reasonable time not exceeding ninety days after the bank's notification to the sender of the fact of the transfer. Failing to do so, would prevent the sender from claiming interest on the refundable erroneous amount for the period before the bank learns of the execution error. This is the only remedy available to the bank for its sender's failure to report erroneous execution of its payment orders within the above specified period.[185] The sender's failure to uphold its duty in the erroneous execution of payment orders does not, unlike the case of erroneous payment orders, shift the risk of loss to the sender. The rationale behind such distinction is that, unlike the case of erroneous payment orders, no fault is attributed to the sender in erroneous execution

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[182] See for the measure of damages for delay in payment, U.C.C. § 4A-305.

[183] U.C.C. § 4A-302(d). This is called par payment. It is not allowed without express authorisation by the sender. U.C.C. § 4A-302(d). See Felsenfeld C., Strange Bedfellows For Electronic Funds Transfers: Proposed Article 4A of the Uniform Commercial Code and the UNCITRAL Model Law, [1991] 42 Alabama L. Rev. 723.

[184] U.C.C. § 4A-303(b).

[185] U.C.C. § 4A-304. See for an exception to this rule U.C.C. § 4A-505 (failure to notify such erroneous execution within a year).

of payment orders.

However, a sender's failure to discover and notify its bank of errors in its account within one year of the notification of a debt in the sender's account terminates the sender's right to the principal sum under the money-back guarantee.[186] So, a sender must investigate very carefully its bank's statements to discover any mistaken debts applied to its account. However, in the light of the large amounts involved in wholesale wire transfers, senders will normally discover and report erroneous debts in a reasonable time to recover, at least, their principal sum.

4.2.2 [b] [ii] [2] Unintended Beneficiary.

A bank that executes its sender's payment order erroneously by instructing the transfer of funds to a beneficiary different from that designated in the sender's payment order is not entitled to be reimbursed by its sender.[187] All previous banks to that bank which are involved in that funds transfer are also not entitled to be reimbursed by their senders. That is so provided that the payment order is carried out by all subsequent banks in the payment process on the basis of such error, with the final result of crediting the account of the wrong beneficiary.[188] This is based on the fact that a bank that pays, or caused payment to be made to, a different beneficiary from that designated in the sender's payment order does not conform to the terms of that sender's payment order as regards the identity of the beneficiary. As such, that sender and all previous senders in the funds transfer are not obliged to payment orders that they issued.[189] If payment is already made to the sender's bank, e.g. the sender's

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[186] U.C.C. § 4A-505.

[187] U.C.C. § 4A-303(c).

[188] U.C.C. § 4A-303(c).

[189] U.C.C. § 4A-303(c).

account is debited, the sender is entitled to be refunded the amount of the payment order with interest from the time of payment.[190] For example, a company instructs its bank to transfer $1,000 to account number (123456) in bank X. The company's bank instructs an intermediary bank to transfer $1,000 to account number (123456) in bank X. The intermediary bank erroneously instructs bank X to credit account number (123457) with $1,000. Receiving the intermediary bank's payment order, bank X duly credited account number (123457) with $1,000. Which bank is liable for that error?

The error was committed by the intermediary bank in issuing a payment order to bank X to credit a wrong account number. Instead of conforming to its sender's payment order by instructing bank X to credit $1,000 to account number (123456), it made a mistake by instructing bank X to credit the same amount to account number (123457). Assuming that bank X is not aware of the error, it conformed to the payment order of its sender, i.e. the intermediary bank, by crediting account number (123457) with $1,000. Thus, the intermediary bank is obliged to pay bank X $1,000 since bank X carried out the intermediary bank's payment order as instructed. However, since the intermediary bank did not execute the company's bank's payment order as instructed it is not entitled to be reimbursed by the company's bank. It has no mandate from its sender, i.e., the company's bank, to transfer the instructed amount to account number (123457) but to account number (123456). The risk of loss resulting from such error falls on the intermediary bank. The error that caused the loss was its. Other subsequent banks were not in a better position to avoid the loss. The remedy of the intermediary bank is to recover $1,000 from the holder of account

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[190] However, the sender is under a duty to exercise ordinary care to determine, on the basis of information available to it, that the order was erroneously executed; and to notify its bank of the relevant facts within a reasonable time not exceeding 90 days after it learns of such error. Failure to meet this duty excuses the bank from paying interest on any refundable amount to the sender. U.C.C. § 4A-304.

number (123457) that received payment by mistake. Recovery is based on the law of mistake and restitution. This may prove costly where the beneficiary is entitled under exceptional circumstances of the law of restitution to keep all or part of the mistaken payment.[191]

However, if the sender of a payment order pays the order, which it was not obliged to pay, the paid bank is obliged to refund the paid amount. Interest is payable, too, on the refundable amount from the date of payment.[192]

A payment order received by the beneficiary's bank may identify the beneficiary by its name and account number. It is clear that there is no problem if the name and the account number identify the same beneficiary. The beneficiary's bank must conform to such identification by paying that beneficiary. The rules discussed above apply. If the two methods of identification, however, identify different persons, the bank's liability for paying according to either method depends on the bank's knowledge of the existence of such discrepancy. First; if the beneficiary's bank does not "know"[193] that the name and account number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order.[194] If the paid person identified by number was not entitled to payment, the beneficiary's bank is entitled to be paid by the originator's bank.[195] That is because the beneficiary's bank is under no duty to determine whether the name and number refer to the same person.[196] Imposing such duty on the beneficiary's bank would cost time

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[191] See para. 4.4.2 [b] [iii] for the recoverability of erroneous payment under the the law of restitution and mistake.

[192] U.C.C. § 4A-402(d).

[193] "Know" is defined in U.C.C. § 1-205(25) to mean "actual knowledge". U.C.C. § 1-205(27) states rules for determining when an organisation has knowledge of information received by it.

[194] U.C.C. § 4A-207(b)(1).

[195] See U.C.C. § 4A-402(b).

[196] U.C.C. § 4A-207(b)(1).

and expenses, and thus the benefits of the electronic transfers would be lost.[197] If the beneficiary's bank pays the person identified by name, the beneficiary's bank is not entitled to be paid by the originator's bank except where the person paid was entitled to receive payment from the originator of the funds transfer.[198] Second, If the beneficiary's bank knows that the name and account number refer to different persons, it should withhold payment. No person has rights as beneficiary; and the payment order cannot be accepted.[199] If the beneficiary's bank, nevertheless, pays the wrong beneficiary, it has no right to be paid by the originator's bank. No acceptance of the originator's bank's payment occurs because there is no beneficiary of that order. Accordingly, since acceptance does not occur, originator's bank is not obliged to pay the beneficiary's bank.[200]

Originators that are banks are deemed to know that where there is discrepancy between beneficiary's name and its account number, beneficiary's bank is entitled to rely on account number to identify beneficiary rather than name. This presumption of knowledge is not valid against originators that are not banks. If payment is made according to the beneficiary's account number rather than its name, the non-bank originator is not obliged to pay its bank if it proves that the person identified by number was not entitled to receive payment from the originator. The originator's bank, however, is entitled to payment in the above case if it proves that the originator, before acceptance of its order, had notice that payment to the beneficiary might be made on the basis of the beneficiary's account number even if it identifies a person

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[197] See the Official Comment 2 of U.C.C. § 4A-207.

[198] U.C.C. § 4A-207(b)(2).

[199] U.C.C. § 4A-207(b)(2).

[200] U.C.C. § 4A-402(c).

different from the named beneficiary.[201] Such notice of the originator's bank's policy can be proved by any admissible evidence. The burden to prove such notice is satisfied if the originator's bank shows that the originator has signed, before the payment order was accepted, a writing stating the information to which the notice relates.[202]

Where the originator is obliged to pay its bank, it has the right to recover from the wrongfully paid person under the law of mistake and restitution. The same rule applies where a bank pays a wrong beneficiary and has no right to be paid by its sender.[203]

A payment order may instruct payment to a nonexistent or unidentifiable beneficiary or account number. In such a case, no payment should be made to any person or account number.[204] Since there is no beneficiary, or it is unidentifiable, a payment order cannot be accepted.[205] No person is entitled to the amount of the payment order as beneficiary. This means that the funds transfer cannot be completed.[206] Thus, according to the "money-back guarantee rule" each sender paid its bank is entitled to repayment; and those senders that did not pay are not liable to pay.[207]

It is suggested that where there is an inconsistent designation of the beneficiary it is intended that U.C.C. § 4A-207 supersedes U.C.C. § 4A-303 although Article 4A

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[201] U.C.C. § 4A-207(c)(2).

[202] U.C.C. § 4A-207(c)(2).

[203] U.C.C. § 4A-207(d) (the originator's bank); Official Comment 2 of U.C.C. § 4A-207 (the beneficiary's bank).

[204] U.C.C. § 4A-207(a).

[205] Ibid.

[206] U.C.C. § 4A-104(a) provides that "[a] funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order."

[207] U.C.C. § 4A-402(c).

does not state so expressly.[208]

4.2.2 [b] [iii] Recoverability of Erroneous Payment Under the Law of Mistake and Restitution.

In its dealing with erroneous fund transfer, Article 4A allocates the risk of recovery of erroneous payment between senders and banks as described above. The erroneous payment is usually recoverable under the general principles of mistake and restitution. In fact, Article 4A refers to the principles of mistake and restitution in several situations.[209] Examples of such reference are:

(i) U.C.C. § 4A-205(a)(2) allows the receiving bank to recover payment made to unintended beneficiary and the amount of a duplicate transfer if the erroneous payment order was transmitted pursuant to an agreed security procedure for the detection of error which failed to detect such error;

(ii) U.C.C. § 4A-205(a)(3) allows the receiving bank to recover overpayment caused by erroneous payment order not detected by a security procedure;

(iii) U.C.C. § 4A-207(d) allows the originator or its bank, depending on the satisfaction of certain requirements, to recover payment made rightly by the beneficiary's bank to a person identified by number if that person was not entitled to receive such funds from the originator;

(iv) U.C.C. § 4A-209(d) allows the originator's bank to recover from the beneficiary any payment made contrary to a cancellation order by the originator if the bank executes the originator's payment order before the execution date; and

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[208] Baxter & Bhala, "Proper and Improper Execution of Payment Orders", supra, at 1460.

[209] See for example, U.C.C. § 4A-205(2) (the receiving bank's right to recover erroneous and duplicate payment orders transmitted pursuant to an agreed security procedure for the detection of error); U.C.C. § 4A-205(3) (the receiving bank's right to recover overpayment caused by an erroneous payment order which is made pursuant to an agreed security procedure for the detection of error); U.C.C. § 4A-206(d) (the originator's right and originator's bank's right to recover erroneous transfers to an unentitled beneficiary); U.C.C. § 4A-209(d) (the originator's bank's right to recover from the beneficiary where payment is made contrary to a cancellation order by the originator); U.C.C. § 4A-303(a) and (c) (the receiving bank's right to recover payment made as a result of erroneous execution of payment order).

(v) U.C.C. § 4A-303(a) and (c) allows the receiving bank to recover payment made as a result of erroneous execution of payment order.

The principle that a party who pays money, under a mistake of fact, to one who is not entitled to it should, in equity and good conscience, be permitted to recover it back is a long standing and well recognised rule. The rule has its underpinning in unjust enrichment and rests upon the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another.[210] It is an obligation which the law creates, in the absence of any agreement, when and because the acts of the parties or others have placed in the possession of one person money or benefit which in justice and equity belong to another.[211]

Thus, the general principles of the law of mistake and restitution are crucial to recovery of erroneous payment even under Article 4A's provisions. These are briefly discussed below.

A person who pays money under a mistake of fact[212] is entitled, generally, to recover it from the payee or the payee's bank.[213] Courts have restricted recovery of erroneous payment to cases where the mistake was a mistake of fact, not a mistake of law. Although this distinction is heavily criticised by commentators,[214] and modified in several states,[215] it continues to prevail today in a majority of states.[216]

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[210] *Tulalip Shores, Inc. v. Mortland*, 511 P.2d 1402, 1404.

[211] *L & D Drywall, Inc. v. Whitmore Const. Co., Inc.*, 603 P.2d 626, 630.

[212] This cause of action is recognised in the mistaken payment of cheques. See U.C.C. §§ 1-103, 3-418, and 4-302. For a detailed discussion on the payer bank's right to recover mistaken payment under common law and provisions of the U.C.C., see Steven B. Dow and Nan S. Ellis, The Payer Bank's Right to Recover Mistaken Payments: Survival of Common Law Restitution under Proposed Revisions to Uniform Commercial Code Articles 3 and 4, [1990] 65 Ind. L.J. 779. Hereinafter cited as "Dow & Ellis, Restitution".

[213] Palmer, G.E. "The Law of Restitution", Vol.II, at 500.

[214] See, e.g., 13 Williston, A Treatise on the Law of Contracts, (3rd ed. 1970), at §§1581-1582 ("[T]he rule ... distinguishing mistake of law from mistake of fact is founded on no sound principle.", ibid, at 536); and D. Dobbs, Handbook on the Law of Remedies, (1973), at 760-762.

[215] See, e.g., Cal. Civ. Code §§ 1576-1578 (Deering 1971); GA. Code Ann. § 23-2-21, 22-2-22, 23-2-27 (1982); N.D. Cent. Code § 9-03-12, 9-03-13, 9-03-14 (1987); Okla. Stat. Ann. Title 15, §§ 62-64 (West 1983).

§ 1 of the Restatement of Restitution defines "mistake" as "a state of mind not in accord with the facts". § 7 of the Restatement provides that a "mistake of fact" means "any mistake except a mistake of law"; and a "mistake of law" means "a mistake as to the legal consequences of an assumed state of facts". A bank that erroneously executes its sender's payment order twice thinking that a letter affirming the original order is a new payment order commits an error in fact. In *In re Berry,*[217] a plaintiff, who mistakenly paid a debt a second time, was entitled to recover from the payee since, *inter alia*, its mistake was one of fact.

The erroneous payment must have been caused by the mistake.[218] It is not necessary that the payment was caused by the payee's mistake. It is sufficient that the payment was caused by the payer's mistake. However, the payer must show that it would be unjust to allow the payee to keep the erroneous payment.[219] It is suggested that this is the most problematic aspect of an action to recover erroneous payments.[220] The payee is entitled to assert that it would not be unjust for him, either in law or in equity, to retain all or part of the money paid.[221] However, the payer's negligence in making the payment does not preclude restitution.[222] A payer who proves that payment was made under a mistake of fact; and that such mistake

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[216] See the Restatement of Restitution, § 45 and cases cited in the Appendix.

[217] 147 F. 208 (2nd Cir. 1906).

[218] § 9 of the Restatement of Restitution.

[219] See, e.g., *Morgan Guarantee Trust Co., v. American Saving & Loan Assoc.,* 804 F.2d 1487, 1487 (9th Cir. 1986); *American Hominy Co. v. Millikin National Bank*, 273 F. 550, 556 (S.D. Ill. 1920); *Louisa National Bank v. Kentucky National Bank*, 239 Ky. 302, 39 S.W.2d 497, 499 (1931); and *Bryan v. Citizens National Bank*, 628 S.W.2d 761, 763 (Tex. 1982).

[220] Dow & Ellis "Restitution", supra, at 86.

[221] See, e.g., *Grand Lodge v. Towne*, 136 minn. 72, 78; 161 N.W. 403, 405 (1917); *Texas Bank & Trust Co. v. Custom Leasing*, Inc., 498 S.W.2d 243, 250 (Tex. Civ. App. 1973).

[222] See, e.g., *Morgan Guarantee Trust Co.*, 804 F.2d 1487, 1493 (9th Cir. 1986); *City National Bank v. Crocker National Bank*, 150 Cal. App. 3d 290, 197 Cal. Rptr. 721, 725 (1983); and *Bank of Naperville v. Catalano*, 86 Ill. App. 3d 1005, 1008, 408 N.E.2d 441, 444 (1980). *C.f. Chase Manhattan Bank v. Burden*, 489 A.2d 494, 497 (D.C. Cir. 1985); *Northern Trust Co. v. Chase Manhattan Bank*, 582 F.Supp. 1380, 1384-85 (S.D.N.Y. 1984); and *Rohrville Farmers Elev. Co. v. Frison*, 77 N.D. 235, 238, 42 N.W.2d 354, 356 (1950).

was the reason for the erroneous payment will probably succeed in his action for recovery, unless the payee proves that he is entitled to retain the money according to one of the equitable defences discussed below. As such, there is no significant difference between the English and the American jurisdictions on this issue.

American Courts have applied these principles in erroneous EFT transactions even before the enactment of Article 4A. In *In re Country Club Casuals Inc.*,[223] the court held that:[224]

> "The fact that the transfer of funds in our case was effected electronically does not require application of any different principles than would govern if [the transferor] had mistakenly delivered $100,000 in currency by messenger to the plaintiff."

Thus, the method of payment does not affect the payer's right to recover money paid under this equitable cause of action. In that case, a person who mistakenly transmitted $100,000 to the account of another, sought the recovery of such amount under the law of restitution. The court held that such person is entitled to the recovery of its funds, since the transfer was a result of a clerical error, and never intended to be transferred to the wrong payee, but rather was "intended for two other, unrelated clients in other cities".[225] The mistake has "resulted from a clerk's use of the wrong form while encoding instructions to the computer of its bank".[226] No party including the beneficiaries acted in reliance upon the mistaken transfer.

The payee argued that payment was final and irrevocable when it reached his account. Relying on the earlier case of *In re Berry,*[227] the court rejected such

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[223] 1 B.R. 274, 28 U.C.C. Rep. Serv. 474 (Bkrtcy. S.D.Fla. 1979).

[224] Ibid, 1 B.R. 274, at 276.

[225] In *re Country Club Causuals, Inc.*, 1 B.R. 274, at 275 (Bkrtcy. S.D.Fla. 1979).

[226] In *re Country Club Causuals, Inc.*, 1 B.R. 274, at 275 (Bkrtcy. S.D.Fla. 1979).

[227] 147 F. 208 (2nd Cir. 1906).

argument since "[t]he 'final payment' doctrine has not been applied ... and should not be applied to prevent equitable relief to undo a mistake".[228] Moreover, it is of no legal significance that this was a result of the payer's transmission error, "since the essence of a mistaken payment/money had and received action is that while the plaintiff has made a mistake, the defendant will not be allowed to profit unjustly as a result".[229]

In the recent case of *Manufacturers Hanover Trust Co. v. Chemical Bank*,[230] a transferring bank sued a transferee bank for mistaken payment since the transferee bank credited the transferred sum to a wrong account and ultimately used such funds to reduce overdraft in that account. The Supreme Court held that the transferring bank was entitled to recover the funds paid from the transferee bank.

The recoverability of erroneous payment is subject to certain equitable defences enjoyed by the payee. These are the discharge for value defence and the payee's *bona fide* change of position defence. They are available not only in the traditional methods of payment but also in EFT transactions. That was explicitly held in *Banque Worms v. Bank America International.*[231] In an erroneous CHIPS transfer, the court held:[232]

> "The equitable principles justifying the Discharge for Value Rule, as well as the related rules concerning bona fide purchasers, are just as valid whether the payment is by wire or by check."

Those are discussed below separately.

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[228] At 277. The court relied on U.C.C. § 1-103 where it is stated that "principles of equity, including ... the law relative to ... mistake ... shall supplement its provisions".

[229] *Manufacturers Hanover Trust Co. v. Chemical Bank,* 160 A.D.2d 113, 118; 559 N.Y.S.2d 704, 708 (N.Y.A.d. 1st Dept., 1990).

[230] 160 A.D.2d 113; 559 N.Y.S.2d 704 (N.Y.A.D. 1st Dept., 1990).

[231] 726 F. Supp. 940, 58 U.S.L.W. 2430, 10 U.C.C. Rep. Serv.2d 1307 (S.D.N.Y. 1989).

[232] Ibid, 726 F. Supp. 940, at 943.

(i) The Discharge for Value Defence.

§ 14(1) of the Restatement of the Law of Restitution provides that:

"A creditor of another or one having a lien on another's property who has received from a third person any benefit in discharge of the debt or lien, is under no duty to make restitution therefor, although the discharge was given by mistake of the transferor as to his interests or duties, if the transferee made no misrepresentation and did not have notice of the transferor's mistake."

Palmer in the Law of Restitution stated that:[233]

"In situations of endless variety, courts have denied restitution because money paid by one party was received in good faith by the other, in satisfaction or as a security for a valid claim against a third party."

This defence was successfully pleaded in the recent case of *Banque Worms v. Bank America International.*[234] In that case, an Australian company instructed its bank, Security Pacific International Bank (SPIB) to transfer $1,974,267.97 to Banque Worms (BW) through Bank America International (BAI). BW had outstanding loan to the company which it had called. The amount of the transfer would have satisfied the company's indebtedness to BW. After three hours, the company instructed its bank, SPIB, to disregard the first instructions and transfer the funds to National Westminster Bank Australia (NWBA). After less than three hours of transferring the funds by CHIPS to BAI for BW's account, SPIB informed BAI that the transfer instruction was a mistake. BW refused to repay the funds to SPIB arguing that such funds were applied to off-set the SPIB's customer's debt to BW.

The court held that BW was entitled to retain the funds according to the discharge for value rule. That is because BW, which was alleged to have been unjustly enriched, had a right to the money mistakenly transferred to its account. It was a

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[233] Palmer G., The Law of Restitution, Vol. III, (1978), at 490-491.

[234] 726 F. Supp. 940 (S.D.N.Y. 1989).

creditor of the transferring bank's customer. Thus, if the transferring bank's customer becomes bankrupt, as he was in this case, the transferring bank will bear the risk of loss. It was also held that BW as a creditor receiving the mistaken transfer from its debtor was not required to demonstrate detrimental reliance since it was entitled to the funds.[235]

(ii) The Payee's *bona fide* Change of Position Defence.

In the normal case, recovery of the erroneous payment from the payee does not cause him any loss. It only compels him to give up the amount of funds received as a result of a mistake. After restoring the funds to the payer, the payee will be back in the position he was in before the payment was received. The payee will clearly be no worse off as a result of the restitution. If, however, the payee has changed his position by losing or passing on the money received, restitution will result in an actual loss to the payee.[236] Under such circumstances, it is unjust to compel the payee to return the funds to the payee. The payee's change of position must not result from the payee's negligent.[237] The change of position must also be in a good faith.[238]

This defence was upheld by courts in EFT transactions. In *French Bank of California v. First Nat'l Bank of Louisvilie*,[239] the plaintiff bank (French Bank) sought restitution of $30,000 mistakenly transferred to the defendant bank (FNBL). In that case, a telex operator, employed by French Bank, sent the message to transfer $30,000 three times instead of one time to Bank of America. The latter, as an

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[235] Ibid. See also on banks' liability for erroneous and duplicate orders, *Barnett Bank, N.A. v. Jacksonville Nat'l Bank*, 457 So.2d 535 (Fla. App. 1984); *Continental Ill. Nat'l Bank and Trust Co., v. Consulting Engineering Group*, 594 F. Supp. 1500 (N.D. Ill. 1984); and *Shawmut Worcester County Bank v. First Am. Bank & Trust*, 731 F. Supp. 57 (D.Mass. 1990).

[236] Dow & Ellis "Restitution", supra, at 86-87.

[237] See Note, Defense of Change of Position in Cases of Payment Under Mistake on a Negotiable Instrument, [1929] 42 Harv. L. Rev. 411, at 411 fn.1.

[238] Palmer G., The Law of Restitution, Vol. III, (1978), at 511-512.

[239] 585 S.W.2d 431 (Ky. App. 1979).

intermediary bank, only instructed FNBL to make two transfers to the credit of Total Coal Sales. FNBL received the two transfers and credited $60,000 to the account of Total Coal Sales. Learning of the duplicate order, French Bank requested FNBL to return $30,000 or freeze that amount in Total Coal's account to prevent withdrawal. Although there was a communication between the banks, and an offer by French Bank to indemnify FNBL for any loss, no "document constituting an indemnifying agreement or bond was ever submitted."[240] The court held for FNBL, and refused to return the funds.[241] The court concluded that FNBL "had irrevocably changed its position to its detriment once it credited the money to [its] customer's account".[242] That is because if FBNL returns the funds to French Bank it runs the risk of being sued for "wrongful dishonor" by its customer if it demands payment. Gant J., in the dissenting judgement, questioned the reasoning of the majority on the basis that such "potential wrongful dishonor" was a mere possibility.[243] One suggests that FNBL may not rely on a mere expectation that its customer may present an item for collection which is drawn on the funds mistakenly transferred. To refuse returning the mistakenly transferred funds, the court must have evidence that the beneficiary's bank was presented with demand for payment or items for collection, or at least, has informed its customer of the transfer, who subsequently relied to his detriment on such fact. Alternatively, the bank must prove that its customer has a right to the mistakenly transferred funds, such as being a creditor of the transferring bank's customer.

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[240] Ibid, at 432.

[241] Per Howerton J. at 431-433. Cooper J. concurred and Gant J. dissented.

[242] Ibid, at 432. In fact, the court in *Manufacturers Hanover Trust Co., v. Chemical Bank*, supra at 121-122, 710 respectively, discussed this point, albeit obiter, and concluded that '[t]o assert a valid defense to MHT's mistaken payment/money had and received cause of action, Chemical must demonstrate detrimental reliance on the subject payment.' However, the court found that Chemical did benefit from the mistaken transfer.

[243] Per Gant J. at 433.

4.3 EFTPOS Transactions.

An error in an EFTPOS transaction may occur in the instructions to transfer funds between the different parties to the EFTPOS transaction. Banks' Liability for an erroneous EFTPOS depends on the relationship between the parties in the dispute. For the purpose of this discussion, the assumption is that the purchaser and the retailer maintain accounts in different banks. Thus, an error may occur in the funds transfer instructions between the purchaser and his bank, between the retailer and its bank, and between the banks themselves. Banks' liability for erroneous payment in EFTPOS transactions is discussed, therefore, under two headings; the purchaser's banks and the retailer's banks.

4.3.1 The Purchaser's Banks.

There is a banker-customer relationship between the purchaser and his bank. The bank issues an EFTPOS debit card to its customer according to a standard agreement. This agreement contains the terms and conditions of the use of the card. Under such agreement, a customer usually authorises his bank, *inter alia*, to irrevocably debit his designated account for all valid EFTPOS purchases using the given card. The bank undertakes, *inter alia*, to issue an EFTPOS debit card to its customer; and maintain this service by honouring all valid demands from certain retailers for payment by the use of the customer's card. Thus, the purchaser's bank may, for example, commit an error in debiting its customer's account by greater amount.[244] It may issue as a result of computer error instructions to retailers not to accept certain customer's card.[245] The purchaser's bank may commit an error in

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[244] See 15 U.S.C. § 1693f(f)(2) (incorrect transfer from or to a consumer's account constitutes error for the purpose of applying the mandatory error resolution procedures adopted by EFTA).

[245] 15 U.S.C. § 1693f(f)(4) ("a computational error" by the bank constitutes an error for the purpose of applying the mandatory error resolution procedures adopted by EFTA).

reimbursing the retailer, or other banks in the payment process. The discussion of these issues is undertaken under the U.K. and U.S.A. Law.

4.3.1 [a] Under U.K. Law.

Banks' liability for errors in EFTPOS transactions is mainly governed by the terms and conditions of the use of the customer's card. Banks are required by the Code of Good Banking to have written terms and conditions for the use of EFTPOS debit cards, expressed in plain language.[246] Those terms and conditions should be applied first to any dispute concerning errors in an EFTPOS transaction. However, those terms and conditions should provide a fair and balanced treatment of the relationship between the bank and its customer regarding such issue.[247] Problems may arise if those terms and conditions do not address error resolution.

The Code of Good Banking failed to address the problem of erroneous transfer, whether debit or credit, by card issuers. The code requires banks to offer customers a scheme for handling their complaints generally instead. Any card issuer is required to have its own internal procedures for handling customer's complaints.[248] Card issuers are required to tell customers how to file a complaint; and what further steps are available to them if they believe that the complaint has not been dealt with satisfactorily by the card issuer.[249]

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[246] § 14.1 of the Code of Good Banking.

[247] Ibid. Any variation of such terms and conditions will be notified to customers within a reasonable time before its implementation. § 14.2 of the Code of Good Banking.

[248] See § 20.0 of the Code of Good Banking entitled "Handling Customers' Complaints".

[249] For example, § 5.2 of Bank of Scotland's Code of Banking Practice reads as follows:
"The Bank's procedure for handling customers' complaints are as follows:
i) For a complaint related to a service provided by one of the Bank's branches, there are three stages in the formal complaints procedure. These are:

a) first, the customer should take up any grievance by letter, by telephone or in person, with the senior Manager of the branch where the complaint arose;

b) secondly, if a satisfactory response is not received, then the customer should write to the Regional Manager responsible for that branch; and

c) Failing satisfaction at Regional Manager level, the matter should then be referred to the General Manager with ultimate responsibility for the particular branch.

The purchaser's bank is not entitled, like the transferring bank in credit transfers, to debit its customer's account without authorisation.[250] The problem in EFTPOS transactions is that such authorisation is passed on to the purchaser's bank through the retailer or the retailer's bank. Thus, if the purchaser signs the sale slip with an amount more than his actual bill, the purchaser's bank will transfer that amount to the retailer or the latter's bank, relying on that slip. The error in this case is the purchaser's. The purchaser's bank then can debit the purchaser's account. The purchaser's remedy is against the retailer under the doctrine of money paid under an error of fact. In practice, however, retailers will refund to purchasers any amounts paid to them as a result of clerical errors.

A purchaser's bank may commit an error in preparing and sending its cards' "black list" so as to cause refusal of a customer's card. This, probably would be a breach of the terms and conditions of the use of the card. Alternatively, a bank could be found liable under the principles of agency.

Error in the transfer of funds between the purchaser's bank and other parties such as the retailer's bank is governed by a special agreement; or by the overall EFTPOS scheme agreement between participants. In the absence of any agreement, a bank could be found liable under the principles of agency. Alternatively, monies paid under a mistake of fact is recoverable under the doctrine of money paid by mistake.[251] This, however, is shaped with a great deal of uncertainty. The terms and

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... At every stage, immediate action will be taken to investigate the complaint and respond as soon as possible."

§ 5.3 of the same code, reads in part:

"In the event that a Personal Customer is still not satisfied after following this procedure, he or she may be able to apply to the Banking Ombudsman to arbitrate on the matter in dispute. ... Personal Customers are not bound by the Ombudsman's decision and may submit the matter to a Court to be decided."

[250] Unless the customer is estopped from denying, or has ratified, that debit.

[251] Arora A., Electronic Banking and the Law, supra, at 104.

conditions of most banks' account agreements are usually drafted in general terms, and mainly to protect banks' interests. Consumers' protection in this area is not sufficient as it is in the United States. One area of superiority there is that banks are obliged to recredit consumer's account with the disputed amount (as a result of an error) during the bank's investigation, and need not wait the result of the investigation.[252]

4.3.1 [b] Under U.S.A. Law.

The purchaser's bank's liability to its customer, the purchaser, for an error in EFTPOS transactions is governed by EFTA. EFTPOS transaction is within the ambit of the term "electronic fund transfer" as defined by EFTA.[253] Thus, it falls within the scope of EFTA as far as the relationship between the purchaser's bank and its customer, the purchaser, is concerned.[254] U.C.C. § 4A is not applicable.[255]

EFTA provides for a mandatory error resolution procedures for solving errors in EFT transactions, including EFTPOS ones. To the extent applicable, these error resolution procedures are the same in all EFT transactions subject to EFTA provisions. To this end, there is no need to repeat what has been discussed under banks' liability for erroneous credit transfers in consumer-based transactions. That discussion, to the extent applicable, is valid as to erroneous EFTPOS transactions between the purchaser's bank and the purchaser.

However, The "four-walls" investigation rule discussed in errors in credit transfers under consumer-based transactions is not applicable in the case of erroneous

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[252] When the bank applies the longer investigation procedure. See the discussion under the U.S.A. law below.

[253] 15 U.S.C. § 1693a(6).

[254] It is assumed that the purchaser is a consumer as defined by 15 U.S.C. § 1693a(5). Errors in the EFTPOS transaction between a bank and the retailer falls outside the scope of EFTA since a retailer is usually a merchant store which is not a consumer.

[255] U.C.C. § 4A-108 ("This Article does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 [15 U.S.C. § 1693 et seq.] as amended from time to time").

EFTPOS transaction. Purchaser's banks are expected to have an agreement with retailers to accept banks' cards. As such, where an error occurs in an EFTPOS transaction in relation to the purchaser, his bank is expected to extend its investigation beyond its "four-walls" to the records of the retailer from which the purchaser bought goods or obtained services.

However, EFTA is not applicable to erroneous payment instructions between the purchaser's bank and the retailer and other banks. A retailer or a bank is not a consumer, as none of them is a "natural person".[256] Contractual agreements are usually reached between those parties, and thus govern disputes between them. U.C.C. § 4A governs erroneous payment orders, and erroneous execution of payment orders between non-consumers. Disputes between banks and business customers as to errors in transferring funds between them is subject to the provisions of U.C.C. § 4A if implemented in the state concerned.

4.3.2 The Retailer's Banks.

The retailer's bank in EFTPOS transactions, undertakes, *inter alia*, either to credit the retailer's account by the purchases' price of all valid EFTPOS transactions, or to mere collect such price from purchasers' banks.[257] The retailer undertakes, *inter alia*, to accept valid EFTPOS debit cards by following certain rules, such as verifying signatures etc., and to authorise the bank, where applicable, to collect amount due from purchasers' banks and debit the retailer's account by an agreed service charge.

A retailer's bank may err in crediting its customer's account, or in collecting

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[256] See 15 U.S.C. § 1693a(5). See also *Kashanchi v. Texas Commerce Medical Bank*, 703 F.2d 936 (5th Cir. 1983).

[257] Less an agreed fee.

amount due to the retailer from purchasers' banks. It may occur in the reimbursement process between the retailer's bank and the purchaser's bank where the retailer's bank undertakes to pay the retailer and then reimburses itself from the purchaser through a guarantee by the purchaser's bank. Those issues are discussed under U.K. and U.S.A. law.

4.3.2 [a] Under U.K. Law.

A bank cannot, normally, acquire retailers unless its a member to an EFTPOS card scheme. This means that there is an "umbrella contract" between the participant banks. This contract governs the relationship between these banks, whether retailer's acquirers, card issuers or both. Another contract is usually entered into between each retailer and its bank.

The transfer of funds between banks to settle obligations arising from the use of their scheme's EFTPOS card is normally governed by their overall "umbrella contract". Thus errors as to transfer of funds between the retailer's bank and the purchaser's bank is govern by such contract. If no terms governing such issue are found, one suggests that the law as discussed in credit transfers should be referred to as the applicable law.

As to errors in the payment of the retailer by its bank, their contract must be applied first to govern such dispute. Where there is no provision in their agreement concerning error resolution, the retailer's bank's liability for its errors in crediting the retailer's account will be governed by general principles of the banker-customer relationship. To that extent, express and implied terms of such relationship are applicable. Thus, where the retailer's bank commits an error in collecting a lesser amount, for example, it should be liable for breaching its customer's instructions. The

position of the retailer's bank in EFTPOS transactions is mainly a collecting bank's position.

4.3.2 [b] Under U.S.A. Law.

Errors in the payment instructions between the retailer and the retailer's bank are not governed by EFTA provisions. Nor, are errors between the retailer's bank and the purchaser's bank. That is because none of those parties is a "consumer" as defined in EFTA.[258]

Special agreements between the parties may provide for procedures for solving errors. Alternatively, U.C.C. § 4A provisions are applicable in fund transfers between banks involved in a given EFTPOS scheme. Errors in fund transfers between a retailer and its bank is probably subject to provisions of U.C.C. § 4A.

4.4 ATM Transactions.

4.4 [a] Under U.K. Law.

ATMs are susceptible to various types of payment errors, such as debiting the customer's account even if it dispenses no money. Another possible error is where the bank wrongfully deny the customer's access to his funds even if the consumer uses his valid cash card properly.

Banks' liability for such errors are usually governed by the terms of the customer's account agreement. A customer who discovers an error in account is liable under the new code of Good Banking to inform his bank "as soon as reasonably practical" after he finds that an item in his account seems to be wrong.[259] Generally, however, a bank cannot debit its customer's account by any amount not authorised by

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[258] 15 U.S.C. § 1693a(5) ("consumer" means a "natural person").

[259] § 17.1 of the Code of Good Banking.

the customer.

4.4 [b] Under U.S.A. Law.

Errors in ATMs transactions is governed by EFTA provisions. The term "electronic fund transfer" includes, *inter alia*, "automated teller machine transactions".[260] The consumer's receipt of an incorrect amount of money from an electronic terminal, e.g. ATM, constitutes an error subject to error resolution procedures under § 1693f of EFTA.[261] Moreover, a computer's error regarding customer's withdrawals from an ATM is also an error subject to the error resolution procedures. Thus, where an error occurs in an ATM's transaction, the error resolution procedures as discussed earlier are applicable. The post-error resolution rules are applicable too.

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[260] 15 U.S.C. § 1693a(6).

[261] 15 U.S.C. § 1693f(5).

CHAPTER FIVE

UNAUTHORISED ELECTRONIC FUND TRANSFER TRANSACTIONS

5.1 Authority in General.

An authority may be actual or ostensible.[1] Actual authority arises out of the principal's manifestation of consent to the agent.[2] Actual authority may be express or implied.[3] It is express where the principal explicitly confers upon the agent an authority to do some thing for and on behalf of him; and implied where it is inferred from the parties' words and conduct that the agent has such power. On the other side, apparent or ostensible authority arises where a person (the principal) intentionally or through want of ordinary care causes or allows a third person to believe that he is bound by the acts of another person (the agent).[4] The principal only creates an inference that an agent has authority to act on his behalf even though no authority exists in fact.[5]

5.2 Definition of Unauthorised EFT.

There is no statutory or judicial definition of what constitutes an unauthorised EFT in the United Kingdom. Although the Code of Good Banking does cover banks' liability for losses caused by "transactions not authorised" by banks' customers in payment cards, it does not, however, define what constitutes an unauthorised

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[1] See generally, Bowstead on Agency, (15th ed.), Chap.3.

[2] In the American law, see Restatement (Second), Agency § 7.

[3] See, e.g., Anson's Law of Contract, 26th ed., at 530.

[4] In Scots law, this is commonly referred to as the principle of authority or agency by "holding out". See, e.g., *International Sponge Importers Ltd. v. Watt & Sons*, 1911 S.C. (H.L.) 57. See in the English law, e.g., Anson's Law of Contract, 26th ed., at 533-537; and in the American law, see Restatement (Second), Agency § 8.

[5] See, e.g., *Hely-Hutchinson v. Brayhead Ltd.* [1968] 1 Q.B. 549, 583 ("Ostensible or apparent authority is the authority of an agent as it *appears* to others.")

transaction.[6] However, since an EFT order constitutes a mandate to a bank (usually by a customer) to make an EFT transaction, the general principles of authority under agency law apply. Accordingly, an EFT transaction is unauthorised if the bank that carries it out has done so without actual or ostensible authority.

The term "unauthorized electronic fund transfer" is statutorily defined under the American law. § 1693a(11) of EFTA defines it as:

> "an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate such transfer and from which the consumer receives no benefit ...".[7]

It appears from the wording of this definition that banks should obtain their customer's "actual" authority to make an EFT. This means that customer's apparent or ostensible authority is not sufficient defence for banks if it is argued that such transaction was "unauthorized". However, although both EFTA and Truth in Lending Act are titles of the same statute,[8] the Truth in Lending Act has explicitly stated that the use of a credit card in reliance on an ostensible authority of its cardholder is sufficient to consider such use an authorised one. § 1603(o) of that Act defines the term "unauthorized use" of a credit card as:

> "a use of a credit card by a person other than the cardholder who does not have actual, implied or apparent authority for such use and from which the cardholder receives no benefit".[9]

Therefore, the exclusion of apparent authority from the definition of "unauthorized" EFT in the light of its inclusion in the definition of "unauthorized use" of a credit card should be construed as a deliberate act by the Congress; and thus

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[6] See § 18 of Code of Good Banking (1991). The Glossary of Terms attached to this Code does not define this term too.

[7] Subject to the exceptions discussed below.

[8] Truth in Lending Act is the commonly used name for Consumer Credit Cost Disclosure Act, which constitutes Title I of the Consumer Credit Protection Act, 15 U.S.C. §§1601 et seq.; and EFTA is Title IX of the same Consumer Credit Protection Act, 15 U.S.C. §§ 1693 et seq.

[9] For the definition of "credit card" and "cardholder", see 15 U.S.C. § 1603(k) and (m) respectively.

should be given full effect.[10] This means that according to EFTA language, an EFT transaction is unauthorised even if it is conducted by a person with an apparent or ostensible authority to do so.

The absence or existence of an authority to make an EFT should be determined, in absence of any indication in EFTA or Regulation E, by State law.[11] However, three situations are explicitly excluded from being "unauthorized" EFT transactions. Those include any EFT (i) "initiated by a person other than the consumer who was furnished with the card, code, or other means of access to such consumer's account by such consumer, unless the consumer has notified the financial institution involved that transfers by such other person are no longer authorized";[12] (ii) "initiated with fraudulent intent by the consumer or any person acting in concert with the consumer"; and (iii) "which constitutes an error committed by a financial institution".[13]

In both definitions, however, it seems that where the transaction confers a benefit on the consumer, he is not entitled to allege that the transaction was "unauthorized". In any case, authority, whether actual or ostensible, is terminated by the principal's revocation of such authority, or by the agent's renunciation. A notification of such revocation to the bank by the principal is, *prime facie*, sufficient to terminate the authority; and thus renders any subsequent transfers unauthorised.

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[10] It was held in *Kashanchi v. Texas Commerce Medical Bank*, 703 F.2d 936, 939 (5th Cir. 1983) that it is "well-established principle of statutory construction that where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." The court in that case was dealing with the interpretation of two sections in EFTA. This should not, however, mean that its restricted to the interpretation of inclusion and exclusion of terms only within EFTA. EFTA and Truth and Lending Act are titles of one Statute. Thus, the dictum probably covers the point in discussion. That case was followed on the same point by *Abyaneh v. Merchant Bank*, 670 F.Supp. 1298, 1300 (M.D. Pa., 1987).

[11] Baker & Brandel (1988), supra, at para.13.02[3][a], drawing an analogy with credit card cases. See in credit card transactions, Regulation Z, 12 C.F.R. § 226 Supp. I, Comment 12(b)(1)-1 (1986).

[12] Section 1693a(11) of EFTA; and Regulation E, 12 C.F.R. § 205.2(1) (1986). See Baker & Brandel (1988), supra, at 13.02[3][a], for a discussion on the required notification to banks which is sufficient to terminate any authority to make transfer.

[13] See 15 U.S.C. § 1693a(11).

The above definition of "unauthorized electronic fund transfer" is applicable to consumer-based transactions in the American law. Article 4A of the Uniform Commercial Code has its own approach of defining authorised payment orders. According to U.C.C. § 4A-202(a) a payment order is authorised if the person identified as a sender of that order has "authorized the order or is otherwise bound by it under the law of agency." This definition by itself does not add any thing to the common law principles of authority. However, it should be read in conjunction with other relevant provisions of Article 4A.[14] Article 4A's approach to authorisation of payment orders is some what new and different. As a general rule, whether or not a payment order is authorised is determined, in the absence of a statute or agreement that specifically addresses the issue, by the law of agency. That means the applicability of such doctrines as actual authority, ostensible authority and authority by estoppel.[15] However, contemplating paperless payment orders, Article 4A adopts a verification procedure to test whether a given payment order is that of the sender or not. Since a bank may be instructed to act on the basis of a message that appears on a computer screen, common law concepts of authority of agent to bind principal are not helpful.[16] There is no way of determining the identity or the authority of the person who caused the message to be sent.[17] Therefore, Article 4A introduced what it terms a "security procedure", pursuant to which the authenticity of the payment order can be "tested".[18] Such a "security procedure" should be agreed on by the

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[14] Namely, U.C.C. § 4A-202(b) (Authorized and Verified Payment Orders).

[15] See Restatement (Seconed) of Agency § 7 (Express and Implied Authority); § 8 (Apparent Authority); and § 8B (Estoppel - Change of Position). For an example on the doctrine of estoppel and the doctrine of apparent authority, see the Official Comment 1 of U.C.C. § 4A-203.

[16] The Official Comment 1 of U.C.C. § 4A-203.

[17] Ibid.

[18] See U.C.C. § 4A-201.

parties to the fund transfer; and designed to provide certainty that the payment order is that of the sender identified in the payment order. A payment order is treated as that of the person in whose name it is issued if it is properly tested pursuant to an agreed upon "security procedure" and the order successfully passes the test.[19] Where parties did not agree on the use of a "security procedure", pursuant to which payment orders are to be tested, the principles of agency law apply.[20]

5.3 Authentication of Instructions.

Authentication of customer's instructions is required in all payment methods. Signature is the method of authentication in paper-based payment transactions.[21] It is noted that as regards instructions in EFT transactions, "no satisfactory technique has yet been evolved, which enables those instructions to be personalised in the way paper-based debit transfer instructions have up to now been personalised by the customer's signature on a cheque."[22] The commonly used authentication or security procedure in ATM's and EFTPOS's transactions is a plastic debit card with a magnetic strip used in conjunction with a PIN.[23] This is commonly used by British and American banks to authenticate EFTPOS and ATM transactions.[24] There is no such common authentication procedure in relation to credit transfer transactions. However, banks usually reach an agreement with their customers on a given

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[19] Ibid.

[20] U.C.C. § 4A-202(a); and the official Comment 2 of U.C.C. § 203.

[21] Although it is the commonly used method in bills of exchange, it is not defined by BEA 1882. Chalmers & Guest on Bills of Exchange, (14th ed., 1991), at 150, defines "signature" as "the writing of a person's name on a bill or note in order to authenticate and give effect to some contract thereon." See also Byles on Bills of Exchange, (25th ed.), at 12-13. In *Ex p. Birmingham Banking Co.* (1886) L.R. 3 Ch. 651, the court was of the opinion that liquidators in a voluntary winding up might accept a bill by impressing a printed mark thereon. In the American law, it is defined as any name or symbol adopted by the person as such, and may be made by word, mark, or written signature. See U.C.C. § 3-401(2), § 1-201(39). It could be made by the person concerend personally, or by his agent or representative. See U.C.C. § 3-403(1).

[22] The Review Committee Report, at para. 10.02.

[23] For a discussion on the shortcomings of this authenticity procedure, see the Review Committee Report, supra, at paras. 10.02 - 10.33.

[24] However, some EFTPOS schemes use a debit card and the purchaser's signature on a sale slip rather than a PIN.

authentication procedure, such as passwords, codes or a call-back requirement where the customer uses telephone to send his payment instructions.[25] The effect of customer's or bank's failure to follow the agreed upon steps of an authentication procedure is not governed by statutory law in Britain. Under the provisions of Article 4A, if a payment order is tested pursuant to an agreed upon "security procedure" and has successfully passed such test, it is considered as an "authorized" payment order, although it could be in fact "unauthorized".[26]

Authentication procedures used by banks to determine the authorisation of EFT orders should have certain degree of reliability. It was recommended by the Review Committee that authentication procedures adopted by banks "must meet certain minimum standards of security ... so as to provide an acceptable degree of protection for the customer against the consequences of unauthorised instructions."[27] In EFT systems, security of payment systems concentrates on two distinct points: hardware or physical security and software security. The software used by banks should contain monitoring systems which will advise of attempted unauthorised access.[28] The Code of Good Banking adopts some measures to ensure the security and authenticity of transactions made by the use of payment cards.[29] These took the form of shouldering customers with the duty to keep their cards and PINs safe and out of the use of others.

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[25] See *Midland Bank v. Brown Shipley* [1991] 1 Lloyd's Rep. 576, 582 (A bank must telephone its customer back on the telephone number agreed upon, which is known only to the bank, if so agreed to authenticate customer's instructions delivered by telephone).

[26] U.C.C. § 4A-202(b).

[27] Recommendation 10(1) of the Review Committee Report.

[28] Barclays Bank will sooner introduce a computer programme called Fraud 2000 to detect unauthorised use of credit cards. See for more detail on security of hardware and software, Gait, Security of E.F.T. Systems, [1981] 32 Journal of Systems Mangement 6; Comer, How to Prevent Computer Fraud, [1982] Asian Banking 35; Nycum, Security for Electronic Funds Transfer Systems [1976] 37 U. Pitt. L. Rev. 709; and Tyree A., Electronic Transfer Systems -a Survey of the Legal Issues [1984] 58 Law Institute Journal 1200, 1202-1203.

[29] § 16.0 of the Code of Good Banking (1991). This is however, restricted to payment cards. § 16.1 provides that "[c]ard issuers will issue PINs separately from cards and will advise the PIN only to the customer." Banks also should warn customers that they should take care of their cards and PINs in order to prevent fraud. See § 16.2 of the Code of Good banking (1991). In the American law, see in consumer-based transactions the disclosure requirement under 15 U.S.C. § 1693c.

This reflects the fact that the banking industry has invested heavily in the PIN procedure. The Code does not implement the Review Committee's recommendations that banks should give an undertaking to upgrade their security systems by introducing new technology based on the recognition of the customer's physiological characeristics such as signature, thumbprint or retina. This is properly due to the Government findings in the White Paper that much EFT fraud was due to the irresponsibility of customers. The Code does not even address the question of what minimum security standards ought to be imposed on banks in respect of the current security systems.[30] The Review Committee raised the question of improving the security of the current systems by encryption or by the use of On-Line systems.

Under CHAPS Clearing Rules, settlement banks are required to observe certain procedures to preserve the integrity of the payment system and to insure that the payment messages are authentic. Each settlement bank participant in CHAPS "will use a currently supported release of standard CHAPS Gateway Software as its interface to the interbank distributed network and will not modify this software or make it available for use by any other party (except for another Settlement Bank, under sharing or standby arrangements)."[31] All payment messages between banks "will be encrypted in accordance with the Code of Conduct for Encryption."[32] All payment messages will be authenticated by the transferring bank and tested by the beneficiary's bank in accordance with the Code of Conduct for Authentication.[33] Each settlement bank is responsible for its own payment process software and "ensuring that any

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[30] See Duxbury J., The Draft Code of Banking Practice: Implications for Electronic Banking [1991] 3 J.I.B.L. 116, 117-118.

[31] Rule 10(a) of the CHAPS Clearing Rules (1985).

[32] Ibid, Rule 10(b).

[33] Ibid, Rule 10(c).

changes which it makes are adequately tested so as to maintain the integrity of the overall CHAPS network system."[34] Since no authentication method can be guaranteed, CHAPS rules require the bank or banks concerned to take some contingency steps. Each settlement bank must allocate a unique Sorting Code Number known as the "Repair Sorting Code Number" to which payment messages that contain insufficient information will be directed.[35] Thus, where a beneficiary's bank receives a payment order that does not contain a valid Authentication Code or valid Authentication Serial Number, the value of such order must be returned to the Repair Sorting Code Number of the transferring bank, "as soon as practicable, but in any case no later than 12.00 on the next business day".[36]

Under the American law, authentication or security procedures used by banks in EFT transactions must satisfy certain statutory requirements. These requirements are discussed in some detail under the scope of banks' liability in commercially-based credit transactions.[37]

5.4 The Scope of Banks' Liability for Unauthorised Credit Transfer Transactions.

Fraud is usually the common cause behind unauthorised credit transfers. EFT systems are not immune from such risk. Indeed, the immaterial nature of EFT orders, especially those transmitted as electronic signals *via* telecommunication networks or as magnetic information on tapes or disks, are vulnerable to duplication, alteration, or imitation without leaving a clue. In most cases, there are no peculiarities resulting from the personality of the sender, such as the shape of handwriting, a signature, or

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[34] Ibid, Rule 10(e).

[35] Ibid, Rule 6 (Use of a repair sorting code number).

[36] Ibid, Rule 8 (Authentication failures). The bank that comply with this rule will not pay interest on the principal sum received.

[37] See U.C.C. § 4A-202; and para. 5.4 [b] [ii] below.

a letterhead or of an individualised preprinted form, available to authenticate the payment order. This will put more pressure on banks to find new methods to combact new frudulant schemes and unauthorised transactions. One possible method is a specially designed computer software to check payment orders against fraud.[38]

Banks' liability for unauthorised credit transfer is discussed separately under U.K. and U.S.A. law.

5.4 [a] Under U.K. Law.

The principle laid down in *Orr and Barbour v. Union Bank of Scotland*[39] can be applied by analogy to payment orders in EFT transactions if the sender's signature in a paper-based order is forged or unauthorised.[40] Accordingly, the transferring bank is not entitled to debit the sender's account by the amount of the forged or unauthorised payment order. Moreover, the forger or unauthorised signatory is liable to the transferring bank in deceit or for breach of warranty of authority.[41] Under common law, a bank is only entitled to debit its customer's account if it has an authority to do so; and only if it conforms to the terms of such authority.[42] There is no difference as far as this point is concerned between a paper-based payment order and a bill of exchange. In both cases, a bank has no authority from its customer to debit his account. It was held that where a bank pays a cheque in reliance on a forged signature of the drawer, it generally pays without mandate and thus bears the risk of

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[38] It is reported that, from January 1993 Barclays Bank will operate an on-the-spot computerised fraud check on its customers that use credit cards. The programme is called Fraud 2000 which is designed to get to weigh up the odds of a transaction being fraudelant. See The Independent, on 18 September 1992, p.8.

[39] (1854) 1 Macq. (H.L.) 513.

[40] See Penn G.A., Shea A.M. & Arora A., The Law Relating to Domestic Banking Law, 1987, at para. 18.169.

[41] Ibid.

[42] Penn G.A., Shea A.M. & Arora A., The Law Relating to Domestic Banking, 1987, at para. 18.191.

recovery from the forger.[43] Where a payment order instructs transfer of funds from a joint account, it should be authorised, unless otherwise agreed, by both account holders. Thus, where a bank executes a payment order authorised by one of the account holders, it exceeds its mandate regarding the other account holder.[44] That is because a bank owes a joint obligation in debt to the joint account holders. It also owes a further contractual duty to each account holder separately. This means that a bank in this case accepts an express contractual obligation to conform with the customer's mandate, which it exceeds if it allows one of the account holders to draw on the account without the consent of the other.[45]

Where a company's mandate authorises a bank to honour credit payment orders if authorised by any two signatories, the bank is not entitled to debit the company's account if it executes a payment order which is authorised by one signatory.[46] But, if the board confers authority upon a single person to direct the transfer of a particular sum, the bank is entitled to act upon his instructions only if he was acting within his authority.[47] Thus, if the bank fails to observe the discrepancy between the instructions and the mandate, or if it does so but makes no inquiries, it takes the risk that the sole signatory may not in fact be authorised.[48] However, it was held that "in the absence of telling indications to the contrary, a banker will usually approach a

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[43] *Greenwood v. Martins Bank Ltd* [1933] A.C. 51. In this case, however, the customer was estopped by his conduct from asserting that the bank was not entitled to debit his account.

[44] By analogy with cheques cases, see *Catlin v. Cyprus Finance Corporation (London) Ltd.* [1983] 1 All E.R. 809.

[45] Ibid. See also Penn G.A., Shea A.M. & Arora A., The Law Relating to Domestic Banking, 1987, at para. 18.192.

[46] See, e.g., *Midland Bank v. Brown Shiply* [1991] 1 Lloyd's Rep. 576 (a letter confirming telephone payment instructions was patently not in accordence with the bank's mandate. The bank did not ckeck either the terms of its authority or whether the signatures were those of the authorised signatories); and *Agip (Africa) Ltd. v. Jackson* [1991] 3 W.L.R. 116 (a bank's chief accountant, who was entrusted with payment orders signed by an authorised signatory of the account, fraudulently altered the names of the payees, thus enabling the substituted payees to receive money totalling in exess of U.S. $10.5m). However, both cases did not deal with the customer's right against the bank, but with the bank's right of recovery from the payees.

[47] Halsbury's Laws of England, 4th ed. Reissue, at para. 175 citing *London Intercontinental Trust Ltd. v. Barclays Bank Ltd* [1980] 1 Lloyd's Rep. 241.

[48] Ibid.

suggestion that a director of a corporate customer is trying to defraud the company with an intial reaction of instinctive disbelief."[49]

Banks' liability for unauthorised electronic credit transfer transactions is not covered by the Code of Good Banking. Although BEA 1882 is inapplicable to electronic credit transfer orders, an analogy can be made with banks' liability for unauthorised payment of a bill of exchange. A bank that pays a bill of exchange, including a cheque, without the authority of its customer is not entitled to debit its customer's account by the amount of the bill, unless the customer ratifies the payment.[50] This rule is applicable to any payment made without mandate regardless the method of such payment. It was held in *Limpgrange Ltd. v. Bank of Credit and Commerce International*[51] that if debits were made without authority they should be disregarded. The customer can claim as money owed by the bank the credit balance remaining when such unauthorised transfer are left out of his account. If such unauthorised transfer increases an overdraft the customer is only liable to the amount remaining as an overdraft after deletion of the disputed debits.[52] Thus, where a computer message to transfer funds to a given account number is intercepted by a person who inserted his account number instead of the payee's account number, the bank, if pays to the inserted account number, is not entitled to debit its customer's account number by the amount of transfer. That is based on lack of mandate to pay to that account number.

The basis of customer's action against his bank that pays an unauthorised

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[49] *Barclays Bank Plc v. Quincecare Ltd.* [1988] 1 F.T.L.R. 507.

[50] See § 24 of BEA 1882. See also *Orr v. Union Bank of Scotland* (1854) 1 Macq. (H.L.) 513; Halsbury's Laws of England, 4th ed. Reissue, V. 3(I), at para. 175; and Encyclopaedia of Banking Law, V.I, at para. 208.

[51] [1986] F.L.R. 36 (Staughton J.).

[52] Ibid.

credit transfer order was recently discussed by Webster J. in *National Bank of Commerce v. National Westminster Bank.*[53] There, the defendant debited the plaintiff's account with eight amounts totalling £268,227.08 in respect of eight mail transfer orders (MTOs) purporting to have been signed by two authorised officers of the plaintiff. The plaintiff alleged that none of those MTOs was in fact signed by two authorised officers of the plaintiff and it alleged that each of the eight debits was ineffective. The plaintiff, thus, asked for recrediting its account by the amount debited plus interest. On whether the action is based on contract or tort, the court held that the "claim is clearly not an action in tort: it is founded only on contract indebtedness. It is, therefore, an action founded on simple contract."[54] Webster J. said that where a bank debits a customer's account in reliance on unauthorised instructions, three claims are open to such customer. Those are:[55]

(i) A claim of declaration that the bank was not entitled to debit his account with the unauthorised amount transferred.[56] In *Limpgrange v. Bank of Credit and Commerce International,*[57] which was followed by *National Bank of Commerce v. National Westminster,*[58] Staughton J. said:[59]

> "If debits were made without authority they should be disregarded, and the company [i.e. the bank's customer] can claim as money owed to it by (the bank) the credit balance remaining when those debits are left out of account, or, if there would still be an overdraft, the company would be liable to (the bank) only for such amount as the account was overdrawn after deletion of the disputed debits."

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[53] [1990] 2 Lloyd's Rep. 514.

[54] Ibid, at 516.

[55] Ibid, at 516.

[56] See also Encyclopaedia of Banking Law, V.I, at para. 208.

[57] [1986] F.L.R. 36.

[58] [1990] 2 Lloyd's Rep., 514.

[59] At 47.

(ii) A claim "to be repaid the principal sum in respect of which the defendant [the bank] is alleged to be indebted to the plaintiff [the customer] following a demand to repay that sum, and a similar claim in respect of interest on that sum".[60]

(iii) A claim for damages for breach of the obligation, under the agreement governing the account, to repay the principal sum and interest thereon. Webster J. said:[61]

> "If a customer suffers damage as a result of an unauthorized debit, it seems most likely, subject to the precise terms of the agreement between banker and customer, that he has in principle a claim for damages for breach of contract (if only a claim for nominal damages) which arises when the breach occurs."

The bank's breach of its customer's account agreement to repay him those two sums should not be construed as referring only to breach of the obligation to repay after demand (under English law) was made. Webster J. was:

> "satisfied that the pleading can be read as referring to a breach of that obligation. But it can also be read ... as referring to a breach of an obligation not to debit the account in respect of MTOs unless signed by two authorized officers of the plaintiff [the customer]".[62]

Unauthorised credit transfer may be subsequently ratified by the bank's customer.[63] Ratification is "equivalent to an antecedent authority".[64] The customer must ratify from a position of knowledge of what his bank has done.[65] Thus, he can only ratify what he himself had legal power and capacity to do at the time of the purported transfer.[66] Thus, where two signatories at least are required to issue payment orders on a company's account, one signatory cannot ratify what was

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[60] Scots law does not require demand for repayment of one's funds in his account. See per Lord Justice-Clerk Cooper in *Macdonald v. North of Scotland Bank*, (1942) S.C. 369 at 374, 375; [1942] S.L.T. 196, at 203.

[61] *National Bank of Commerce v. National Westminster* [1990] 2 Lloyd's Rep., 514, at 517.

[62] Ibid, at 516.

[63] See § 24 of BEA 1882 as regards bills of exchange.

[64] *Koenigsblatt v. Sweet* [1923] 2 Ch. 314, 325, per Lord Sterndale M.R.

[65] See The Laws of Scotland, Stair Memorial Encyclopaedia, V.1, at para. 624; and Bowstead on Agency, 15th ed., Article 16.

[66] Bowstead on Agency, 15th ed., at Article 15 and its comment.

unauthorised payment order. Ratification should not prejudice the rights of third parties validly acquired prior to it.[67] Where a bank carries out an unauthorised credit transfer in reliance on an ostensible authority by its customer, ratification is not possible under English law. This is based on the principle that "civil obligations are not to be created by, or founded upon, undisclosed intentions".[68] It is argued that there is no clear authority in Scotland on this latter point.[69]

Where an unauthorised credit transfer caused by a forgery, it is submitted that it cannot be ratified, and a reason given for that is that forgery is a nullity. The leading English case of *Brook v. Hook*,[70] seeks to make a distinction between voidable acts, which can be ratified, and void acts, such as forgery, which cannot. It is submitted that as "a general criterion this is however unsatisfactory".[71] It is also submitted that "the true reason why there can normally be no ratification is that a forger who counterfeits a signature or seal makes no profession of being agent, so that agency doctrines do not apply to him."[72] The Review Committee found no support from its consultees for the proposition that a person whose signature was forged in a negotiable instrument should be allowed to ratify it, at least to allow him to assume liability for the obligation that would, but for the forgery, have been created.[73] However, a forged signature may be adopted.[74] It is, however, often treated as a

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[67] The Laws of Scotland, Stair Memorial Encyclopaedia, V.1, at para. 624 citing Lord Salvesten in *Goodall v. Bilsland*, (1909) S.C. 1152, 1182; [1909] 1 S.L.T. 376, 382. See also Bowstead on Agency, 15th ed., Article 19.

[68] *Keighley, Maxsted & Co. v. Durant* [1901] A.C. 240, at 247 (H.L.) per Lord Macnaghten.

[69] The Laws of Scotland, Stair Memorial Encyclopaedia, v.1, at para. 625. See also T.B. Smith, A Short Commentary on The Law of Scotland (1962) at 775-777.

[70] (1871) L.R. 6 Ex. 89

[71] Bowstead on Agency, 15th ed., at 56.

[72] Ibid, citing Treitel, Law of Contract (6th ed.), at 540; *Brook v. Hook*, supra, at 100; *Greenwood v. Martins bank Ltd.* [1932] 1 K.B. 371, 378-379, aff'd [1933] A.C. 51; *Imperial Bank of Canada v. Begley* [1936] 2 All E.R. 367, 374-375; and *Rowe v. B. & R. Nominees Pty. Ltd.* [1964] V.R. 477.

[73] The Review Committee Report, supra, at para. 8.24.

[74] *M'Kenzie v. British Linen Co.* (1881) 8 R. (H.L.) 8, 6 App. Cas. 82.

promise, and thus requires consideration under English law. It is argued that the proper solution to the adoption of a forged signature must "lie within the areas of formation of contract, waiver, estoppel [personal bar in Scots law], and perhaps the rules of gifts".[75]

If no ratification or adoption is made by the bank's customer of the unauthorised credit transfer, the bank may seek other possible defences. By analogy with cheque cases, it is likely that courts will prevent a customer from asserting that his bank is not entitled to debit his account if such a customer issues his payment orders in such a manner as may facilitate fraud or forgery;[76] and fails to inform the bank of any unauthorised transfers as soon as he becomes aware of it.[77] The Privy Council in *Tai Hing Cotton Mill Ltd. v. Liu Chong Hing Bank Ltd*[78] refused to widen such duties in a forged cheque case. It was argued by the banks concerned that the relationship of bank and customer gives rise in contract and in tort to a duty owed by the customer to the bank to exercise such procautions as a reasonable customer in his position would take to prevent forged cheques being presented to the bank or at the very least to check his periodic bank statements so as to be able to notify the bank of any items which were not, or may not have been, authorised by him. The Privy Council refused to imply a term for a wider duty in the banker-customer relationship for the following reasons. The test of implication is necessity. The term sought to be implied should be read into the contract as the nature of the contract implicitly

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[75] Bowstead on Agency, 15th ed., at 57.

[76] This duty is enunciated by the House of Lords in relation to cheques in *London Joint Stock Bank Ltd. v. Macmillan* [1918] A.C. 777. However, it was held in *Silngsby v. District Bank* [1932] 1 K.B. 544 that not drawing a line through the space following the payee's name was not sufficient grounds to constitute negligence.

[77] This duty was laid down in relation to cheques cases by the House of Lords in *Greenwood v. Martins Bank Ltd* [1933] A.C. 51.

[78] [1985] 2 All E.R. 947.

requires. It was held that such a term must be one without which the whole transaction would become futile, inefficacious and absurd.[79] A bank's customer should not bear the risks of its bank's business. Where a bank pays outwith its mandate, it cannot plead its customer's authority in justification of its unauthorised transaction. However, it was held that a customer is obliged to notify its bank of any forgeries or unauthorised drawing he actually discovers.

A bank may prove that its customer is personally barred (or in England estopped) from asserting that the funds transfer was unauthorised. In was held in *Greenwood v. Martins Bank Ltd* that a customer who was aware that his wife had forged his signature on cheques drawn on their joint account and kept silent was estopped from claiming recovery from the bank. The customer's inaction led the bank to believe that the signature was genuine.[80] Although that was an English case, it is noted that in similar circumstances personal bar would apply in Scotland.[81] Mere silence or inaction cannot amount to a representation unless there is a duty to disclose or to act.[82] It was mentioned earlier that a bank's customer owes his bank a duty to inform it of any unauthorised debit as soon as he becomes aware of it. Thus, if a bank's customer fails to inform his bank of an unauthorised debit in his account within a reasonable time, and the bank alters its position for the worse, the customer is personally barred (estopped in England) from asserting that the debit was unauthorised.[83] Waller J. in *Midland Bank v. Brown Shiply,*[84] has recently held that

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[79] *Liverpool City Council v. Irwin* [1977] A.C. 239, [1976] 2 All E.R. 39 (H.L.).

[80] See also *London Joint Stock Bank Ltd. v. Macmillan and Arthur* [1918] A.C. 777 (customer was estopped from asserting that the bank was not entitled to debit his account on payment of a cheque which had been fraudulently altered after having been signed by such a customer before it had been properly completed).

[81] See Hutton G.H., Case Law (1990), at 47.

[82] Halsbury's Laws of England, 4th ed. Reissue, V. 3(I), at para. 185.

[83] See in English law, Halsbury's Laws of England, 4th ed. Reissue, v.3(I), at para. 185.

[84] [1991] 1 Lloyd's Rep., 576.

"the facts that should be revealed are ones which any reasonable person in the position of the representee would appreciate that the representor would want to know before making the representation."[85]

The bank that executes an unauthorised credit transfer order is entitled in equity to debit its customer's account if such unauthorised payment has conferred a benefit on that customer, and to the extent of that benefit. The leading case is *Liggett (B.) (Liverpool) Ltd. v. Barclays Bank Ltd.*[86] In that case, Wright J. held that the bank was entitled to the benefit of unauthorised payment of cheques (signed by one director where they should have been signed by two) if it could show that the payment went to discharge a legal liability of that customer. That is based on the equitable doctrine that a person who had paid the debits of another without authority is allowed to take advantage of his payment.[87] *Liggett's* case explained this principle on the basis of subrogation. The bank is subrogated to the payee's rights against its customer, and is entitled to rely on these rights when the customer disputes the payment involved. The Court of Appeal in *Re Cleadon Trust Ltd*[88] held that the decision of Wright J. in *Liggett's* case that the bank was entitled to debit the company [the bank's customer] was justified provided that the signatory [the director that signed the cheques] had authority as between himself and the company to pay the debits.[89]

However, a bank that executes an unauthorised payment order may, if failed

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[85] Ibid, at 586. However, in that case, it was the customer who successfully relied on its bank's representation that a banker's draft was not forged or made fraudulently.

[86] [1928] 1 K.B. 48.

[87] See The Encyclopaedia of Banking Law, V.1, at 232 (The Liggett Defence); and Ellinger, Modern Banking Law, supra, at 300-301.

[88] [1939] 1 Ch. 286, Scott L.J. at 316-318, Clauson L.J. at 326-327. Greene M.R., at 303-305 disagreed.

[89] See also *Limpgrange Ltd. v. Bank of Credit and Commerce International* [1986] F.L.R. 36 (Staughton J. said that in a sense there is a stronger argument for allowing credit when money has been returned directly to the person who was deprived of it, than when it has been used to pay that person's debts).

to plead any defence against its customer, recover the unauthorised payment from the payee under common law and equity principles. A bank may recover under doctrines such as "repetition" in Scots law, and "money had and received" in English law. A bank may, under English law, trace money in equity into the hands of the unentitled payee and recover it if the requirements of such an action are satisfied.[90] The Court of Appeal has recently faced this point in *Agip (Africa) Ltd. v. Jackson and Others*.[91] In that case, the plaintiff's chief accountant, who was entrusted with payment orders signed by an authorised signatory of the plaintiff's account in a Tunisian bank, fraudulently altered the names of the payees, thus enabling substituted payees to receive in their account in a British bank the fund transferred. The unauthorised instructions were carried out by debiting the plaintiff's account with the instructed sum, telexing instructions to the British bank to credit the substituted payees' account with that sum. Settlement was made by telexing a New York correspondent of the Tunisian bank to credit the British bank's account with it by the same sum. When the plaintiff failed to recover from its Tunisian bank under the Tunisian law, it sought to trace the fund, in common and equity law, in the hands of the payee under English law.[92] The Court of Appeal upheld the lower court judge's view (Millett J.) that the plaintiff was not entitled to trace in law.[93] Millett's view, which the Court of Appeal quoted with approval states:[94]

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[90] See for these requirements the bank's right to trace erroneous payment in para. 4.4.2 [a] [iii] [2]. Tracing funds in common law is not possible in EFT transactions, since in most cases funds transferred are unidentifiable.

[91] [1991] 3 W.L.R. 116.

[92] Concerning the plaintiff's right to sue, the court held that in carrying out the payment order the Tunisian bank acted as the plaintiff's agent; that the payment by the bank was in substance made with the plaintiff's money; and that, since the money was paid under a mistake of fact, the plaintiff was entitled to pursue the remedies available for its recovery. See per Fox L.J., at 126-128

[93] See per Fox L.J., with whom the other two judges concurred (Butler-Sloss and Beldam L.JJ., quoting at 128 with approval Millett's dictum that the bank was not entitled in common law to trace the fund in the hands of the payee because the fund was not identifiable.

[94] [1990] Ch. 265, at 286.

> "The money cannot be followed by treating it as the proceeds of a cheque presented by the collecting bank in exchange for payment by the paying bank. The money was transmitted by telegraphic transfer. There was no cheque or any equivalent. The payment order was not a cheque or its equivalent. It remained throughout in the position of the Banque du sud [i.e., the transferring bank]. No copy was sent to Lloyd's Bank [i.e. the payee's bank] or Baker Oil [i.e. the payee] or presented to the banque du Sud in exchange for the money. It was normally the plaintiffs' practice to forward a copy of the payment order to the supplier when paying an invoice but this was for information only. It did not authorise or enable the supplier to obtain payment. There is no evidence that this practice was followed in the case of forged payment orders and it is exceedingly unlikely that it was. Nothing passed between Tunisia and London but a stream of electrons. It is not possible to treat the money received by Lloyds bank in London or its correspondent bank in New York as representing the proceeds of the payment order or of any other physical asset previously in its hands and delivered by it in exchange for the money."

The Court of Appeal, however, held that the plaintiff should succeed in tracing the fund under equity law. The fraudster was in a fiduciary relationship with the plaintiff since he was the plaintiff's chief accountant and was entrusted with the signed drafts or orders upon the transferring bank.[95] Concerning the payees (strangers to the unauthorised transaction), the court held that two circumstances make a stranger to a fiduciary relationship liable in equity. First, "[k]nowing receipt of or dealing with the trust property". Second, "[k]nowing assistance: a person may be liable, even though he does not himself receive the trust property, if he knowingly assists in a fraudulent design on the part of a trustee, including a constructive trustee."[96]

The following circumstances satisfy the requirement of knowlege: (i) actual knowldege, (ii) wilfully shutting one's eyes to the obvious, (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make, (iv) knowledge of any circumstances which would indicate the facts to an honest and

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[95] Millett J. the trial judge in that case concluded in an unjudicial writing that the requirement of fiduciary relationship should not stop tracing the proceeds of fruad in equity. See Millet P.J., Tracing the Proceeds of Fraud [1991] 107 L.Q.R. 71, at 85.

[96] *Agip (Africa) Ltd. v. Jackson* [1991] 3 W.L.R. 116, at 131.

reasonable man, (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.[97] In the circumstances of the case, the judge came to the conclusion that the payees were aware of the unauthorised transfer. As such the requirements of recovery under equity law were met, and thus the court held that the plaintiff was entitled to recover the funds transferred. The Court of Appeal accepted that conclusion.[98]

Unauthorised payment orders in EFT transactions could be difficult to prove. Where there is a dispute to the authority of the customer in a paper-based transaction, the customer often proves the existence of a forged cheque, for example, from the examination of the signature appearing on the forged cheque. In EFT transactions it is difficult for a customer to discharge the burden of proof. First, a customer must prove a negative proposition which is always difficult.[99] Secondly, unlike the forged cheque, forgery in EFT transaction may leave no traces. The records usually show that a transfer occurs based on an electronic payment message (where such method is used) which is difficult to be attributed to or not attributed to a particular person. Since computer record will be admissible in evidence,[100] the customer's failure to show that such record was incorrect would probably result in a finding that the customer is liable. This shows the uncertainty surrounding the parties' rights and duties in EFT transactions in the United Kingdom. One solution is what is so-called verification procedures. In such procedure, both the bank and its customer agree on

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[97] Per Gibson J. in *Baden, Delvaux and Lecuit v. Societe General pour Favoriser le Developpement du Commerce et de l'Inductrie en France S.A.* [1983] B.C.L.C. 325, 407. Adopted by Fox L.J. in *Agip (Africa) Ltd. v. Jackson*, supra, at 132 (where his lordship said "I accept that formulation. It is, however, only an explanation of the general principle and is not necessarily comprehensive.")

[98] See for an analysis of the Court of Appeal judgment in that case, McKendrick E., Tracing Misdirected Funds [1991] L.M.C.L.Q. 378.

[99] Kolodziej A., Customer-Banker Liability in Electronic banking [1986] 7 The Company Lawyer 191, 193.

[100] § 9 (as amended) of Bankers' Books Evidence Act 1879.

a given security procedure to test the authentication of customer's payment orders. Those orders that passes the test successfully, should be considered as authentic. However, the adoption of such system in the lack of minimum standards of security which must be present in each system will throw the risk of unauthorised transactions on the shoulders of bank's customers. The issue needs express regulation.

5.4 [b] Under U.S.A. Law.

The American law differs from the British law in its detailed regulation of banks' liability for unauthorised credit transfers; and in its distinction between consumer-based and commercially-based transactions. Another major difference is that under the American law, a verified payment order could be considered as an authorised one although it is in fact unauthorised. Security procedures are introduced to verify payment orders and as a method for avoiding losses resulting from unauthorised transactions, with the result that a payment order that passes such test is considered as an authorised one regardless whether it is, in reality, an unauthorised order. Banks' liability is discussed under consumer protection legislation and wholesale commercially based transfers.

5.4 [b] [i] Consumer-based Transactions.

Credit transfers as well as EFTPOS and ATMs transactions are all included under the term "electronic fund transfer".[101] The allocation of losses resulting from "unauthorised electronic fund transfer" is governed by EFTA.[102] Thus, to the extent applicable, the scope of banks' liability for unauthorised credit transfer is the same as that for unauthorised EFTPOS and ATMs. This is equally true as to what constitutes

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[101] 15 U.S.C. § 1693a(6).

[102] 15 U.S.C. § 1693g.

an unauthorised credit transfer transaction, the allocation of loss resulting from such transaction, and the burden of proof.

However, the means of instituting credit transfer transactions is usually different from that in EFTPOS and ATMS transactions. Generally, EFTA adopts what it is called "accepted card or other means of access" as a method for initiating instructions to banks.[103] As a credit transfer transaction, it will not be initiated by a debit card and PIN as the case in EFTPOS and ATM transactions. It is usually initiated by a certain code or other means of access whereby the user of such method can be identified as the person authorised to use it. Such means of access could be a signature, telephone or any electronic or mechanical confirmation.

5.4 [b] [ii] Commercially-based Transactions.

Article 4A, which governs such transactions, has a different approach for allocation of losses resulting from unauthorised payment orders. The approach adopted by Article 4A is heavily dependant on the avoidence of such losses by encouraging the use of what is called "security procedure".[104] The use of a "security procedure" is not mandatory. However, by allocating losses resulting from unauthorised payment orders in a certain way, Article 4A attempted to give parties to the transfer incentives to avoid such loss by using such procedures.[105] Thus, banks' liability for such losses varies according to whether the credit transfer in question was carried out pursuant to a "security procedure" agreement.

5.4 [b] [ii] [1] No Security Procedure is Used.

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[103] See for the definition of the term "accepted card or other means of access", 15 U.S.C. § 1693a(1).

[104] U.C.C. § 4A-201.

[105] For allocation of loss in commercial transactions including EFT, see Scott H., The Risk Fixers [1978] 91 Harvard L. Rev. 737.

U.C.C. § 4A-202(a) provides that:

> "A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency."

The question here is whether the sender of a payment order authorises such order. This question is resolved, in absence of a statute or agreement, by the law of agency. A sender is responsible for the payment order received by its bank if such order is actually or ostensibly authorised by such sender. Alternatively, where a sender ratifies an unauthorised payment order, or cannot assert that it was unauthorised under estoppel doctrine, the order will be enforced at the sender's risk. Take for example a receiving bank that executes a payment order by means of a letter apparently written by a corporation that is a customer of the bank and apparently signed by an officer of the corporation. If the bank acts solely on the basis of this letter, the corporation is not bound as the sender of the payment order unless the signature was that of the officer and that officer was authorised to act for the corporation in the issuance of payment orders, or that some other agency doctrine such as ostensible authority, ratification, or estoppel causes the corporation to be bound.[106] Where a bank does not dispute that the payment order was unauthorised, it usually reverses the debit of its customer's account and claims recovery from the payee or the payee's bank.[107]

The rule of U.C.C. § 4A-202(a) is described as "fairly straightforward: If the payment order was authorized by the customer or the customer was bound by the law of agency, then the customer must bear responsibility for the order. If the order was not authorized and the customer was not otherwise bound by the law of agency, then

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[106] See the Official Comment 1 of U.C.C. § 4A-203.

[107] See *Securities Fund Services v. American National Bank & Trust Co.*, 542 F.Supp. 323 (N.D.Ill. 1982); and *Bradford Trust Co., v. Texas American Bank-Houston*, 790 F.2d 407 (5th Cir. 1986).

the bank must bear the loss."[108] This is unlike some pre-Article 4A judicial decisions dealing with unauthorised credit transfers, which indicate that courts should determine whether a receiving bank exercised good faith and used ordinary care in handling its customer's account.[109] This liability is based on the nature of the banker-customer relationship as debitor-creditor, in which the bank's duty to charge the customer's account only on the customer's authorised instruction is absolute.[110]

Ratification and estoppel are two valid defences for banks in unauthorised credit transfer transactions. Banks are relieved from liability for an unauthorised order if the customer's conduct satisfies the requirements of an estoppel against asseting that the order was authorised. Estoppel can be illustrated by the following example.[111] Suppose P is aware that A, who is unauthorised to act for P, has fraudulently misrepresented to T that A is authorised to act for P. T believes A and is about to rely on the misrepresentation. If P does not notify T of the true facts although P could easily do so, P may be estopped from denying A's lack of authority. A similar result could follow if the failure to notify T is the result of negligence rather than a deliberate decision.[112] In *Old Security Life Insurance Co., v. Continental Illinois*

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[108] French J. K., Article 4A's Treatment of Fraudulent payment Orders- The Customer's Perspective, [1991] 42 Alabama L. Rev., 773, at 779. Hereinafter cited as French, Article 4A's Treatment.

[109] See, e.g., *Walker v. Texas Commerce Bank*, 635 F. Supp. 678, 682 (S.D. Tex. 1986). For a survey of the pre-legisaltion EFT cases compared with the solution if they were to be tried under Article 4A, see Davis T., Comparing Article 4A with Existing Case Law on Funds Transfers: A Series of Case Studies [1991] 42 Alabama L. Rev. 823. See also Effros R.C., A Banker's Primer on the Law of Electronic Funds Transfers [1988] 105 Banking L. J. 510, 529-535 discussing some of the leading common law cases in fraud in EFT transactions.

[110] See Brady on Bank Checks, (6th ed., with 1991 Supp. No.3), at para. 19.12. See also *Kashanchi v. Texas Commerce Medical Bank, N.A.*, 703 F.2d 936 (5th Cir. 1983) where $4900 was withdrawn from the a joint owned saving account without the authority of either owner. The transfer was initiated by a telephone conversation between an employee of the bank and a person other than the plaintiff or her sister, the joint owners of the account. Although the plaintiff failed to recover under EFTA provisions (mainly because the transaction was outside the scope of EFTA's application), the Court of Appeal of the Fifth Circuit did not rule out a recovery under a breach of the customers' account agreement and/or negligence. See ibid, at 941, per Randall J.

[111] Mentioned by the Official Comment 1 of U.C.C. § 4A-203.

[112] See Restatement, Second, Agency, § 8B.

National Bank and Trust Co. of Chicago,[113] ratification and estoppel were accepted, in principle, as valid defences in an unauthorised credit transfers. In that case, the court found that principal's acceptance of mortgages, purportedly worth $2,200,000 but which later turned out to be worthless, from an agent who had ordered unauthorised transfer of $1.5 million from principal's bank account did not constitute a "ratification" of unauthorised transfer as would relieve the bank of responsibility for the loss of the transferred funds.[114] In the estoppel count, the court found that a depositor was not estopped from asserting a claim against bank for making an unauthorised transfer of $1.5 million from its account on the ground that, at some time after the depositor informed bank that the transfer was unauthorised, the depositor told the bank representative that the depositor was attempting to get mortgages that would alleviate the problem of missing funds, in the absence of any evidence to show that the bank relied on depositor's statement in deciding to forego any efforts to retrieve the money.[115]

However, If the bank fails to establish that the transfer was authorised, actually or ostensibly, or that its customer has ratified it or was estopped from asserting that the transfer was unauthorised, the bank may recover from the payee under other equitable causes of action such as subrogation or restitution.[116] Payment under a mistake of fact is recoverable provided that the requirements of such action are satisfied.[117]

5.4 [b] [ii] [2] The Use of Security Procedure.

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[113] 740 F.2d 1384 (7th Cir. 1984).

[114] Ibid, at 1392.

[115] 740 F.2d 1384, at 1392-1393.

[116] The official Comment 1 of U.C.C. § 4A-203.

[117] See the discussion in chapter four, para. 4.2.2 [b] [iii].

The authentication of some forms of payment instruction, such as those transmitted as electronic signals which will be readable on a computer screen, are difficult to verify according to the common law concepts of authority and agency law. The introduction of new electronic devices, through which payment orders and all related instructions such as amendments and cancellations are dispatched, suppresses the natural relationship between an order and the issuer. For example, where payment orders are to be authenticated by the use a facsimile signature machine, the identification of the person who actually caused the machine to create and send a given payment order is probably impossible to discover from the mere receipt of the order. The customer, who possesses such machine, must assume responsibility for the use of it, thus ensuring its operation by an authorised person in compliance with the customer's instructions. The bank, by accepting the payment order, is not relying on the authority of any particular person to act for the purported sender. This is unlike, for example, the case of a forged signature in a cheque.

Thus, new technology requires the adoption of certain devices or procedures to test the genuineness of customer's instructions. The law of agency was developed in a world of oral and written messages that could be traced to their source. Article 4A introduces what is called a "security procedure". Payment orders are to be tested by the use of such procedures under certain circumstances. This will help in filling the gaps of authority concepts under agency law, which resulted from the introduction of new technology. Under U.C.C. § 4A-202(b) a receiving bank and its customer[118] may agree on the use of a "security procedure" pursuant to which the authentication

[118] "Customer" refers to a "person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders." U.C.C. § 4A-105(a)(3).

of payment orders will be verified. If they reached such an agreement, customer's orders transmitted to the bank through such procedure will be treated, under certain circumstances, as that of the customer, even though unauthorised.

a- The Nature of the Security Procedure.

The term "security procedure" means "a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or cancelling a payment order is that of the customer ...".[119] Article 4A does not dictate the use of specific procedure. This is left to the banking industry, since the technology of electronic security is continually evolving. However, a security procedure may "require the use of algorithms or other codes, identifying words or numbers, encryption, callbacks procedures, or similar security devices."[120] One method, however, is explicitly excluded. "Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure."[121] There is a valid reason for excluding signature comparison from the definition of security procedure. If the signature alone qualified as a security procedure, then banks would be entitled to the protection of § 4A-202(b). The protection of banks under § 4A-202(b) is given because of "the inability of banks to verify the authenticity of electronic payment orders as is possible with paper instruments."[122] Banks can easily compare signatures on payment orders to specimen signatures, and thus verify their authenticity. Allocation of loss resulting from failure to detect unauthorised or forged signatures

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[119] U.C.C. § 4A-201.

[120] U.C.C. § 4A-201.

[121] U.C.C. § 4A-201.

[122] French, Article 4A's Treatment, supra, at 786.

will, therefore, be governed by agency rules under § 4A-202(a). The situation is not clear as regards "voice recognition" procedures. No explicit exclusion from the definition of "security procedure" is made except that of "comparison of a signature". As such, although banks have a "way of determining the identity or the authority of the person who caused the message to be sent", "voice recognition" procedure probably constitutes a "security procedure" for the purposes of § 4A-202(b). However, there is no direct authority on the point, and it is thus arguable.[123]

"Agreement" is not defined by the provisions of Article 4A. However, U.C.C. § 1-201(3) defines agreement as "the bargain of the parties in fact found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance ...". The commentary to § 4A-201 states that any security procedure adopted unilaterally by the bank does not constitute "[a security] procedure established by agreement" of the parties involved. Assume that a bank unilaterally adopts a certain security procedure to verify its customers' payment orders against fraud. A customer, who used such security procedure few times before without problems, sends a payment order *via* this security procedure but this time the order is fraudulently intercepted and two extra digits to the amount are inserted. Who incurs the risk of such fraudulent act? The customer argues that he never agreed a security procedure with his bank, so § 4A-202(a) should govern the case.[124] The bank argues that, although there was no express agreement between it and its customer on a security procedure, their course of dealing indicates that the customer has agreed to send his orders pursuant to the security procedure used to verify the unauthorised

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[123] French, Article 4A's Treatment, supra, at 787 (argues that voice recognition is similar to signature comparison, and as such does not meet the definition of "security procedure" under § 4A-201).

[124] That is, the bank should be liable, since the order was not authorised.

order. Accordingly, § 4A-202(b) should apply. One suggests that the commentary should be restricted to a security procedure adopted by the receiving bank unilaterally, and should not be extended to those cases where the course of dealing between the bank and its sender suggests that the sender has accepted the use of such security procedure as a method of verification of his orders. This needs to consider all the circumstances surrounding the dealing between the two parties. Moreover, the general definitions under § 1-201 apply to other provisions in the U.C.C. unless preempted by the provisions of the relevant article or section, but not by its commentary.[125] However, the agreement should include the fact that the bank and its customer have agreed that the authentication of the customer's payment orders is to be verified pursuant to a security procedure. That is because a bank and its customer may agree on a security procedure to detect errors only.

b- Security Procedure's Requirements.

Where parties have agreed on a particular "security procedure", payment orders that successfully pass such security procedure are considered as an authorised orders by such customer. However, four conditions must be satisfied in any agreed upon security procedure before shifting the risk of loss to a sender according to U.C.C. § 4A-202(b). First, the security procedure must be "a commercially reasonable method of providing security against unauthorised payment orders".[126] Second, the receiving bank must "prove"[127] "that it accepted the payment order in good faith".[128] Third, the receiving bank must "comply[] with the security procedure" agreed upon.[129]

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[125] See French, J.K. "Unauthorized and Erroneous Payment Orders", supra, at 1430 (no view is given as to this point).

[126] U.C.C. § 4A-202(b).

[127] U.C.C. § 4A-105 provides that the word "'prove' with respect to a fact means the burden of establishing the fact".

[128] U.C.C. § 4A-202(b).

[129] Ibid.

Fourth, the receiving bank must comply with "any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer."[130] One suggests that the allocation of loss for unauthorised transfer depends on how courts will interpret such requirements.[131] Those are discussed below under separate headings.

1. The Commercial Reasonableness of the Security Procedure.

The security procedure agreed upon must be "a commercially reasonable method of providing security against unauthorized payment orders."[132] This requirement is to ensure that banks will not use "out-of-the shelf" security procedure notwithstanding its reliability. Banks should not be allowed to shift the risk of loss for unauthorised payment orders to their customers if they offered uninformed customers a commercially unreasonable security procedure. Thus, a security procedure that fails to meet "prevailing standards of good banking practice applicable to a particular bank" is not commercially reasonable.[133] However, although it is assumed that the security procedure which is commercially reasonable should be effective in detecting unauthorised payment orders, the mere fact that an unauthorised payment order has not been discovered by the security procedure does not necessarily mean that such security procedure was not commercially reasonable.[134] The purpose of the provision is to encourage "banks to institute reasonable safeguards against fraud but not to make

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[130] Ibid. However, the receiving bank "is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted." U.C.C. § 4A-202(b).

[131] For a review of banks' liability in a question-and-answer format under Article 4A, see Patrikis E.T., Baxter Th.C. & Bhala R., Article 4A: The New Law of Funds Transfers and the Role of Counsel [1991] 23 Uniform Commercial Code Law Journal 219.

[132] U.C.C. § 4A-202(b)(i).

[133] Ibid.

[134] French, Article 4A's Treatment, supra, at 788.

them insurers against fraud".[135]

Commercial reasonableness of security procedures is a question of law.[136] However, whether a receiving bank has complied with the security procedure agreed upon is a question of fact.[137] The commercial reasonableness of a security procedure can be determined by considering different factors.[138]

First; the "wishes of the customer expressed to the bank" must be considered. This will encourage customers to participate actively in choosing, where practically possible, the security procedures that they wish their payment orders to be verified against. Some customers would prefer safety as opposed to costs. Others may prefer minimising costs at the expense of safety. Customers are advised to take care in ensuring that their wishes expressed to their banks are accurately and carefully documented. It is preferable for customers, who are not experts in security procedures, to avoid choosing a specific procedure, where possible. Rather they should assert the qualities and effectiveness of the security procedure that they desire the security procedure to possess. A customer who is sensitive as to fraudulent orders more than costs, for example, may ask his bank for the most fraud-detective security procedure available. One suggests in this case that if a fraudulent order has not been discovered by such system, a customer, who wants to escape reshifting the risk of loss to him, needs only prove that his bank had at the time of instructions another security procedure, which was more effective in detecting fraud than the one used by his bank.

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[135] The Official Comment 4 of U.C.C. § 4A-203.

[136] U.C.C. § 4A-202(c). The argument behind this was that "it is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standarized in the banking industry and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers." See the Official Comment 4 of U.C.C. § 4A-203.

[137] The Offical Comment 4 of U.C.C. § 4A-203.

[138] Those are explicitly set forth in U.C.C. § 4A-202(c).

The specification of a certain security procedure by the customer may give the inaccurate impression that the customer chose such security with a full knowledge of its shortcomings. Thus, it is important that the customer documents its reliance on his bank's expertise and representations in choosing a security procedure.[139]

Second, "the circumstances of the customer known to the bank, including the size, type and frequency of payment orders normally issued by the customer to the bank" are to be considered.[140] Thus, what is commercially reasonable for one type of transfer, e.g. a wire transfer, may not be commercially reasonable for another transfer, e.g. ACH transfer. Similarily, "the state-of-art-procedure" which is reasonable for a large-dollar amount might be costly and infeasible for a customer that transmits orders infrequently or in low-dollar amount.[141]

The question that arises is whether those particular circumstances are to be considered only if the bank had actual knowledge of them, or it is assumed that it should have knowledge of them and thus must consider them? One commentator argues that since the receiving bank usually has an ongoing funds transfer relationship with its customer at the time a security procedure was chosen, it should be deemed to have knowledge of the circumstances of the pre-existing relationship, and therefore must consider them.[142] This could help banks since the burden of proving the commercial reasonableness of the security procedure used is on the receiving bank.[143] Thus, a bank is expected, although it is not bound, to inquire into these

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[139] See French, Article 4A's Treatment, supra, at 789.

[140] U.C.C. § 4A-202(c).

[141] Baker & Brandel (1988), para.12A.07[3][b].

[142] French, Article 4A's Treatment, supra, 790-792.

[143] The official Comment 3 of U.C.C. § 4A-203 ("The burden of making available commercially reasonable security procedures is imposed on receiving banks because they generally determine that security procedure can be used and are in the best position to evalute the efficacy of procedures offered to customers to combat fraud").

relevant circumstances. After all, whether a security procedure is commercially reasonable is intended to be based on the situation of the particular bank and sender. Thus, for a bank to be able to prove its case, it should have knowledge of its customer's circumstances. Otherwise it risks failing on evidence. However, one suggests that in the light of uncertainty on how courts will interpret the term "circumstances ... known to the bank", customers are advised to ensure that their banks know their circumstances. This might increase their chances that their banks will choose a security procedure which takes their circumstances properly into account.

There is no strict rule on how courts will weigh such circumstances. However, one suggests that courts will require higher level of protection for greater amounts of transfer. The type of transfer may suggest certain type of security procedure. For example, where the sender sends its payment orders in a magnetic tape to the bank to be made through ACH, banks are expected to concentrate on whether such tape is physically or electronically altered rather than checking each individual payment order contained in the tape. However, individual scrutiny may be necessary in the case of wire transfers.

Although, size, type and frequency of payment orders are explicitly mentioned by § 4A-202(c) to be considered in determining the commercial reasonableness of the security procedure used, they are not exclusive. Other circumstances may be considered if they brought to the knowledge of the receiving bank. The language of § 4A-202(c) is flexible enough to allow the consideration of other circumstances.

Third, Whether a sender has been offered an alternative security procedure is another factor in determining the commercial reasonableness of security procedures. In determining whether a security procedure is commercially reasonable the court

should consider whether an alternative security procedure has even been offered to the sender. The question here will be whether the mere fact of the bank's failure to offer an alternative security procedure does in itself transform an otherwise commercially reasonable security procedure into one is not, or *vice versa*. A sender may argue that the bank's failure to offer him an alternative procedure narrowed his chances of choosing; and he could have chosen a security procedure, if offered, that might have prevented the unauthorised transfer. However, the mere failure to offer an alternative security procedure is only a factor in determining the commercial reasonableness of the security procedure used. There is no authority to support the proposition that such failure would turn an otherwise commercially reasonable procedure to one that is not.

Fourth, whether the security procedure used was "in general use by customers and receiving banks similarily situated" is another factor to be considered in determining the commercial reasonableness of security procedures.[144] This factor will force banks to take account of the general practice of other banks and customers. Banks should update their security procedures so as to keep up with the development in technology as used by other similarily situated banks. This will increase the likelihood of preventing the acceptance of unauthorised orders. Thus, it is not sufficient for courts to restrict their investigation of this factor to those security procedures used by the sender's bank only. The practical effect of this factor is to force banks to keep their security procedures up to the time, and hence foster one of the main goals of Article 4A: minimisation of losses due to unauthorised payment orders.[145]

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[144] U.C.C. § 4A-202(c).

[145] French, Article 4A's Treatement, supra, at 794.

However, this factor can be abused by banks. A bank may argue that although its security procedure is full of "holes", it is nonetheless commercially reasonable because other similarly situated banks and customers use the same or a similar security procedure. In order to preserve a higher standard of commercial reasonableness, courts must not allow banks to find "safety in numbers". Permitting receiving banks to find "safety in numbers" would not encourage receiving banks to "pursue improvements in security procedure technology and could result in commercial reasonableness being synonymous with the lowest common denominator of security procedures in general use."[146] Otherwise, banks would not be encouraged to search and develop a highly stanadard security procedures. Whether courts will construe the term "similarly situated" in terms of geography, or in terms of financial and technological power is far from clear.[147] The Official Comment of § 4A-203, however, indicates that the term "similarly situated" suggests a comparison among similar banks. The example given by that comment was that comparing a security procedure used by a large money centre bank to a small country bank would be inappropriate.[148]

The problem that might face courts is where one or more of the above discussed factors militate in favour of determining that the security procedure in question is not commercially reasonable, while some other factors militate against such a conclusion. What shall the court do? How the court is going to weigh such factors; and is there any of them merits an assignation of more weight than others?

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[146] Ibid, at 795.

[147] It is argued that such term should not be limited in terms of geography. See French, Article 4A's Treatement, supra, at 795. This is, however, should be construed within the United States of America.

[148] The Official Comment 4 of U.C.C. § 4A-203.

No specific answer is offered by Article 4A. However, § 4A-203 states that the commercial reasonableness is a question of law to be determined by considering the above discussed factors. The question, thus, is left to the discretion of the court. The court will have a great deal of latitude in applying the four factors discussed above, and other relevant factors. This makes "commercial reasonableness" a flexible standard. However, courts should construe the term in the light of the main object of introducing such test. Therefore, courts should encourage, in interpreting the commercial reasonableness of a security procedure, the protection against unauthorised payment orders. However, this interpretation should not go too far to the degree of holding banks as insurers against unauthorised transfer.

2. The Acceptance of the Payment Order in Good Faith.[149]

The application of § 4A-202(b) requires that a payment order should be accepted by the receiving bank in good faith. The bank must prove that it has accepted the order in good faith. Article 4A defines "good faith" differently from the general definition of "good faith" in Article 1.[150] It is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[151] This definition reflects the drafters' intention to support reasonable banking and commercial standards of practice and fair dealing. It is suggested that the drafters intentionally abandoned the definition of the term "good faith" under § 1-201(19) because of the inconsistent treatment of such term by courts under Article 4.[152] The definition adopted by

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[149] For a fairly detailed discussion of this factor, see French, "Unauthorized and Erroneous Payment Orders", [1990] 45 The Business Lawyer, 1425 at 1435-1436; and by the same author, Article 4A's Treatment, supra, at 804-805.

[150] U.C.C. § 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned". This is so called "white heart, empty head" definition of "good faith". See for more detail J. White & R. Summers, Uniform Commercial Code, (3rd ed. 1988) at § 6-3.

[151] U.C.C. § 4A-105(6).

[152] See French, Article 4A's Treatment, supra, at 804-805.

Article 4A is closer to the definition of "good faith" contained in Article 2 dealing with the sale of goods.[153] Thus, case law construing "good faith" under Article 2 may be found relevant in construing the same term under Article 4A.

3. The Bank's Compliance with the Security Procedure.

A bank which agreed on verifying its customer's payment orders according to an agreed upon security procedure must honour such agreement by following all the necessary steps to verify the incoming orders by the use of such procedure.[154] The security procedure that the bank must comply with is the one that the bank and its customer have agreed upon for the verification of customer's order in question. It is not sufficient for the bank to comply with any other commercially reasonable procedure used by the bank. This is significant where the bank and its customer have reached agreement to verify different types or sizes of transfer by different security procedures. The compliance should be with the security procedure agreed upon to verify the order in question itself. Two situations may arise. First, it may be proved that had the bank complied with the security procedure agreed upon, the unauthorised payment order would have been discovered. Second, it may be proved that an unauthorised order in question could not have been discovered even if the bank had complied with all necessary steps specified in the agreed upon security procedure. Does such distinction make any difference as to the satisfaction of the security procedure's requirements? It is clear that in the first case, a bank does not meet such requirement. The answer to the second case depends on whether it is required that a bank should strictly comply with the security procedure. In such a case, the receiving

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[153] U.C.C. § 2-103(1)(b). See also Baxter & Bhala, "The Interrelationship of Article 4A with Other Law", [1990] 45 Business Lawyer, 1485, 1497.

[154] U.C.C. § 4A-202(b)(ii).

bank may argue that the nature of the fraudulent payment order was as such that it would have occurred even if the bank followed each step of the agreed upon security procedure. A sender may rely on the explicit language of § 4A-202(b) that "a payment order received by the receiving bank is effective as the order of the customer, whether or not authorised, *if* ... the bank proves that it accepted the payment order in complience with the security procedure ...". It is obvious that arguments can be advocated by both sides.

It is argued that a bank that does not strictly comply with an agreed upon security procedure should be liable for the fraudulent payment order regardless whether, or not, such noncompliance has caused the fraudulent payment order.[155] Thus, if the bank proves that even if it had complied with the agreed upon security procedure, such compliance could not have stopped the occurrence of the fraudulent payment order, it cannot shift liability to its sender. The Official Comment of § 4A-203 states that there is no compliance with the security procedure if "the fraud was not detected because the bank's employee did not perform the acts required by the security procedure."[156] This is merely an illustration of noncompliance, and is not intended to limit the definition of the term "compliance".[157] Allowing the receiving bank to breach the very steps that it had agreed to observe would not reduce the risk of loss, or even the cost of the transfer. The language of § 4A-202(b) supports a strict compliance with the security procedure. The fact that the fraud complained of would have occurred even if the receiving bank had complied with all steps required by the security procedure is no excuse. If the drafters wanted to excuse the bank for such

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[155] French, Article 4A's Treatment, supra, at 806-807.

[156] The Official Comment 3 of U.C.C. § 4A-203.

[157] Ibid. See French, Article 4A's Treatment, supra, at 805.

type of failures they could have adopted the same language they did in relation to erroroneous payment orders.[158] The sender of an erroneous payment order through an agreed upon security procedure for detection of error can shift the risk of loss resulting from such erroneous order if he proves that the error would have been detected had the receiving bank complied with that procedure.[159] "The drafters clearly chose to require proof that the bank's noncompliance with the security procedure caused acceptance of erroneous payment orders but not to require causal connection with noncompliance in unauthorized payment order cases."[160]

It is suggested that courts should not be tempted to mitigate such view on equitable considerations by arguing that technical noncompliance with security procedures which does not cause the fraudulent payment should not hender courts to come to banks' rescue.[161] This is especially important where no fault is found on the part of the customer. There is "no reason for assigning liability to the customer as opposed to its bank."[162] § 4A-202(b) is applicable only when certain requirements are met, while § 4A-202(a) acts as the residual rule for loss allocation resulting from unauthorised payment orders.[163] This is based on policy considerations provided for in that section and its commentary. Supplementing or ignoring such policy considerations by courts will change the rules of loss allocation adopted by Article 4A.

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[158] *C.f.* McKelvy T.E., Article 4A of the Uniform Commercial Code: Finality, Banks and their Customers Know Where they Stand and Who Pays When a Wire Transfer Goes Awry, [1991] 21 Memphis State University L. Rev. 351 (where it is argued that although a strict reading of § 4A-202(b) might arguably encourage banks to comply fully with the security procedure agreed upon by the parties and provide a bright line rule to follow, such a reading seems a harsh consequence for a minor bank's error.)

[159] U.C.C. § 4A-205(a)(1).

[160] French, Article 4A's Treatment, supra, at 806.

[161] Ibid, at 806-807.

[162] Ibid, at 807.

[163] Ibid.

4. Compliance with any Written Agreement or Instructions of the Customer Restricting Acceptance of Payment Orders.

Although the requirement that a security procedure must be commercially reasonable and that the bank must accept customer's orders in good faith provide some comfort to banks' customers, a customer may find itself liable for unauthorised payment order. This is possible since not every security procedure that is commercially reasonable is infallible. This deficiency of the loss allocation rule of § 4A-202(b) was attacked by the representatives of the users of wholesale wire transfer systems. They argued that some formula should be reached to provide customers with mechanisms to limit their exposure.[164] The drafters accommodated this objection by requiring receiving banks to comply with "any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer."[165]

A customer may use this requirement to shift the risk of loss for unauthorised payment orders back to the receiving bank.[166] A customer, for example, may designate an account from which the receiving bank is to obtain reimbursement for payment orders received from the customer. This power to designate an "authorized account"[167] from which a receiving bank may reimburse itself for its customer's payment orders is seen as one means for corporate customers to control their risk of loss from unauthorised orders.[168] The importance of this customer's right is obvious when one considers that when a customer "does not designate an account, any account

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[164] See Ballen, Baxter, McTaggart, Nyquist & Rubin, Commercial Paper, Bank Deposits and Collections, and Other Payment Systems, [1989] 44 The Business Lawyer, 1515, at 1532; and Fry, P., Basic Concepts, supra, at 1421.

[165] U.C.C. § 4A-202(b)(ii).

[166] French, Article 4A's Treatment, supra, at 807.

[167] For the definition of this term, see U.C.C. § 4A-105(a)(1).

[168] Fry, Basic Concepts, supra, at 1421.

of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account."[169] A customer may also instruct his bank to restrict wire transfer to a supplied list of beneficiaries' names. This means that the risk of loss resulting from paying a beneficiary whose name was not in the list falls on the receiving bank. Other examples include specifying a maximum amount limit in each single payment order, or instructing the bank not to honour orders that exceed the customer's credit balance at the time of instruction. The receiving bank's failure to obey such instructions shifts the risk of loss resulting from an unauthorised transfer to the bank.

It is clear that this requirement is significant because it gives customers some amount of leverage in their fund transfer relationship with their receiving banks.[170] A customer who fails to incorporate an important limitation in the agreement of the security procedure may mitigate the situation by using its right to give the receiving bank later instruction. Such instruction may be given unilaterally by customers.[171] Receiving banks must comply with such instruction unless (i) it "violates a written agreement with the customer; or (ii) "notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted."[172]

Taking into account that "instructions might be unilaterally given by the customer",[173] a customer may instruct his bank "not to accept an unauthorised payment orders generally". It is clear that allowing such instruction would shift all the

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[169] U.C.C. § 4A-105(a)(1).

[170] See French, Article 4A's Treatment, supra, at 808.

[171] The Official Comment 3 of U.C.C. § 4A-203.

[172] U.C.C. § 4A-202(b)(ii).

[173] The Official Comment 3 of U.C.C. § 4A-203.

risk of loss resulting from unauthorised payment orders to the receiving bank. In other words, while the customer agreed on the use of a security procedure under § 4A-202(b), he wants to escape the rule of this section to the heaven of § 4A-202(a). In short, he wants to have both worlds, the protection of the security procedure and the common law rule that a bank is not entitled to debit its customer's account without authority.

Before one discusses the effectiveness of such instruction, it must be recalled that such instructions must (i) not violate a previous written agreement between the customer and the bank; and (ii) be received by the bank at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted. Assuming that those two conditions have been satisfied in the above hypothetical situation, may the customer succeed in an action against his bank for unauthorised payment order?

It is strongly argued by one commentator that such instructions should be upheld as binding upon the receiving bank.[174] Two main arguments in support of this view were offered. First, giving effect to such instruction is "consistent with the plain language of subsection 4A-202(b) and does not violate the policies pursued by Article 4A ... since permitting a customer to give an instruction that may increase the cost of and slow down that particular customer's funds transfers does not interfere with this policy objective."[175] Second, such instruction is not unfair to receiving banks, since for an instruction to be binding, it must be received by the bank at a time and in a manner affording the bank a reasonable opportunity to act upon it before the

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[174] French, Article 4A's Treatment, supra, at 809-810.

[175] Ibid, at 809.

payment order is accepted. "Thus, banks are given the opportunity to decide whether they will continue to provide funds transfer service subsequent to receipt of such instructions."[176]

One argues that, although § 4A-202(b) uses the unqualified term "*any* written agreement or instruction," allowing the above interpretation would be costly, and contradicts the general object of introducing the idea of "security procedure". Allowing such interpretation of § 4A-202(b) would mean that banks would become insurers of fraudulent payment orders. It could be argued that there is nothing wrong with that so long as the particular customer is willing to pay for such service. However, one argues that such protection is freely available to the customer under the residual rule of § 4A-202(a). Under that rule, as discussed earlier, a customer is not obliged to pay for any order unless he authorised such order, or alternatively was bound by such order under the law of agency. The argument that banks would not accept payment orders unless their customers enter into an agreement on security procedure would deny the very existence of § 4A-202(a). Moreover, it is unlikely that banks would accept such instructions. Although banks are not insurance companies, such instructions will not be so common in the market as to economically justify such insurance task by the willing banks. It is, also, expected that customers will not see the risk of unauthorised payment orders, in the light of the agreed upon security procedure, as high enough to justify paying an expected high premium for accepting such instructions.

c- Special Case: Customer's Refusal of Commercially Reasonable Procedure.

A security procedure is deemed to be commercially reasonable if (i) "the security procedure was chosen by the customer after the bank offered, and the

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[176] Ibid, at 809-810.

customer refused, a security procedure that was commercially reasonable for that customer"; and (ii) "the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer."[177]

A customer may insist on using a cheaper and more convenient security procedure as opposed to a more expensive and efficient procedure. In this case, Article 4A allocates the risk of loss resulting from unauthorised payment orders to such customer. However, it must be noted that this special rule is applicable only if the bank has initially offered a security procedure that was commercially reasonable for the particular customer involved.[178] The procedure chosen by the customer should be a security procedure as defined in Article 4A.[179] Thus, this rule is not applicable where a customer refuses a commercially reasonable security procedure in favour of a signature comparison alone because signature comparison by itself is not a security procedure as defined by § 4A-201.[180]

This rule is meant to make allowances for the informed customer who rejects a commercially reasonable procedure for a security procedure that may be more convenient or cheaper, although could entail higher risk.[181] By doing so, "the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in writing to assume that risk."[182] The bank that accedes to the wishes of its customer

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[177] U.C.C. § 4A-202(c).

[178] U.C.C. § 4A-202(c). See Baker & Brandel (1988), 1991 Comulative Supp. No. 2, supra, para. 12A.07[3][b][ii].

[179] U.C.C. § 4A-201.

[180] See Baker & Brandel (1988), 1991 Supp., supra, para. 12A.07[3][b][ii].

[181] The Official Comment 4 of U.C.C. § 4A-203.

[182] Ibid.

in this regard is not acting in bad faith provided that the customer is made aware of the risk.[183]

The commercial reasonableness of the offered and refused security procedure by the bank's customer is qualified by being commercially reasonable "for that customer".[184] Thus where the offered and refused security procedure provides less security than needed for the customer's fund transfer business, it could be argued that it was not commercially reasonable *for that customer*. The question that may arise is whether the offered and refused security procedure which exceeds the security needs of the customer is a commercially reasonable security procedure *for that custumer*. A customer may complain that his fund transfer business does not need all the offered highly cost and inconvenient security steps. One example is where a bank insists on offering all its customers, small and large, its state-of-the-art security procedure. Can a customer, who refuses such security procedure, escape liability under this special rule on the ground that the security procedure offered and refused was not commercially reasonable for him in particular?

Neither Article 4A nor its commentary offers any explicit answer. It is argued that the language of Article 4A "appears to be flexible enough to permit a court to find such security procedure not to be commercially reasonable 'for that customer'".[185] That argument was based on that (i) the phrase "wishes of the customer" used in § 4A-202(c) "appears broad enough to include the customer's expressed desires to avoid expense and inconvenient procedures not required for the level of security appropriate for the nature of customer's funds transfer business.

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[183] Ibid.

[184] U.C.C. § 4A-202(c)(i).

[185] French, Unauthorized and Erroneous Payment Orders, supra, at 1435.

Additionally, the comments state that the expense involved may make use of the state-of-the-art procedure 'infeasible' for customer that normally transmits payment orders infrequently or in relatively low amounts."[186] One supports this argument so long as the offered and refused commercially reasonable security procedure was "infeasible", relatively expensive, and unjustifiably provided the customer with security steps too far beyond the needs of his funds transfer business. Such interpretation would encourage banks to offer reasonable security procedures which meet customers' needs, so there will be no need for a customer to refuse an offered security procedure and assume a higher risk.

Another condition should be satisfied for a security procedure to be deemed commercially reasonable. That is the customer must "expressly agreed in writing to be bound by any payment order, whether or not authorised, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer."[187]

The question that arises here is whether the customer's refusal of a security procedure that was commercially reasonable; and his agreement to be bound by a chosen security procedure means the waiver of other requirement that must be satisfied in any security procedure. In other words, does the customer's agreement to be bound by payment orders verified by the use of his chosen security procedure according to § 4A-202(c) relieve the bank of the requirements that it must accept payment orders in good faith, comply with the chosen security procedure and comply

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[186] French, Unauthorized and Erroneous Payment Orders, supra, at 1435. See also the Official Comment 4 of U.C.C. § 4A-203.

[187] U.C.C. § 4A-202(c)(ii).

with later instructions?[188]

It is suggested that a bank is not relieved from complying with these duties by the mere fact that a customer has chosen to waive his right to the commercial reasonableness of a chosen security procedure.[189] The reason is said to be that "the customer and the bank lack the ability to dispense with the requirement that the bank meet these additional requirements."[190] The allocation of loss for unauthorised payment orders is not variable by agreement, except as provided in § 4A-202 and § 4A-203(a)(1).[191] § 4A-202(c), which deals with the point in issue, provides that the effect of allowing a customer to vary the loss allocation rule in § 4A-202 is that his chosen security procedure, after being offered a commercially reasonable one and expressly agreeing in writing to be bound by this procedure, "is deemed to be commercially reasonable". That is the only effect. The language of § 4A-202(c) does not state that the effect is to relieve the bank from meeting other requirements under § 4A-202(b)(ii). § 4A-202(c) provides a "mechanism by which customers and banks may in effect vary the definition of a commercially reasonable security procedure but it does not dispense with the requirements contained in subsection 4A-202(b)."[192]

A contrary interpretation can be made in reliance on the general wording of § 4A-202(c)(ii), in which a customer expressly agrees in writing "to be bound by any payment order, whether or not authorized". However, this should be read within its context. A customer agrees "to be bound by any payment order, whether or not authorized", if and only if such unauthorised payment order was caused by the fact

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[188] U.C.C. § 4A-202(b)(ii).

[189] French, Article 4A's Treatment, supra, at 803-804.

[190] Ibid, at 802.

[191] U.C.C. § 4A-202(f).

[192] French, Article 4A's Treatment, supra, at 802.

that the customer's chosen security procedure was deemed commercially reasonable, while in reality it was not. That is the risk that the customer has assumed when he refused his bank's offer of a commercially reasonable security procedure for a one of his choice, which turns out to be not commercially reasonable.

d- Unenforceability of Certain Verified Payment Orders.

Enforceability of a verified payment order pursuant to a commrecially reasonable security procedure under the provisions of § 4A-202(b) is the ultimate aim of the receiving bank. If the payment order is tested pursuant to a security procedure, which satisfies all the requirements under the provisions of § 4A-202, it will be "effective as the order of the customer, whether or not authorized."[193] However, where the verified order was not authorised, this rule has two exceptions.[194] First, a receiving bank may limit, by express written agreement, the extent to which it will enforce or retain payment of the payment order.[195] Second, the receiving bank is not entitled to enforce the unauthorised, but verified, payment order if the customer "proves" that his "shop was clean".[196] Those two exceptions are discussed separately.

1. Express written agreement of the bank.

A receiving bank may, by express written agreement, assume all or part of the risk of loss resulting from an unauthorised, but verified, payment order which the customer would ordinarily otherwise bear. On other words, a receiving bank may by an express written agreement with its customer increase its liability for an unauthorised payment orders. In practice, this needs a customer who has strong

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[193] U.C.C. § 4A-202(b).

[194] Needless to say that these exceptions are not operative against the rule of § 4A-202(a).

[195] U.C.C. § 4A-203(a)(1).

[196] U.C.C. § 4A-203(a)(2).

bargaining power to force his bank to accept higher standard of liability. Alternatively competition between banks may result in such higher standard of banks' liability.[197] Customers with little bargaining leverage may find their banks unwilling to negotiate away the protection that they have under § 4A-202(b). It must be noted that a customer's liability cannot be increased by express agreement under § 4A-203(a)(1). This is restricted to an increase in banks' liability only.

2. Proof that the customer's "shop" was "clean".

The second exception for enforceability of verified payment orders pursuant to a commercially reasonable security procedure is the customer's proof that the unauthorised order was not caused, directly or indirectly by a person:

> "(i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault."[198]

Proving that, a customer will shift the risk of loss for unauthorised transfer to the receiving bank. This is in fact the last hope for a customer who tried a security procedure, but such procedure nevertheless failed to discover a fraudulent order, to shift the risk of the loss resulting from such unauthorised order back to his bank. This subsection was heavily debated during the drafting process. Previous versions of this subsection required the customer to prove that the unauthorised payment order was accomplished by a person possessing confidential information about the security

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[197] However, it is not unlikely that banks' regulators will find receiving banks' acceptance of additional liability an unsafe and unsound banking practice. See 12 U.S.C. §§ 93(b)(2)(A)(ii), 203(a)(5) and 504(b)(1)(B) (1988) (each referring to unsafe and unsound banking practices); 12 C.F.R. § 208.8 (1990) (providing that no state member bank of the Federal Reserve System shall engage in practices which are unsafe or unsound).

[198] U.C.C. § 4A-203(a)(2).

procedure which was received from an insider of the receiving bank.[199] Representatives of customers objected to this drafting by arguing that receiving banks should be held liable for unauthorised orders by all parties including third parties, except customers' employees. Moreover, they argued that the burden of proof should be the responsibility of receiving banks.[200] The official text of § 4A-203(a)(2) is the compromise result which has been assented to by most parties.

An unauthorised payment order could be initiated by (i) someone from within the "customer's shop"; (ii) someone from within "the receiving bank's shop"; and (iii) third parties not associated with either the customer or the receiving bank. The last category can be divided into two subcategories; (a) third parties obtaining access to information or facilities controlled by the customer; (b) third parties obtaining access to information or facilities controlled by the receiving bank.

If the customer proves that the unauthorised transfer was caused by either the "receiving bank's shop" or by third parties who obtained access to information or facilities controlled by the receiving bank, he can shift the risk of loss resulting from such unauthorised payment order to the receiving bank. The burden of proof is the customer's, and it is a difficult one as negative facts are always difficult to prove. A customer is not required to prove that the unauthorised payment order was caused by the "receiving bank's shop", or by third parties who had information or access to facilities controlled by the receiving bank. Rather, he has to prove that none of his employees, people entrusted by him, or third parties with information or access to information or facilities controlled by him, did cause the unauthorised payment order.

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[199] See Ballen, Baxter, McTaggart, Nyquist & Rubin, Commercial Paper, Bank Deposits and Collections, and Other Payment Systems, [1989] 44 The Business Lawyer 1515, 1532.

[200] Ibid.

The customer needs only to establish that it is more probable that the unauthorised payment order was not caused by his "shop" or third parties with information or access to facilities controlled by him than it was so caused.[201] A customer may choose to focus on proving that his "shop" was "clean". Additionally, or alternatively, he may focus on proving that the "receiving bank's shop" was not "clean". However, he may face, after proving that his "shop" was clean, evidence by his bank that the "bank's shop" was also clean. It is suggested that a customer may have recourse to the probability test, arguing that it is more likely that the source of the fraud did not come from his "shop".[202] The language of U.C.C. § 4A-203(a)(2) does not require, however, more than proving that the sender's "shop" was "clean" to shift the risk of loss to the bank. Therefore, whether or not the fraud has been caused by the bank is irrelevant to the sender's defence so long as he proves that it was not attributed to him or his "shop". Thus, the risk of fraud caused by a party who is not related to the sender nor to the bank falls on the bank. The bank is in a better position to either gaurd against such fraud or absorb losses caused by it.

To facilitate such "evidence" task, customers are advised to reduce the number of individuals obtaining access to their funds transfer transmitting facilities. This will reduce the number of people that the customer has to prove that they did not facilitate the alleged unauthorised transfer. Reducing the number of individuals who are entrusted with funds transfer duties to the minimum will produce the same result. To reduce the possibility of a third party having information or access to facilities controlled by the customers, customers are advised to handle confidential information

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[201] U.C.C. § 4A-105(7) provides that "prove" with respect to a fact means "to meet the burden of establishing the fact". U.C.C. § 1-201(8) provides that "the burden of establishing" a fact means the burden of persuading the fact finder "that the existence of the fact is more probable than its non-existence".

[202] See French, Unauthorised and Erroneous Payment Orders, supra, at 1439.

on the bases of "need to know". The more individuals and information the "customer's shop" knows about the security procedures the more likelihood that such information will fall in the hands of a dishonest person who will use it for unauthorised transfers; and also the more difficult the burden of proof will be.

For the purpose of unenforceability of unauthorised, but verified payment orders, information includes any access device, computer software, or the like.[203] The above discussion is not only applied to payment orders verified pursuant to an agreed upon security procedure, but also to any amendments of such payment orders to the same extent it applies to payment orders.[204]

e- The Liability of the Receiving Bank to Refund Customers for Unauthorised and Unenforceable Payment Orders.

Where the receiving bank is liable for an unauthorised or unenforceable payment order, it must refund any payment received from the customer in connection with the unauthorised and unenforceable payment order; and to pay interest on that amount from the date the bank received payment to the date of the refund.[205] This obligation is generally not variable by agreement.[206]

However, a customer is not entitled to the interest on the amount refundable if he fails to exercise ordinary care to determine that the order was not authorised and notify the bank of the relevant facts.[207] The notification must be given to the bank within a reasonable time not exceeding ninety days after the date the customer has received notification from his bank that the order was accepted or the customer's

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[203] U.C.C. § 4A-203(a)(2).

[204] U.C.C. § 4A-203(b).

[205] U.C.C. § 4A-204(a).

[206] U.C.C. § 4A-204(b). The only exception to this rule is the reasonable time during which a customer must notify his bank of any relevant facts on the unauthorised payment orders. Ibid.

[207] U.C.C. § 4A-204(a).

account was debited with respect to the order.[208] Such failure by the customer does not affect the recovery of the principal sum of the payment order.[209]

It must be noted that the ninety days limit of notification is a maximum one. A customer must notify his bank of the unauthorised or unenforceable payment order with reasonable time up to ninety days. This reasonable time may be varied by agreement.[210] To clear ambiguity and to limit the court's discretion in determining such time, banks' customers are advised to make use of subsection § 4A-204(b) by reaching an agreement with their banks on determing such time. They should ensure that the agreed period allows them adequate time to discover and report unauthorised and unenforceable payment orders. Moreover, customer must make sure that they read and investigate any communications from their banks, e.g., statements, in order to discover and report in a timely manner.

However, a customer may lose his right to the principal sum debited to his account in addition to the interest thereon if he fails to discover and notify such debit to his bank within one year of receiving a notification of such debt.[211]

5.5 The Scope of Banks' Liability for Unauthorised EFTPOS and ATMs Transactions.

5.5.1 Security System in Use.

A debit card coupled with a PIN is the commonly used authentication procedure in ATM transactions both in U.K. and U.S.A. It is also used in EFTPOS transactions. However, some EFTPOS schemes rely on the use of a debit card and the

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[208] Ibid.

[209] Ibid.

[210] U.C.C. § 4A-204(b).

[211] U.C.C. § 4A-505. See for more detail, French, Article 4A's Treatment, supra, at 820-821.

customer's signature on a sale slip as an authentication and security procedure. It is a basic term in customer's account agreement with his bank that the latter is authorised to debit the former's account with the amount of the transaction upon the use of the customer's valid card in conjunction with his PIN or signature. The customer agrees not to pass his card nor disclose his PIN to any other person. Banks' liability for unauthorised use of EFTPOS and ATM cards resulting in an unauthorised debiting of customers' accounts is discussed separately under both British and American law.

5.5.2 Security and Authentication Concerns.

5.5.2 [a] In the United Kingdom.

Concerns over the security of PIN system and the authentication of instructions made through it were echoed by the Review Committee Report.[212] The risk of unauthorised debiting of customers' accounts stems from the design and/or operational aspects of the system. It was reported by the Review Committee that:[213]

> "As to design aspects, a majority of the expert evidence ... sees the PIN system, from a security standpoint, as vulnerable. Any system that requires a keyboard input to validate a transaction is ... open to fraud. As far as ATM's at least are concerned, the prime security concern is to ensure that access is restricted to the authorised customer and card. Yet experts assure [the committee] that it is not too difficult to steal a card, having already made a note of the PIN by watching it being keyed in; and that it is relatively simple to forge cards by wiping out existing information on the magnetic strip and inserting new data."

Concerning operational aspects of the system, the Review Committee noticed that the level of fraud is "not easy to come by". There is a wide complain of what so-called "phantom transactions", in which customers' accounts were debited as a result

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[212] The Review Committee Report, *supra*, at paras. 10.02 - 10.22.

[213] Ibid, at para. 10.06.

of ATM withdrawals apparently made with their card and PIN, but for which they disclaimed all responsibility.[214] The percentage of ATM complaints submitted to the office of the Banking Ombudsman were the highest among other complaints in 1990.[215]

5.5.2 [b] In the United States.

As of 1986, there were more than 186 million ATM cards in use in the United States. The fact that more than 1,300 of them are lost or stolen every day shows the extent of the risk of unauthorised transactions.[216] A person who loses his card is basically protected against fraudulent use of his lost or stolen card by the fact that the unauthorised user needs the customer's PIN to withdraw money from an ATM. To minimise the risk of knowing the PIN by trial and error, most ATM are programmed to retain the card after entering the wrong PIN several times, commonly three times.

It is not impossible that despite the PIN security device, the risk that someone other than the legal cardholder will gain access to accounts still exists. If a cardholder writes down his PIN in the same place as his card, e.g., in a wallet, a thief needs only steal the wallet. Surveys estimate more than 70% of ATM users carry their PIN close to the card, most likely out of fear of forgetting it.[217] Banks may reduce such risk by allowing customers to select their own PINs at the time of application. By selecting a number or letter combinations that have special significance to the customer, e.g., telephone number or birthday, it is more likely that he does not need to write it down.

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[214] Ibid, at para. 10.07. See also "Losing at Cards" a published study by the National Consumer Council (1985).

[215] This percentage was 12.3% of all complaints made to the Ombudsman. See The Banking Ombudsman 1990 Annual Report. For a commentary on the role of the Banking Ombudsman, see Hodgin R.W., Ombudsman and Other Complaints Procedures in the Financial Sector in the United Kingdom, [1992] Anglo-American Law Review 1, 7-12. ATM also topped the complaints list of the Building Societies Ombudsman, Ibid, at 13.

[216] Baker & Brandel (1988), supra, at para. 6.03[1].

[217] Baker & Brandel (1988), supra, at para. 6.03[1].

Reducing the now four characters may make it easy for discovering PINs by trial and error. Increasing the characters, however, will reduce such risk, but it may make it harder to remember.

The risk of intercepting the card and the PIN in mail is reduced by preventing banks from providing customers with unsolicited cards.[218] This risk can also be reduced by sending the card and the PIN, where solicited, in separate unmarked envelopes. However, retaining either the card or the PIN to be collected in person by the customer, although possibly inconvenient, is very much safer, taking into account that most banks' customers live in their bank's area.

More sophisticated fraudulent schemes are not impossible. Three fraudulent processes, at least, are known in ATM transactions in banking circles in the United States. These are what so-called "scam", "skimming" and "spoofing".

The "scam" process was described as follows:[219]

> "A customer enters the automated teller machine (ATM) area for the purpose of using a machine for the transaction of business with the bank. At the time that he enters, a person is using the customer service telephone located between the two automated teller machines and appears to be telling customer service that one of the machines is malfunctioning. This person is the perpetrator of the scam and his conversation with customer service is only simulated. He observes the customer press his personal identification code into one of the two machines. Having learned the code, the perpetrator then tells the customer that customer service had advised him to ask the customer to insert his [ATM card] into the allegedly malfunctioning machine to check whether it will work with a card other than the perpetrator's. When a good samaritan customer accedes to the request, the other machine is activated. The perpetrator then press a code into the machine, which the customer does not realize is his own code ... [permitting] a cash withdrawal from the unwary customer's account."

The security of an Off-Line system can be breached by a process called

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[218] See in the American law, 15 U.S.C. § 1693i (Issuance of cards or other means of access). In British law, see § 15.0 of the Code of Good Banking (1991)(Issue of cards).

[219] *Ognibene v. Citibank, N.A.*, 112 Misc.2d 219; 446 N.Y.S.2d 845, 846 (N.Y. Civ. Ct. 1981).

"skimming". Since an Off-Line authorisation requires the encoding of PINs on magnetic stripes on the plastic cards, experts can decipher and transfer the PIN recorded on the original card to a counterfeit card and then access funds using the counterfeit card.[220]

Bank's employees or computer programmers can gain access to ATM or EFTPOS systems directly by certain modifications to the hardware or software in a communications processor in order to alter electronic messages and authorisation sent to banks or the systems used.[221] This process is called "spoofing".

The risk of insider abuse increases in shared network systems. In 1989 a programmer in a data processing centre obtained data encryption codes that enabled him to obtain access to accounts of cardholders at each of the banks participating in the network in which his employer processed debit transactions.[222]

5.5.3 Scope of Liability.

Losses resulting from unauthorised use of debit cards in EFTPOS or ATM transactions can be allocated on three possible grounds. First, losses can be allocated according to traditional negligence standards, in which one party's negligence can be used as a partial or complete defence to liability by another party. Second, a flat amount limitation can be imposed on a customer regardless of the extent of his negligence. This approach is based on the assumption that banks are in a far better position to reduce and absorb such losses than their individual customers. Both a customer and his bank have an incentive to safeguard against unauthorised use, since

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[220] Baker & Brandel (2nd ed. 1988), supra, at para. 6.03[1].

[221] Baker & Brandel (2nd ed. 1988), supra, at para. 6.03 [1]; and Nycum, Security for Electronic Funds Transfer Systems, [1976] 37 U. Pitt. L. Rev. 709, at 721.

[222] See Baker & Brandel (2nd ed. 1988), 1991 Supp. No.2, supra, at 6.03[1]. See for an ATM fraud prevention checklist, ibid, at para. 6.03[1][a].

in case of breach in security causing unauthorised loss, the customer loses the flat amount, and the bank loses the rest of the amount if the amount lost is greater than the flat limitation. Finally, there is a combination of the above two approaches. According to this approach, a flat limitation is imposed on the customer for losses not involving his negligence. If, however, the customer is contributorily negligent, e.g., writting his PIN on his debit card, the customer must be liable for any loss which could have been prevented by nonnegligent action. The question is what grounds of liability do the British and the American jurisdictions adopt? An attempt to answer this question is made under separate headings.

5.5.3 [a] Under U.K. Law.

Banks' liability for unauthorised EFTPOS and ATM transactions is governed by the provisions of the Code of Good Banking.[223] The Code imposes on card issuers, e.g., banks, certain specific duties before spelling out the extent of their liability for unauthorised transactions.

5.5.3 [a] [i] Issue of Cards and PINs.

§ 15.1 of the Code of Good Banking prohibits the sending of unsolicited cards. An EFTPOS and an ATM card will be sent to a customer only when such customer requested that specific card "in writing"; or to replace or renew a card that has already been issued.

Where a card is multifunction, a bank should inform its customer of such character. Thus, where a card can be used as an EFTPOS debit card, an ATM card and a cheque guarantee card, the bank issuing that card should inform its customer

[223] See Part B of the Code of Good Banking (1991).

that the card has these functions.[224] If a customer requests his bank not to activate a function in such multifunction cards the bank should comply with such request.[225]

5.5.3 [a] [ii] Security of Cards and PINs.

Banks should issue PINs separately from cards.[226] Banking practice shows that this is implemented by sending the card and the PIN in a separate unmarked envelopes. Sending both in one envelope, coupled with a request to the customer to sign an enclosed acknowledgement to activate the card is probably a violation of this requirement. Such letter could be intercepted, and the signature could be forged. It is not clear whether courts will construe the requirement that a card issuer "will advise PIN only to the customer"[227] as to mean that if the customer does not receive his PIN, he is not liable for unauthorised transactions made.[228]

Banks are under a duty to "tell customers of their responsibility to take care of their cards and PINs in order to prevent fraud."[229] Usually, a statement advising customer to memorise his PIN and destroy the notice that informs him of his PIN at once is printed on such notice. The Code of Good Banking has spelled out four particular events that should be communicated to customer upon issuing them a card and a PIN. These are:[230]

(a) A customer "should not allow anyone else to use his card and PIN;"

(b) A customer "should take all reasonable steps to keep the card safe and the PIN

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[224] For example, Royal Bank of Scotland issues a card called "Highline" card. This is a three function card, i.e. cheque guarantee, cashline, and SWITCH card.

[225] § 15.2 of the Code of Good Banking (1991).

[226] § 16.1 of the Code of Good Banking (1991).

[227] § 16.1 of the Code of Good Banking (1991).

[228] § 18.1(a) of the Code of Good Banking provides that a bank is liable for "the full losses incurred in the event of misuse when the card has not been received by the customer".

[229] § 16.2 of the Code of Good Banking (1991).

[230] § 16.2 of the Code of Good Banking (1991).

secret at all times;"

(c) A customer "should never write the PIN on the card or on anything usually kept with it;" and

(d) A customer "should never write the PIN down without making a reasonable attempt to disguise it."[231]

5.5.3 [a] [iii] Notification of Lost or Stolen Cards and Unauthorised Transactions.

A customer "must" notify his bank "as soon as reasonably practicable" after he finds that: (a) his card has been lost or stolen; (b) someone else knows his PIN; and (c) his account included an item which seems to be wrong.[232] Banks should inform customers that they owe them such duty.[233] Customers should be informed, and reminded at regular intervals, e.g., on their statements of accounts, of the place and the telephone number where they can notify banks of lost or stolen cards and unauthorised items.[234] Customers expect this service to be maintained twenty four hours a day and during all week days. Notification to card notification agency is notification to the bank if the bank accepted such course of action at the time of opening the account or at any time later prior to the notification event.[235]

5.5.3 [a] [iv] The Extent of Customers' Liability.

The approach adopted by the Code of Good Banking is mixed between a flat amount limitation and contributory negligence. As a general rule, customer's liability

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[231] For a comment on these requirements, see Duxbury J., The Draft Code of Banking Practice: Implications for Electronic Banking [1991] 3 J.I.B.L. 116 ("It is difficult to see how customers can in fact comply with the last requirement (unless they record their PIN in code or do not keep a record of it at all) since any written record of four digits is potentially recognisable as a PIN and in breach of this requirement."). One suggests the implication is to memorise the PIN. Indeed, the note that contains PIN usually requires customers to memorise their PINs and destroy the note.

[232] § 17.1 of the Code of Good Banking (1991).

[233] Ibid.

[234] § 17.2 of the Code of Good Banking (1991). Moreover, banks should arrange for that telephone number to be included in British Telecom Phone Books. Ibid.

[235] § 17.4 of the Code of Good Banking (1991).

is limited to £50 or the actual amount lost, whichever is lesser, if the unauthorised transaction was made before the bank has been notified that the customer's card has been lost or stolen or that someone else knows his PIN.[236] After the customer notifies his bank that his "card has been lost or stolen or that someone knows or may know [his] PIN", the bank will be liable for "the full losses incurred" as a result of "all transactions not authorised by the customer".[237] Banks are in a good position to mitigate such losses by preventing the use of such card and/or PIN. It is in fact a bank's duty to "take action to prevent further use of the card" on being advised of a loss, theft or possible misuse of such card or that the PIN has become known to someone else.[238]

5.5.3 [a] [v] Two Exceptions: Customer's Fraud and Gross Negligence.

Banks' liability for unauthorised transactions is affected by the customer's acts and omissions as to the unauthorised transactions before and after such transactions occurred. "Customers will be held liable for all losses if they have acted fraudulently".[239] This is an understandable exception. It is unrealistic to hold banks liable for losses incurred by unauthorised EFTPOS or ATMs transaction if such transactions were caused by the customer's fraudulent act. Whether a customer has "acted fraudulently" in a given situation should be judged according to the general principles of law.

The second exception is that customers "may be held liable for all losses if they have acted with gross negligence".[240] The use of "may be held liable" in the

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[236] § 18.3 of the Code of Good Banking (1991).

[237] § 18.1(b) of the Code of Good Banking (1991).

[238] § 17.5 of the Code of Good Banking (1991).

[239] § 18.4 of the Code of Good Banking (1991).

[240] Ibid.

case of customer's gross negligence and "will be liable" in the case of customer's fraudulent act suggests that it is in the court's discretion to hold the customer liable for "all losses" in the former case, while it is bound to do so in the latter case. It is almost certain that courts will consider the customer's failure to observe his duties under the Code, in particular those security precautions relating to handling his card and PIN,[241] as constituting gross negligence. Writing PIN on the card or on anything kept with it without disguising it would amount to gross negligence.[242] It seems that writing PIN in a disguised form, e.g. possibly as a telephone number in an address book, does not constitute a gross negligence.[243] The justification of the exception of customer's gross negligence is debatable.

The Code of Good Banking does not provide for a maximum period of notification after which customer's liability will increase if he fails to notify his bank of the stolen or lost card, or that someone knows or may know his PIN. Instead, it provides that a customer "must tell [his bank] ... as soon as reasonably practicable after" he finds that his card has been lost or stolen; someone else knows his PIN; or his account includes an item which seems to be wrong.[244] The term "as soon as reasonably practicable" will definitely cause some debate in courts before they settle on a certain definition.

Banks' liability for unauthorised EFTPOS and ATMs transaction is limited to to "those amounts wrongly charged to customers' accounts and any interest on those amounts."[245] This clearly rules out the recovery of any consequential damages.

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[241] § 16.2 of the Code of Good Banking (1991).

[242] See § 16.2(c) of the Code of Good Banking (1991).

[243] See § 16.2(d) of the Code of Good Banking (1991).

[244] § 17.1 of the Code of Good Banking (1991).

[245] § 18.2 of the Code of Good Banking (1991).

5.5.3 [a] [vi] The Burden of Proof.

§ 18.5 of the Code of Good Banking provides that:

> "In cases of disputed transactions the burden of proving fraud or gross negligence or that a card has been received by a customer will lie with the card issuer. In such cases card issuers will expect customers to co-operate with them in their investigation."

5.5.3 [b] Under U.S.A. Law.

Since EFTPOS and ATM transactions are consumer-based ones, they are governed by the Federal EFTA so long as they satisfy its requirements. One important qualification is that EFTA is preempted by those state laws that afford consumers greater protection than EFTA does.[246]

In allocating liability for unauthorised EFT transactions, EFTA does not distinguish between credit transfer and debit transfer. There are, however, practical differences between the two categories of EFT. The discussion of banks' liability for unauthorised EFTPOS and ATM transfers will be divided into three sections. First, what constitutes unauthorised EFTPOS and ATM transactions. Second, how does EFTA allocate the risk of loss resulting from such unauthorised transactions. Third, who is under the burden to prove the unauthorised transaction.

5.5.3 [b] [i] Unauthorised EFTPOS and ATM Transactions.

EFTPOS and ATM debt transactions are normally made by the use of a "debit instrument". A "debit instrument" is an access device which is defined as a "card, code, or other device, other than a check, draft, or similar paper instrument, by the use of which a person may initiate an electronic fund transfer."[247]

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[246] 15 U.S.C. § 1693q. Whether a state law affords more protection to consumers is detremined by the Board of Governers of the Federal Reserve Bank. This power can be used by the Board's own motion, or by a request of any bank, State, or other interested party.

[247] 15 U.S.C. § 1693n. For the definition of "accepted card or other means of access", see 15 U.S.C. § 1693a(1).

An "unauthorized electronic fund transfer", which includes unauthorised EFTPOS and ATM debt, is defined to mean "an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate such transfer and from which the consumer receives no benifit". Thus, if the transfer is not "unauthorized electronic fund transfer", the liability rules under EFTA do not apply. The rights and responsibilities of the parties will be governed by the terms of the banker-customer account agreement and other applicable laws.[248]

Before discussing whether a given EFTPOS or ATM transaction is authorised or not, the transaction should qualify as an "electronic fund transfer". Although § 1693a(6) of EFTA explicitly provides that EFTPOS and ATM transactions are included in the definition of "electronic fund transfer", doubts have been raised concerning EFTPOS transactions that are initiated by the use of debit cards and sales slips. There is no disagreement, however, in concluding that all ATM transactions are "electronic fund transfer". Some EFTPOS systems require the signature of consumers on a duplicate receipt in addition to the debit card, rather than the use of PINs. Until October 1984, such transactions were considered outside the definition of "electronic fund transfer" since they were not "initiated through an electronic terminal". To overcome this problem, the Board of the Governers of the Federal Reserve Bank amended the definition of "electronic fund transfer" to include "all transfers resulting from debit card transactions, including those that do not involve an electronic terminal

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[248] Baker & Brandel (1988), at para. 13.02[3][a]. Parties to an EFTPOS or ATM agreement can agree on a greater liability on the part of the bank. State law may impose greater liability on banks in EFT. See, e.g., *Gaffney v. Community Federal Saving & Loan Ass'n*, 706 S.W. 2d (Mo. Ct. App. 1986) (a consumer was not liable for unauthorised withdrawals from an account under a state law governing deposit account relationship).

at the time of the transaction."[249] Another argument made against considering such transactions as an "electronic fund transfer" was that such transactions are originated by "paper instrument".[250] Again, the Board of Governers of the Federal Reserve Bank viewed such transactions as electronically initiated since in most cases the sales slips were truncated and the data converted into an electronic form and transmitted to the purchaser's bank. Moreover, the Board noted that such a transaction was initiated with debit card, or with a debit card and a sales slip and not a sales slip alone; and that a sales slip was not a "similar paper instrument" for the purposes of the EFTA and Regulation E.[251] This interpretation would put consumers who use electronic-initiated EFTPOS systems (a debit card and PIN) and those who use sales slip and debit cards on equal terms as far as consumer protection from unauthorised transactions is concerned.[252] This amendment resulted in an increase in the time period permitted for error resolution.[253]

5.5.3 [b] [ii] The Extent of Customers' Liability.

The EFTA's approach to allocation of liability depends on a flat dollar amount vairies according to passage of time after the customer's learns that his access device has been lost or stolen. This scheme of allocating the loss is not restricted to EFTPOS and ATM transactions. It includes electronic credit transfer in consumer-based transactions that are subject to the scope of EFTA. That is because in discussing allocation of loss resulting from unauthorised transactions, EFTA provides for

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[249] 49 Fed. Reg. 40,798 (1984); Regulation E, 12 C.F.R. § 205.2(g) (1986).

[250] According to the definition of "electronic fund transfer", a transafer of funds which is "... originated by check, draft, or *similar paper instrument* ..." is not "electronic fund transfer". See 15 U.S.C. § 1693a(6).

[251] 49 Fed. Reg. 40,795 (1984). See also Baker & Brandel (1988), supra, at para. 12.05[1].

[252] However, the transactions that made by the use of sales slip and debit card are not subject to the receipt requirements of Regulation E. See Regulation E, 12 C.F.R. §§ 205.2(h), 205.9(a); Regulation E, 12 C.F.R. § 205 Supp. II, Ques. 2-24 (1986).

[253] See Baker & Brandel (1988), supra, at para. 12.05[1] (double the time period previously permitted for error resolution); Brandel & Barr "Electronic Fund Transfers" [1985] 40 Business Lawyer 1051, at 1067-1073.

"unauthorized electronic fund transfer" generally. Thus, the following discussion on allocation of loss resulting from unauthorised EFTPOS and ATM is applicable to electronic credit transfer transactions within the scope of EFTA, so long as the nature of the transaction permits.

1. Tiers of Liability.

EFTA offers the parties in EFTPOS and ATM transactions incentives to prevent unauthorised transactions. Following the Truth-in-Lending Act, EFTA's approach to allocation of loss resulting from unauthorised transactions consists of three tiers of potential liability.

First, if the consumer notifies the bank of the loss or theft of the access device within two business days of learning of such event, the consumer will be liable for $50 or the amount of the transaction, whichever is less.[254]

Second, if the consumer fails to notify the bank of the loss or theft of the access device within two business days of learning of such event, he will be liable for the lesser of $500 or the sum of (i) the amount of unauthorised transfers that occur before the close of the two business days up to $50, in addition to (ii) the amount of unauthorised transfers that occurred after the two business days and before the consumer notified the bank, provided that the bank can establish that such loss would not have occurred had the consumer notified the bank.[255]

Third, if the consumer fails to notify the bank of the loss or theft of the access device within sixty business days of the transmittal of any periodic statement that shows the unauthorised transactions, the consumer may face unlimited liability. He is

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[254] Regulation E, 12 C.F.R. § 205.6(b) (1986); and 15 U.S.C. § 1693g.

[255] Regulation E, 12 C.F.R. § 205.6(b)(1) (1986).

liable for the amount of the unauthorised transactions that occurred during the sixty day period up to $500, in addition to the amount of any unauthorised transactions that occurred after the sixty day period and before the consumer notifies the bank, provided that the bank proves that the latter amount would not have occurred had the consumer notified the bank within the sixty day limit.[256] This unlimited liability creates an incentive for consumers to verify their monthly statements.[257]

The limitation of liability is determined by reference to any single unauthorised transfer or series of related transfers that occur following the loss, theft, or unauthorised use.[258] Interpreting such limitation as applicable to each single transaction could cause a drastic results. Take for example, a thief who withdrew 20 withdrawals of $50 each using a stolen ATM card. If the second interpretation is adopted, the customer may lose the entire amount of $1,000 if such amount was withdrawn before the notification of the card's loss was notified to the bank, even if such withdrawal occurred within two business days after the loss of the card. On the contrary, under the Federal Reserve interpretation, the consumer will be liable for $50 only if he notified the bank within the required two business days.

2. The Effect of Consumer's Negligence.

Questions may arise as to the effect of consumer's negligence on liability for unauthorised transactions. What about issues like consumer's contributory negligence, or mitigation of bank's loss caused, in full, or in part, by the consumer's negligence?

A negligence standard has not been adopted by EFTA as a ground for liability.

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[256] Regulation E, 12 C.F.R. § 205.6(b)(2) (1988).

[257] See Clark B., Bank Deposits, Collections and Credit Cards (Revised ed. 1981), at para. 10.8[2].

[258] Regulation E, 12 C.F.R. § 205.6(b) (1986). The Federal Reserve has interpreted EFTA to apply to a series of related transactions, as the case in Truth-in-Lending Act, 15 U.S.C. § 133(a); and 44 Fed. Reg. 18,473 (1979).

In addition, since EFTA preempts any state law imposing greater liability on consumers it is certain that any state law adopting a negligence standard to increase consumers' liability for unauthorised transactions would be preempted.[259]

The Federal Reserve Board has concluded that consumer's negligence is irrelevant in determining the consumer's liability for unauthorised transfers. Consumer's negligence cannot, unlike the case under the British Code of Good Banking, be taken into account in imposing greater liability on the consumer than permisssible under EFTA. In particular, a bank cannot take into account whether a consumer has been negligent in writing his PIN on an ATM card or on a piece of paper in determining the consumer's liability for unauthorised use.[260] This ruling was followed in *Russell v. First America Bank-Michigan, N.A.*[261] There, a consumer gave her ATM card to her daughter and wrote her PIN on the ATM card or a piece of paper so that the daughter would remember the number. The daughter subsequently lost the ATM card and PIN number. An unauthorised transaction occurred. The court held that any negligence by the cardholder in giving her ATM card and her PIN to her daughter, or by the daughter in losing the card and the PIN number was irrelevant in deciding the cardholder's liability for the unauthorised withdrawal. Moreover, the court indicated that although the cardholder did breach her agreement with bank by placing her PIN on or near her ATM card, such breach had no effect on the cardholder's liability for unauthorised use of the card.

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[259] 15 U.S.C. § 1693q. Indeed, this is what the Federal Reserve Board has decided concerning the State of Michigan. Michigan enacted a statute that would not allow the bank to impose any liability on the consumer unless his or her negligence substantially contributed to loss resulting from unauthorised transaction. Mich. Comp. Laws Ann. § 488.14 (West 1986). See also Montana Code Ann. § 32-6-303 (1987) (uses consumer's negligence standard in determining liability for unauthorised transactions). For state laws see Baker & Brandel (1988), supra, at para. 13.02[6]; and Zimmer & Einhorn, The law of Electronic Funds Transfer (1991), Vol. II

[260] Regulation E, 12 C.F.R. § 205, Supp. II, Oues. 6-6.5 (1991); Regulation E, 12 C.F.R. § 205.6(b) (1991).

[261] Fed. Banking L. Rep. (C.C.H.) para. 87,524 (W.D. Mich. 1988).

3. Notice of Unauthorised Use.

It is clear that the crucial factor in moving liability from one tier to another is the time of giving a notice that an access device is lost or stolen, or that there exist other circumstances that indicate the occurance of an unauthorised transaction. Such notice is deemed to have been given to the bank when the consumer takes whatever steps are reasonably necessary in the ordinary course of business to provide the bank with the pertinent information regardless whether such notice is received by any particular officer, employee, or agent of the bank.[262] The mail-box rule applies to written notice.[263] Banks would be unfairly affected by the adoption of the mail-box in some cases. On the other side, the "receipt rule" would unfairly work against consumers where a delay in the mail occurs. Banks are in a better position to spread losses, so the risk of loss is put on banks in this case. A bank is deemed to have received notice if the bank becomes aware of circumstances that lead to the reasonable belief that an authorised transaction involving the consumer's account has been or may be made.[264] If the consumer gave notice to the bank on an address or telephone number other than the one specified by the bank for such notification, the notice is valid for the purpose of limiting the consumer's liability.[265] The Official Staff Commentary suggests that it is not necessary to provide the bank with the account number or the EFTPOS or ATM card number. Providing adequate information that sufficiently identifies the account in question is valid notification.[266]

These time limits of notification can be extended for a "reasonable" period if

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[262] 15 U.S.C. § 1693g(a)(2); Regulation E, 12 C.F.R. § 205.6(c) (1986).

[263] Regulation E, 12 C.F.R. § 205.6(c) (1986). Originally the Federal Reserve promulgated a "receipt rule". See Baker & Brandel (1988), supra, para. 13.02[4][c].

[264] Regulation E, 12 C.F.R. § 205.6(c) (1986).

[265] Regulation E, 12 C.F.R. § 205 supp. II, Ques.6-7 (1986).

[266] Regulation E, 12 C.F.R. § 205 Supp.II, Ques.6-8(1986); Regulation E, 12 C.F.R. § 205.6(c) (1986).

the consumer's failure to notify his bank was caused by "extenuating circumstances" such as external travel or hospitalisation.[267] The interpretation of this "reasonable" extention depends on the particular circumstances of the customer concerned.

5.5.3 [b] [iii] The Burden of Proof.

Since the approch is to impose limited liability on the consumer and the rest of the risk of loss resulting from unauthorised transactions on the bank, EFTA imposes the burden of proof on banks. Thus, in any case involving a consumer's liability for unauthorised EFTPOS or ATM transaction, the bank must prove that the transaction was authorised, or, if unauthorised, prove that the conditions for imposing liability on the consumer were met.[268]

A bank must prove that the transaction in question is authorised by the customer to hold him liable for all the loss. Alternatively, if the bank failed to prove that the transaction was authorised, it must satisfy the conditions of imposition of the limited liability on the consumer.[269] Courts have held that where the bank failed to prove that the transaction was authorised, or the customer proves that the transaction was unauthorised, banks will bear the whole risk of loss resulting from such transactions.[270] In *Judd v. Citibank*,[271] a consumer alleged that $800 had been

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[267] 15 U.C.C. § 1693g(a).

[268] There are, in fact, three prerequisites that a bank should prove to impose liability on the consumer. Those are: (i) the access device used for the unauthorised transaction must be an "accepted card or other means of access" as defined in 15 U.S.C. § 1693a(1); (ii) the bank must provide a means to identify the consumer to whom the access device was issued; and (iii) the bank must disclose in writing to the consumer (a) a summary of the consumer's laibility for unauthorised transactions; (b) the telephone number and address of the person or office to be notified in the event the consumer believes that an unauthorised transaction has been or may be made; and (c) the bank's "business day" as determined under Regulation E. See Baker & Brandel (1988), supra, at para. 13.02[3][b].

[269] See *United States v. Goldblatt*, 813 F.2d 619 (3ed Cir. 1986) (consumer whose wallet containes two ATM cards and the correspondent P.I.Ns, was stolen by his son. The son used the cards and the numbers to withdraw $1,515 from his father's account. The consumer notified his bank within two business days of his knowledge of the theft. His bank, eventually, recredited his account by the amount withdrawn without authorisation less $100. The $100 is charged against his account pursuant to 15 U.S.C. § 1693g(a). That was the first tier limit of $50 per card. However, if the plaintiff's son has used one card, the bank would be entitled to charge him with $50 only.

[270] It must be noted that the consumer is under no obligation to prove that the transaction was unauthorised to escape liability.

[271] 107 Misc.2d 526, 435 N.Y.S.2d 210 (N.Y. Civ. Ct. 1980).

withdrawn from her account through an ATM without her authorisation. She sued the bank for this sum of money. She testified that she was at work on the dates and at the times funds were allegedly withdrawn from her account; and she had not let any one use her card, nor told anyone of her PIN. The bank opposed the plaintiff's argument by asserting "that the funds in question were and could only have been withdrawn from the [plaintiff's] account by use of a validated Citicard at a Citibank electronic teller, coupled with entry of the correct [P.I.N.]. Citibank has submitted a statement in support of its contention that it has effected stringent security measures to prevent the unauthorized use of Citicards."[272] The court held that:[273]

> "The question presented is a basic one, of evidence, burdens and credibility: Has plaintiff proven her case by a fair preponderance of the credible evidence? In this case we are met with a credible witness on the one hand and a computer printout on the other. It is evident that there was no opportunity to cross examine the computer or the printout it produced. ... The question then becomes, who (or what) to believe, the person or the machine? ... [T]his court is not prepared to go so far as to rule out that where a credible witness is faced with the adverse "testimony" of a machine, he is as a matter of law faced also with an unmeetable burden of proof. It is too commonplace in our society that when faced with the choice of man or machine we readily accept the "word" of the machine everytime. This, despite the tales of computer malfunctions that we hear daily. Defendant's own witness testified to physical malfunctions of the very system in issue. This court, as trier of fact, finds that plaintiff has proven her case by a fair preponderance of the credible evidence. Accordingly, judgment is awarded to the plaintiff in the amount of $800,00 plus interest and disbursements."

The court in *Porter v. Citibank*,[274] which faced another claim of unauthorised ATM withdrawals, addressed the argument that accepting the consumer's testimony over the computer's printouts may open the door for fraudulent transfers. In that case, the plaintiff alleged that although it conducted all the necessary steps to withdraw

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[272] *Judd v. Citibank*, 107 Misc.2d 526, 527; 435 N.Y.S.2d 210, 211.

[273] Ibid, at 527-529, 211-212 respectively.

[274] 123 Misc.2d 28, 472 N.Y.S.2d 582 (N.Y. Civ. Ct. 1984).

money from an ATM, no money was received, and yet his account was charged. Thus, the court was faced with another type of dispute between man and machine. It is clear that the plaintiff had no means of proving his case. The plaintiff, "a credible witness who had no record of banking problems although he had used the [ATMs] numerous times", testified that the ATM in question did not dispense the instructed funds to him.[275] The witnesses employed in the branch of the bank where the ATM involved was located testified that in examining it on the day after the first of the two withdrawals occurred, they found the account in balance, while on the latter date there was a cash overage of $90. They testified that, on the average, the cash machine were out of balance once or twice per week, but never for a sum in excess of $100. After the court analogised the position of the plaintiff with that of the night depository customer, it noted that while a minority of courts have declined to grant recovery against a bank solely on the testimony of a customer, the preferable majority of courts would allow recovery on the basis of such evidence if they are convinced that the unauthorised transaction was made.[276] The court held that:

> "plaintiff established by a fair preponderance of evidence that he did not receive the money for which he was charged as a result of the above mentioned transaction. Therefore he is entitled to judgment for $500 [the unauthorised amount of withdrawal], plus interest ... In so deciding the court is not unmindful of the possibility of fraudulent suits. However, this fear exists in many areas of the law and the history of jurisprudence has not indicated that Courts have been unable to competently (although certainly not perfectly) deal with such challenges."[277]

This does not mean that computer's printouts are not admissible as evidence in dispute between a bank and its customer in EFTPOS and ATM transactions. This

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[275] *Porter v. Citibank*, 123 Misc.2d 28,30; 472 N.Y.S.2d 582, 583 (N.Y. Civ. Ct. 1984).

[276] Ibid, at 29-30, 583 respectively.

[277] Ibid, at 30, 583 respectively.

issue was the subject of litigation in *In re Denslow*.[278] The issue was whether documents reflecting computer-stored data were admissible in evidence. Denslow denied making the alleged ATM cash withdrawals. The bank offered in evidence copies of Denslow's computer-prepared VISA and Mastercard statements which reflect a series of ATM withdrawals. Two witnesses testified in support of such documents as "business records".[279] The court held that documents reflecting computer-stored data that recorded ATM transactions were admissible in evidence. A proponent of document offered into evidence under "business records" exception to hearsay rule need not introduce testimony of qualified person, usually custodian, that document was made by person with knowledge at or near time of incident recorded and that it is business' regular practice to maintain and rely upon such records in course of its business.[280]

One assumes that courts would treat the onus of proof under unauthorised EFTPOS transactions in the same way as they did in unauthorised ATM transactions, since the law is the same in both.

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[278] 104 B.R. 761; 28 Fed. R. Evid. Serv. 1501 (D. Virg. 1989).

[279] "Business records" are accepted in evidence as an exception to the hearsay rule. See Fed. Rules Evid. Rule 806(6), 28 U.S.C.A.

[280] See Budnitz, Problems of proof when there's a Computer Goof: Consumers Versus ATMs [1980] 2 Computer L. J. 49 (arguing for imposing the burden of proof in such transactions on banks); and Nickles S.H., Matheson J.H. & Dolan J.F., Materials for Understanding Credit and Payment Systems, 1987, at 872-880 (discussing issues of evidence and others in two ATM's cases: *Gaffney v. Community Federal Savings & Loan Association* 706 S.W.2d 530 (Mo. App. 1986) and *McEvans v. CitiBank, N.A.*, 96 Misc.2d 142, 408 N.Y.S.2d (Civ. Ct. 1978).)

CHAPTER SIX

DAMAGES

6.1 General.

McGregor on Damages defines damages, generally, as "the pecuniary compensation, obtainable by success in an action, for a wrong which is either a tort or a breach of contract, the compensation being in the form of a lump sum which is awarded unconditionally and is generally, but now not necessarily, expressed in English currency".[1]

There is no statute or case law regulating the award of damages in EFT transactions in the United Kingdom.[2] Moreover, since an EFT payment order does not constitute a bill of exchange, the measure of damages under § 57 of the Bills of Exchange Act 1882 is inapplicable to EFT payment orders.[3] On the contrary, damages recoverable from banks in EFT transactions are statutorily regulated in the United States.[4] The absence of statutory regulation of recoverable damages for banks' failure

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[1] McGregor on Damages, (15th ed.), para. 1. Lord Halisham has adopted this definition from the 12th ed. of McGregor on Damages in *Broome v. Cassell & Co.* [1972] A.C. 1027, 1070. A similar definition has been adopted by 12 Halsbury's Laws of England, 4th ed., par.1102 (damages "are the pecuniary recompense given by process of law to a person for the actionable wrong that another has done him". See Pearson J. in *Jabbour v. Custodian of Israeli Absentee Property* [1954] 1 All. E.R. 145, 150; [1954] 1 W.L.R. 139,143. As such defined, damages are distinguishable from other kinds of money payments. This definition excludes, at least, four types of gaining money by success in an action: (i) payment of money under contractual terms other than breach of contract; (ii) actions in quasi-contract; (iii) actions in equity; and (iv) actions under statutes where the equitable or statutory right to recover is independent of any tort or breach of contract. McGregor on Damages, supra, para. 2; and 12 Halsbury's Laws of England, 4th ed., para. 1103. For specialist works on damages generally see, in Scotland, e.g., Prof. Walker, The Law of Civil Remedies in Scotland (1974); and by the same author, the Law of Damages in Scotland (1955). In England see, e.g., McGregor on Damages, (15th ed.); Ogus, Law of Damages (1973); Burrows, Remedies for Torts and Breach of Contract (1987).

[2] The Code of Good Banking fails to address this issue. It does, however, contain provisions for banks' liability for losses resulting from unauthorised EFTPOS and ATM transactions, and malfunctions. See § 18.0 of the Code of Good Banking (1991).

[3] Damages may be awarded under § 57 of the Bills of Exchange Act 1882 for the dishonour of a bill. Such damages include (1) the amount of the bill; (2) interest from the time of presentment for payment if the bill is payable on demand, or from its maturity in any other case; however, interest as damages may be withhold wholly or in part if justice requires that; and (3) the expenses of noting, or the expenses of protest when protest is necessary, and has been extended. For more details and cases on the issue in English law, see Halsbury's Law of England, 4th ed., para. 502-503.

[4] See in consumer-based EFT transactions, 15 U.S.C. §§ 1693f(f), 1693h and 1693m; and in wholesale credit transfer, U.C.C. §§ 4A-305 and 4A-404.

to perform their duties under EFT transactions in the British law requires a search for a solution in the general principles of law. A banks' failure to effect an EFT transaction could be a breach of contractual or delictual duty. This distinction affects the recoverability of damages. The measures of damages for breach of contractual and delictual duties and their applicability in EFT transactions are briefly discussed before one discusses the recoverability and measures of damages in EFT transactions.

6.2 The Measure of Damages for Breach of Contractual Duty and its Applicability to EFT Transactions.

The relationship between banks and their customers is contractual, breach of which triggers, in absence of contractual or statutory regulation to the contrary, the application of the measure of damages in contracts generally. The underlying theme of the measure of damages in contract is that:[5]

> "where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation with regard to damages as if the contract had been performed".

This rule is restricted by the test of remoteness initially formulated by the leading English case of *Hadley v. Baxendale*.[6] Alderson B., in that case, stated the

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[5] Parke B., in *Robinson v. Harman* [1843-60] Eng. Rep. 383 at 385; (1848) 1 Exch. 850, at 855, cited with approval by the House of Lords in *Kaufos v. C. Czarnikow, Ltd, (The Heron II)*, [1967] 3 All E.R. 686, per Lord Pearce, at 710, and per Lord Upjohn, at 714. It is suggested that it is better to state the rule as such rather than a reference to the general principle "*restitutio in integrum*" since "any reference to 'restitutio in integrum' may wrongly suggest that he is to be put in the same position as if there had been no contract". McGregor on Damages, para 10. The applicability of the "*restitutio in integrum*" principle to the measure of damages in contract has originally been stated by Lord Blackburn in *Livingstone v. Rawyards Coal Co.* (1880) 5 App. Cas. 25, 39. Lord Blackburn's view has been referred to or cited with approval by Viscount Sankey L.C., in *Banco de Portugal v. Waterlow* [1932] A.C. 452, 474; Lord Wright in *Monarch S.S. Co. v. Karlashamns Oljefabriker* [1949] A.C. 196, 221; Earl Jowitt in *British Transport Commission v. Gourley* [1956] A.C. 185, 197; and Lord Wilberforce in *General Tire and Rubber Co. v. Firestone Tyre and Rubber Co.* [1975] 1 W.L.R. 819, 824 (H.L.). Two other cases, at least, adopted the same view, but in different phraseology: *Victoria Laundry v. Newman* [1949] 2 K.B. 528, 539 (C.A.) per Asquith L.J. and *The Albazero* [1977] A.C. 774, 841, per Lord Diplock. On the other hand, there are some cases which support the view that this principle encompasses only delict: *Robinson v. Harman* (1848) 1 Ex. 850, 855 per Parke B.; *Lock v. Furze* (1866) L.R. 1 C.P. 441, 450-451 per Blackburn J.; *Wertheim v. Chicoutimi Pulp Co.* [1911] A.C. 301, 307 (P.C.), per Lord Atkinson; *British Westinghouse Co. v. Underground Ry.* [1912] A.C. 673, 689 per Viscount Haldane L.C.; *Hill v. Showell* [1918] 87 K.B. 1106, 1108, 1114 per Viscount Haldane and Lord Parmoor respectively; *Monarch S.S. Co. v. Karlshamns Oljefabriker* [1949] A.C. 196, 220 per Lord Wright; and *The Albazero* [1977] A.C. 774, 841 per Lord Diplock. Those cases are cited, with approval, by McGregor on Damages, supra, para. 10.

[6] (1854) 9 Exch. 341; Eng. Rep. 461.

test as follows:[7]

> "Where two parties have made a contract which one of them has broken the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."

The American Courts, at pre-EFT legislation stage, have faced what the British Courts are expected to face now if an action for recovery of damages resulting from a bank's failure to perform a payment order properly is raised. Having found no statutory regulation to govern an action for damages under an electronic credit transfer transaction, the Court of Appeal of the Seventh Circuit in *Evra Corp. v. Swiss Bank Corp.*,[8] has relied on *Hadley v. Baxendale* to deny the plaintiff the recovery of consequential damages since the losses claimed were too remote a consequence of an intermediary bank's failure to effect a payment order on time.[9] It was held that the payment order did not, on its face, give the defendant notice of potential consequential

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[7] At 354, 465 respectively. McBryde, The Law of Contract in Scotland, 1987, para. 20-02 noted that the famous passage of Alderson B. in *Hadley v. Baxendale* on the remoteness of damages "is frequently cited without, perhaps, the realisation that it expresses the law which had been evolved in Scotland several decades earlier". This has been recognised by *Duke of Portland v. Wood's Trs.*, 1926 S.C. 640, 649, 650 per Lord President Clyde; on Appeal, 1927 S.C. (H.L.) 1. This principle has been consistently followed by British courts. It has been restated and explained by the Court of Appeal in *Vicoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.*, [1949] 2 K.B. 528 (C.A.) (This case has not only restated the measure of damages for breach of contract as laid down by *Hadley v. Baxendale*, but also clarified some issues and phraseology. For example, it was held that what was reasonably foreseeable at the time of entering into a contract depends on "the knowledge then possessed by the parties or, at all events, by the party who later commits the breach." Such knowledge could be "imputed" or "actual". See in particular, per Asquith L.J., at 539-540. Hereinafter referred to as *Victoria Laundry*). See also the House of Lords illuminating judgment in *Kaufos v. C. Czarnikow, Ltd., (The Heron II)* [1967] 3 All E.R. 686 (H.L.).

[8] 673 F.2d 951 (7th Cir. 1982) cer. den'd, 459 U.S. 1017 (1982).

[9] The American Courts have adopted *Hadley v. Baxendale*, especially the rule that unforeseeable damages are not recoverable unless the defendant was given notice of special circumstances. See, e.g. generally, *Contempo Metal Furniture Co., of California v. East Tex. Motor Fright Lines, Inc.*, 661 F.2d 761, 765 (9th Cir. 1981); *Spang Indus. v. Aetna Cas. & Sur. Co.*, 512 F.2d 365 (2nd Cir. 1975); and *Ebasco ser., Inc., v. Pennsylvania Power & Light Co.*, 460 F.Supp. 163 (E.D. Pa. 1978). See for the applicability of the rule in EFT transactions in particular, *Central Coordinates, Inc., v. Morgan Guaranty Trust Co.*, 129 Misc. 2d 804, 494 N.Y.S.2d 602 (Sup. Ct. N.Y. 1985) and *Compania Anonima Venezolana De Navegacion v. American Express International Banking Corp.*, No. 84 Civ. 2047 (PKL), W.L. 1898 (1985) (where *Evra* case, and reliance on the second rule of *Hadley v. Baxendale* in EFT transactions were affirmed). The rule has been incorporated by the Restatement (Second) of Contracts § 351. It is noted that the concept of foreseeability of damages was applied strictly by the American Courts. See Dobbs, D., Handbook On The Law Of Remedies (1973), at 805. Nevertheless, *Hadley v. Baxendale* decision was greatly criticised: see Cooke, Remoteness of Damages and Judicial Discretion, [1978] 37 Cambridge L.J. 288; Danzig, *Hadley v. Baxendale*: A Study in the Industrialization of the Law, [1975] 4 Journal of Legal Studies 249; and Washington, Damages in Contract at Common Law [1932] 48 L.Q.Rev. 90.

damages, nor there were special circumstances to such effect. The court relied on the application of *Hadley v. Baxendale* in telegrams cases. It is argued that functional equivalency of telegrams and EFT messages justifies the applicability of identical rules.[10] Both telegrams and EFT messages are electric means of communication to convey a message in the first case and transfer money in the second case.[11]

The reliance of the American Courts on *Hadley v. Baxendale* to solve damages issues in the pre-EFT legislation period should support the proposition that, until British legislation is introduced to govern the recoverability of damages in EFT transactions, the same recourse should be allowed, in the absence of a contractual agreement, to this principle so long as the banks' failure constitutes a breach of contractual obligation.

6.3 The Measure of Damages for Breach of Delictual Duty and its Applicability to EFT Transactions.

The measure of damages formulated in *Hadley v. Baxendale* is only applicable when the bank's liability is based on breach of contractual obligation, whether express or implied. Where a claim for recovery of damages is based on a breach of delictual duty, a different measure of damages applies.[12] Damages recoverable, in such a case, must "put the [pursuer] who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is

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[10] See, e.g., *Kerr Steamship Co., v. Radio Corp. of America*, 245 N.Y. 284, 157 N.E. 140 (1927); and *Siegel v. Western Union Tel. Co.*, 312 Ill. App. 86, 37 N.E.2d 868 (1941).

[11] See Atlas, J.B., Bank Liability for Negligent Handling of an Electronic Fund Transfer: *Evra Corp. v. Swiss Bank Corp.*, [1984] Annual Review of Banking Law, 325, at 334.

[12] See *Koufos v. Czarnikow, Ltd, The Heron II*, [1967] 3 All E.R. 686 (where the House of Lords made it clear that the measure of damages in breach of conract cases is different from that in tort. See in particular per Lord Reid, at 692; Lord Hodson at 708; and Lord Upjohn at 716).

now getting his compensation or reparation".[13] Courts have applied the test of "reasonable foreseeability" of loss to decide whether, or not, a particular loss is recoverable. This test has been adopted by *The Wagon Mound (No. 1)*.[14] In that case, the Privy Council has rejected the test of "direct consequences" as laid down by the Court of Appeal in *Re Polemis*.[15] Following the doctrine of precedent, *The Wagon Mound (No. 1)*, being a decision of the Privy Council, is not binding on the British courts, but is of persuasive effect. The Court of Appeal, in *Doughty v. Turner Manufacturing Co. Ltd.*,[16] has considered itself free to decide whether, or not, to follow it. The House of Lords, in *Hughes v. Lord Advocate*,[17] considered *The Wagon Mound (No. 1)* as correctly stating the law, but distinguished it on its facts.

American Courts utilised the well-known concept of "reasonable foreseeability" to limit the recovery of special damages in tort actions to those which are a foreseeable consequence of the defendant's carelessness.[18] The foreseeability rule in delict or tort actions imposes a much wider liability than the contemplation rule in contract.[19] "[I]t is clear that what is 'foreseeable' in a tort case may not be 'foreseeable' in a contract case, and a defendant may find himself liable for a given item of damage on the ground that it is foreseeable where he is sued for tort, but not

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[13] The oft-quoted words of Lord Blackburn in *Livingstone v. Rawyards Coal Co.*, (1880) 5 App. Cas., 25, at 39. These words have been restated by Viscount Dunedin in *Admiralty Commissioners v. S.S. Valeria* [1922] 2 A.C. 242, at 248; Lord Wright in *Liesbosch Dredger (Owners) v. S.S. Edison (Owners)* [1933] A.C. 449, at 463; and Lord Scarman in *Lim Poh Choo v. Camden and Islington Area Health Authority* [1980] A.C. 174, at 187.

[14] *Overseas Tankship (U.K.) Ltd. v. Morts Dock and Engineering Co. Ltd.*, [1961] A.C. 388. Hereinafter cited as *The Wagon Mound (No. 1)*.

[15] *Re an Arbitration between Polemis and Another and Furness, Withy & Co. Ltd.* [1921] 3 K.B. 560. Hereinafter cited as *Re Polemis*.

[16] [1964] 1 Q.B. 518, per Harman L.J.,528, see also per Diplock L.J., 532.

[17] [1963] S.L.T. 150; (1963) S.C. (H.L.) 31.

[18] The leading American authority is *Palsgraf v. Long Island R. Co.* 248 N.Y. 339, 162 N.E. 99 (1928).

[19] Teal, L., *Evra Corp. v. Swiss Bank Corp.*: A Limitation on Recovery of Consequential Damages in an Electronic Fund Transfer, [1982] North Carolina Journal of International Law and Commerce, 103, at 112.

liable for the same item of damage where he is sued in contract."[20] That is because, a party to a contract has the opportunity to protect himself from unusual risk by communicating the risk to the other party, while in delict, an injured pursuer does not have the same opportunity to protect himself. Thus, "[i]n contract the pursuer is awarded damages for not obtaining the result he contracted for. In tort he is awarded only compensation for the consequences of any lack of care."[21]

6.4 Damages Recoverable in Electronic Credit Transfer Transactions.

The recoverability of losses sustained in an electronic credit transfer transaction depends on whether the defender bank is a transferring bank, or a beneficiary's bank. Losses resulting from banks' failure to perform their duties under an EFT transaction and the measure of damages applicable to recover such losses are discussed below.

6.4.1 Damages Recoverable from the Transferring Banks.

The amount of damages recoverable for banks' failure to execute a payment order or delayed execution depends on whether the bank's customer elects to rescind the agreement to transfer or sue for damages. An agreement to transfer funds to a given bank's account can be construed as an executory one. It remains so until the bank performs the payment order by creating a credit in the payee's account, or at least, changed its position to its detriment by taking steps considered as partial execution of the order.[22] Therefore, the transferring bank's customer may elect to

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[20] Dobbs, D., Handbook On The Law Of Remedies (1973), at 804, fn.24.

[21] Street on Torts, (8th ed. 1988), at 173.

[22] See Baker & Brandel (2nd. ed. 1988), at para. 29.03[2][a][ii]. In the American law, see *Gravenhorst v. Zimmerman*, 236 N.Y. 22, 139 N.E. 766 (1923) (A distinction was made between a cable transfer and a bank draft or cashier's cheque. The former is described as an executory contract and not an executed sale of exchange, while the latter is described as an executed contract on the ground that the customer receives a negotiable instrument that he must send to the payee); and *Ritchard v. Credit Union Suisse*, 242 N.Y. 346, 152 N.E. 110 (1926) (A customer may elect to rescind a contract to transfer funds abroad for bank's failure to make the credit for a substantial delay, provided that the bank has not changed its position to its detriment in partial execution of the customer's payment order). See, in contract generally in English Law, Atiyah P.S., An Introduction to the Law of Contract, (4th ed. 1989), at 417, ("one would expect the courts to be more willing to contemplate the remedy of rescission *ab initio* where the contract remains wholly executory").

rescind such an agreement on the bank's failure to create the credit or after a substantial delay to do so.[23] This is so, provided that the bank has not changed its position to its detriment in partial execution of the payment order. A customer may choose rescission over a claim for damages when he instructs his bank to transfer funds from one account to another abroad in a foreign currency, if such currency depreciates before the bank took steps to effect the transfer. Electing rescission, when he thinks that he has no better claim on damages, means that the risk of depreciation in foreign currency will fall on his bank. However, rescission does not always work for the interest of the bank's customer. Apart from being a limited remedy in local credit transfer transactions, where no foreign currency is involved, a customer may suffer indirect losses. Since the British and American law adopt different measures of damages for the recovery of losses suffered by customers as a result of their banks' failure to effect credit transfers orders as instructed, separate discussion of the law in these two jurisdictions is needed.

6.4.1 [a] Under U.K. Law.

6.4.1 [a] [i] Damages Recoverable For Breach of Contractual Obligation.

It is concluded that British banks, in the absence of a specific contractual agreement, are under no duty to make an electronic credit transfer. As such, no

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[23] See, in contracts generally, Atiyah P.S., An Introduction to the Law of Contract, (4th ed. 1989), supra, at 417. Rescission could probably be used as an effective remedy in international credit transfer transactions more than local ones. For example, a person instructs his bank to transfer a given amount from his account to another account abroad in foreign currency. Assuming that a bank accepts the instruction but negligently failed to effect the transfer for a substantial delay, during which the foreign currency depreciates dramatically. It becomes obvious that it is better for such customer to leave his money in his account and cancel the payment order. If such customer thinks that he is unable to show any recoverable direct or indirect losses, it is better for him to rescind the contract rather than sue for damages. If he sues for damages, he could be awarded the value of the foreign currency credited, or supposed to be credited, at the time of the bank's breach of the agreement to transfer, plus interest thereon. This means that the risk of fluctuation in the exchange rate will fall on him. A court may justify such ruling on the view that the depreciation in the value of the foreign currency, when measured by the currency of the another country, may not affect the intended use of the money in the foreign country that the customer wants the funds to be transferred to. On the contrary, if the customer elects to rescind the contract as an executory contract, he can keep his funds in his account and thus the risk of depreciation of his money will fall on his bank. See Baker & Brandel (2nd. ed. 1988), supra, at para. 29.03[2][a][ii] discussing banks' liabilities for losses in international transfers.

damages are recoverable if the bank entirely fails to execute an electronic credit transfer order. Banks may, however, enter into a specific agreement with their customers to carry out their credit transfer instructions. Alternatively, the general account agreement may contain a term that binds banks to make an electronic credit transfer. Their complete failure to carry out customers' instructions is a breach of either the express agreement, or the relevant term in their account agreement. A bank may, however, execute a payment order but not in conformity with the customer's instructions. Such an execution may result in either a noncompletion of the instructed transfer, or in an improper performance of such transfer, e.g, late payment.

The likely recoverable heads of damages for banks' breach of their contractual duties and the measure of damages applicable are discussed under separate headings according to the nature of the losses sustained.

6.4.1 [a] [i] [1] Direct Damages.

A bank's failure to execute its customer's payment order does not cause an immediate loss of the principal sum of the payment order because no money has been removed from the customer's account. However, a customer may lose the services charges paid to the bank to undertake such transfer. If the customer had to use the services of another bank to effect the same transfer, he will lose the difference in services charges between the two banks if he had to pay more to the second bank. Electronic credit transfer is a service done by banks for their customers, and some times to non-customers in contractual relationship.[24] It is submitted that where "the breach of contract consists in a failure to render services, the basic loss is the price

[24] At least one American case called a credit transfer a "service" in contrast to a "product", to deny an action for a bank's liability on the ground of "strict liability". See *Central Coordinates v. Morgan Guaranty Trust Co.*, 129 Misc.2d 804, 494 N.Y.S.2d 602 (Sup. Ct. 1985).

the plaintiff would have to pay in the market in order to obtain such services, always deducting the contract price if that has not yet been paid."[25] The customer will not lose interest on his funds, since the funds will remain in his account and if such account is subject to interest, it will continue to run.

Where an improper execution of a payment order results in a noncompletion of the funds transfer, a customer may lose his principal sum. He will also lose the use of such funds until the bank recredits his account or corrects the funds transfer by completing it in conformity with the instructions given. Moreover, unless the funds transfer is corrected, the customer will lose any expenses, including the fee paid, in the funds transfer.[26] Where the bank's failure to execute a payment properly results in a late payment to the beneficiary, the customer's direct losses will be the interest on the principal sum for the period of delay. In practice, it is the beneficiary who will lose such interest, but will probably claim it from the payer. Neither the principal sum of the funds transfer, nor its service charges or expenses will be lost. These are the direct damages that a customer would usually lose for his bank's failure to execute payment orders as instructed. In practice, the reason behind such failure is a bank's error or negligence.

Whether such losses are recoverable depends on the measure of damages

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[25] McGregor on Damages, supra, para. 33. In support of this proposition, he cited *Monarch S.S. Co. v. Karlshamns Oljefabriker* [1949] A.C. 196; *Hinde v. Liddell* (1875) L.R. 10 Q.B. 265 (where the basic measure of damages, in a contract of carriage where the carrier fails to carry, was the market rate less the contract rate); *Mertens v. Home Freeholds Co.* [1921] 2 K.B. 526 (C.A.) (the measure of damages against a defaulting builder was what it will cost the plaintiff to have the work done less the contract price); *Richards v. Hayward* (1841) 2 M. & G. 574; and *National Coal Board v. Galley* [1958] 1 W.L.R. 16 (C.A.) (where the measure of damages in a contract of service was the market price of similar services less the contract price). See for the same view, Walker, The Law of Civil Remedies in Scotland, (1974), at 525.

[26] The court in the American case *Central Coordinates, Inc., v. Morgan Guaranty Trust Co.*, 129 Misc.2d 804, at 806, 494 N.Y.S.2d 602, at 604 held that a "bank's failure to transfer funds as requested or in a reasonably prompt manner can result in direct or general damages (e.g. the loss of the funds themselves, the interest thereon and any fee paid for the failed transfer); or consequential or special damages, here, the profits alleged to have been lost with loss of the option". Moreover, the court in *Compania Anonima Venezolana De Navegacion v. American Express International Banking Corp.*, No. 84 Civ. 2047 (PKL), W.L. 1898 found that the same direct losses mentioned in *Central Coordinates* case were the typical direct losses in any bank's failure to execute a payment order properly. Unfortunately there is no British case in this area of EFT.

applicable. It was concluded earlier that the measure of damages for breach of contract is applicable to banker-customer relationships in EFT transactions.[27] The bank's customer should be put, so far as money can do it, in the same position he would have been in, had his credit transfer order been performed as instructed.[28] This should take into account the remoteness rule of *Hadley v. Baxendale*. Applying these rules to the case in discussion, one suggests that a customer is entitled to recover from his bank that fails to execute his payment order, the paid service fee. If he had to use the services of another bank, which charged him more, he is entitled to recover the difference in fees.[29] Where the failure results in noncompletion of the fund transfer, the customer is entitled to recover (i) the principal sum lost in the transfer; (ii) the services fee and the expenses of the fund transfer; and (iii) the interest on the principal sum until the bank either recredits the customer's account by the lost funds;[30] or corrects the transfer by making funds available to the beneficiary. Finally, where the bank's failure to execute properly results in late payment to the beneficiary, the bank must pay interest on the principal sum during the period of delay.

These losses are recoverable under the first rule of *Hadley v. Baxendale*, as direct damages. It is expected that British Courts will consider such losses as "arising naturally" from the bank's failure to execute its customer's payment order properly; and that such losses arise "according to the usual course of things".[31]

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[27] See also Arora, A., Electronic Banking and the Law, at 72 where it is submitted that "[t]he measure of damages recoverable by the customer of the paying bank [in electronic credit transfer transactions] if that bank fails to carry out the customer's instructions properly because of negligence, will be the measure generally applicable in a breach of contract, which is compensation for the loss as a reasonably foreseeable of a breach of a contract of the kind in question. This is not confined to the amount of the payment which should have been made, or to the amount of the payment which was incorrectly made."

[28] See generally, per Parke B., in *Robinson v. Harman* [1843-60] All E.R. 383 at 385; (1848) 1 Exch. 850, at 855.

[29] See, generally, McGregor on Damages, supra, at para. 33.

[30] See para. 6.4.1 [a] [i] [3] "Recoverability of Interest as Damages" for a detailed discussion of this issue.

[31] *Hadley v. Baxendale*, supra, per Alderson B., at 354, 465 respectively.

6.4.1 [a] [i] [2] Consequential Damages.

The bank's complete failure to execute customer's payment orders, or its failure to execute properly, may cause such customer indirect losses. The effect of such failure is that the payee to whom the customer instructed the fund transfer will not receive an expected fund. This may result in a cancellation of a valuable contract, losing a chance to acquire cheap shares, lowered credit rating, or various inconveniences. A bank's failure to execute properly resulting in a noncompletion of payment or a late payment may cause the same effect leading to indirect losses. The resulting losses, which usually involve a third party, are generally described as consequential damages.[32] The Review Committee recommended that a provision in a proposed legislation should be included to the effect that banks should be "normally liable to the customer for any direct, or clearly consequential, loss due to the failure of EFT equipment to complete a transaction, notwithstanding the terms of any contract to the contrary".[33] This recommendation has not been implemented by any legislation, nor by the Code of Good Banking.

The extent and nature of the consequential losses depend on the relationship between the payer and the payee and their underlying transaction. Take for example, a person who instructs his bank to transfer £400 to his landlord's account for the payment of his flat's monthly rent. Assume that the landlord has the right to rescind the contract if the rent is not paid to his account by the end of each month. Assume, too, that the bank negligently failed to promptly transfer the £400 by the end of one month to the landlord's account. This failure gave the landlord the right to use the

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[32] See Anderson, R. R., Incidental and Consequential damages, [1987] 7 Journal of Law and Commerce 327, at 334, 348-350; and Cooter & Rubin, A Theory of Loss Allocation for Consumer Payments, [1987] 66 Texas Law Review, 63, at 92-97.

[33] The Review Committee Report, supra, Recomm. No.10(11), at 155.

rescission term to terminate the contract, which he used. The customer has lost a favourable lease since the rent in the area has risen sharply after he rented the flat. He had to rent another flat in the same area for £600 per month. The question is whether the bank's customer is entitled to recover the difference in rent for his lost one year contract caused by the bank's failure to transfer the amount of the rent to his landlord's account in time.

The answer to this question can be found in the second rule of *Hadley v. Baxendale*, as restated in the later cases.[34] A customer is not entitled to recover such consequential damages from the bank unless they are "reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it."[35] This means that unless the bank has knowledge that its failure to transfer the funds properly to the payee would cause its customer such losses, no recovery will be allowed. Such losses should have been in the contemplation of the bank as "not unlikely" to result from its failure to execute its customer's payment order.[36] The bank's customer, in the above example, may recover the increase in the rent for the period of the contract if he proves that his bank

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[34] See the House of Lord's judgment in *The Heron II (Kaufos v. C. Czarnikow, Ltd.)* [1967] 3 All E.R. 686 where their Lordships argued about such standards as "not unlikely," "on the cards," "liable to result," "real danger," and "serious possibility" either as a clarification or as a replacement to the test of "arising naturally" and "according to the usual course of things" used by Baron Alderson in *Hadley v. Baxendale*; and in Scotland, *Den of Ogil Co. v. Caledonian Ry* (1902) 5 F. 99 (on remotness and foreseeability of consequential losses). See also Walker, The Law of Civil Remedies in Scotland, (1974), at 457-458.

[35] *Hadley v. Baxendale*, supra, per Alderson B., at 354, and 465 respectively.

[36] See *The Heron II*, [1967] 3 All E.R. 686 (H.L.). See per Lord Reid, at 690 where his Lordship explained what is meant by the term "not unlikely" by saying "I use the words 'not unlikely' as denoting a degree of probability considerably less than an even chance but nevertheless not very unusual and easily foreseeable." His Lordship continued to say, at 693, "that it is generally sufficient that that event would have appeared to the defendant as not unlikely to occur. It is hardly ever possible in this matter to assess probabilities with any degree of mathematical accuracy." His Lordship criticised tests used by *Victoria Laundry* case such as "real danger" and "serious possibility" by saying, at 695, that "to adopt these tests would extend liability for breach of contract beyond what is reasonably or desirable. From the limited knowledge which I have of commercial affairs I would not expect such an extention to be welcomed by the business community, and from the legal point of view I can find little or nothing to recommend it." However, Lord Pearce, at 711, thinks that "the expressions used in the Victoria laundry case [except "on the cards" being not a useful test] were right". See also per Lord Morris, at 700-701.

These standards, however, are criticised by one commentator as "highly manipulable concepts which can be made to mean almost anything to anybody". See Anderson, R., Incidental and Consequential damages, [1987] 7 Journal of Law and Commerce 327, at 353.

was aware of the nature of the transfer; in particular that it was for the settlement of a lease which includes a time rescission option; and that such losses were reasonably in the contemplation of the bank as "not unlikely" to result from the bank's failure to transfer the funds.

The contemplation of the loss results from the bank's awareness of the "special circumstances" that caused the customer's losses. It is probably insufficient for the customer to only draw the banker's attention to the "special circumstances" that may have caused the indirect losses, but rather the "special circumstances" must be presented to the banker in such a way as to show that he has accepted, or is taken to have accepted, the risk.[37] "Not only must the parties contemplate that the damage resulting from the special circumstances may occur, but they must further contemplate that the defender is taking the risk of being liable for such consequences should they occur. Normally they run together, but not necessarily."[38]

The bank's knowledge of such "special circumstances" is either imputed or actual.[39] Prof. McBryde suggests that the knowledge of the reasonable man is imputed to the contract breaker, and such knowledge comes within the first rule of *Hadley v. Baxendale*, while actual knowledge comes within the "special

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[37] See, generally, Walker, The Law of Civil Remedies in Scotland, (1974), at 457-458 citing *Horne v. Midland Ry* (1873) L.R. 8 C.P. 131; and *British Columbia Sawmill v. Nettleship* (1868) L.R. 3 C.P. 499.

[38] McGregor on Damages, supra, para 264. See *Muhammad v. Ali* [1947] A.C. 414 (P.C.) and *Trans Trust S.P.R.L. v. Danubian Trading Co.*, [1952] 2 Q.B. 297 (C.A.) and *Wadsworth v. Lydall* [1981] 1 W.L.R. 598 (C.A.)(where damages have been awarded for contemplated loss). The plaintiff in *Aruna Mills v. Dhanrajmal Gobindram* [1968] 1 Q.B. 655 recovered for the loss resulting from the devaluation of the Indian currency because, although it was too remote, the fluctuations in currency values was, in the circumstances, in the contemplation of the parties. Contrast *Robophone Facilities v. Blank* [1966] 1 W.L.R. 1428, 1448 (C.A.), where it is suggested that the defender can be held liable for special loss even where he has no knowledge of the special circumstances which have made such loss likely to result from his breach. See ibid, per Diplock L.J. at p.1448. However, this case can be restricted to its facts since it seems it was held so because the defendant had expressly undertaken, as a term of the contract, to be responsible for all actual loss to the plaintiff caused by his breach, whatever that loss might turn out to be.

[39] See *Victoria Laundry*, supra, per Asquith L.J. at 539-540.

circumstances" of the second rule.[40] The knowledge of the bank will be imputed according to the test of *Victoria Laundry* case, if in "ordinary course of things" the bank should have known as in deciding what it should have realised would be "not unlikely" to result.[41] It is suggested that the business or profession of the parties, and particularly of the pursuer - most likely to be the bank's customer - may throw light upon what knowledge can be imputed.[42] This factor has been considered by Buckley J. in *Diamond v. Campbell-Jones*[43] where his Lordship said:[44]

> "I cannot believe that Lord Wright, in ... the Monarch Steamship Co. case, meant that anyone entering into a contract must be treated as having constructive notice of the nature of the other party's business, or of its probable bearing on the loss which that other party might suffer in consequence of a breach of contract. In some cases the nature or the subject-matter of a contract or of its terms may be such as to make it clear that one of the parties is entering into the contract for the purpose of a particular business, and the circumstances may be such that the court will infer that the other party must have appreciated that his was so."

Prof. Arora argues[45] that EFT payments are usually made in connection with commercial transactions. Thus, a transferring bank may therefore always be taken to be aware of the likelihood that its customer will suffer some "usual commercial loss" if his instructions are not properly carried out. The damages recoverable by the transferring bank's customer must necessarily be at least the loss which usually results from a commercial payment not being made. One may suggest, however, that although banks, sometimes, are aware of their customers' type of business, they are not

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[40] McBryde, supra, para. 20-62. He adds that "[i]n truth it is sometimes difficult to distinguish imputed and actual knowledge". This is the view of McGregor on Damages too where he thinks "that actual knowledge and imputed knowledge so easily shade into one another", supra, para 255.

[41] McGregor on Damages, supra, commenting on the extent to which knowledge will be imputed in breach of contracts generally, see pars. 257-260.

[42] McGregor on Damages, supra, para 258.

[43] [1961] Ch. 22.

[44] at 35-36.

[45] Arora, A. Electronic Banking and the Law, supra, at 72-73.

necessary aware of the potential losses that their customers may sustain in case of their failure to carry out such transfer orders. Prof. Arora admits that it is difficult to measure such "usual commercial loss" since courts have never yet decided how such a "usual commercial loss" is to be calculated.[46] It is more accurate to say that courts must take into account the special relationship between banks and some of their customers in imputing the banks' knowledge of the likelihood of their customers sustaining some losses from their failure to carry out customers' transfer orders. However, this is a matter of fact; and each case must be judged on its own facts.[47]

The knowledge of the bank of the "special circumstances" that may cause the recovery of consequential damages may be actual rather than imputed. Such knowledge must be established at the time of entering into the contract. This could be difficult to establish in the case of an EFT transaction. The banker-customer contractual relationship may last for a long time during which many transactions could take place. The question is whether such knowledge should be found at the time of opening the account, or it is enough to be found at the time of instructing the bank to carry out a particular EFT order. Prof. McBryde gave an example of an open-ended contract between suppliers and an oil company. He says that after some time the knowledge of the parties and their trading are quite different from their early dealings. He thinks that although it is easier to regard each transaction as a separate contract, it is not always so.[48]

One suggests that as far as electronic credit transfer orders are concerned, each credit transfer transaction should be considered as a separate contract for the purpose

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[46] Ibid.

[47] McGregor on Damages, supra, para 258.

[48] McBryde, supra, para 20-66. He also gave an example of the relationship between a solicitor and a long term client.

of the bank's knowledge of "special circumstances" surrounding the transaction.[49] It is unrealistic to require that the bank must know the "special circumstances" surrounding the transfer at the time of entering into a banker-customer relationship with its customer. A bank's customer might have not even considered such transfer at the time of entering a relationship with his bank. Therefore, it is sufficient that the bank knows about these special circumstances at the time of instruction. The reason is that the bank contracts with its customer with certain assumptions and risks; and as such assumptions and risks are known to the bank when it accepts the instructions to transfer the funds, which also have not been increased by later events, it must bear the result.

A person who has suffered loss from his bank's breach of its duty to make or stop an EFT transaction must take any reasonable steps that are available to him to mitigate the extent of such loss. He is not allowed to recover for the loss resulted from his own failure to act reasonably to reduce or eliminate such loss.[50] Thus, a bank's customer is not entitled to recover from his bank if the proximate cause of the loss sustained by him is caused by his own wrongful or negligent act.[51] However, the pursuer is not required to resort to extraordinary measures in order to mitigate his loss. He is required to do no more that what is reasonable in the circumstances.[52] The principle of minimising the loss recognised in breach of contract generally is applicable in this case. American courts have recognised such principle in electronic

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[49] However, Atkin's L.J. in *Joachimson v. Swiss Bank Corp.*, [1921] 3 K.B. 110, at 127 suggests that there is "one contract" in a banker-customer relationship. See also Paget's law of Banking, (10th ed. 1989), at 162, suggesting that "Atkin LJ's concept of a single contract is the more convincing, and it is this concept which has prevailed."

[50] e.g., generally, *Ireland & Son v. Merryton Coal Co.* (1894) 21 R. 989; and *British Westinghouse Electric Co., Ltd. v. Underground Electic Rys. Co. of London Ltd.* [1912] A.C. 673.

[51] Walker, The Law of Civil Remedies in Scotland, (1974), at 453.

[52] See, e.g., *Gunter & Co. v. Lauritzen* (1894) 1 S.L.T. 435 (O.H.); 31 S.L.R. 359.

credit transfer transactions. In one case, the court suggested that a payer may mitigate losses caused by a delay in a credit transfer by sending another payment order when there was sufficient time to do so instead of spending time inquuiring about the lost first payment order, especially when timeous payment is crucial to such customer.[53]

6.4.1 [a] [i] [3] Recoverability of Interest as Damages.

There are three distinct cases of recovering interest. Pre-judgment interest; interest on the sum awarded in the judgment running from the date of that judgment; and interest as consequential damages.[54] Interest on sum awarded in the judgment is not an award of damages while the other two are an award of damages. The rationale behind awarding interest on sum awarded in a judgment is that the value of that sum declines with each passing day without payment; and thus, imposing interest would, theoretically, keep the value of that sum. This is now recoverable by statute both in Scotland[55] and England.[56]

Pre-judgment interest is an award of damages. It is awarded by courts to compensate the innocent party for his losses from the time of breach of contract till the judgment day. This is based on the view that the contract-breacher should have paid at the time of the breach. Therefore, the contract-breacher's failure to pay at that time deprives the other party from the use of his money. This suggests that "the allowance of such interest is theoretically an award of general damages, because the plaintiff's injury arises naturally and necessarily as a result of the wrong."[57]

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[53] *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (5th Cir. 1982), cer. den'd. 103 S.Ct. 377 (1983).

[54] See Anderson, R., Incidental and Consequential Damages, [1987] 7 Journal of Law and Commerce, 327, at 432.

[55] See Interest on Damages (Scotland) Act 1958 as amended by Interest on Damages (Scotland) Act 1971. § 1 provides that in cases of damages the court has a discretionary power to award interest from the date the right of action arose.

[56] See § 15 of part III of the Administration of Justice Act 1982 which modifies § 35 of the Supreme Court Act 1981 (Interest on Debts and Damages). For interest on damages awarded by arbitrators, see § 19A inserted into the Arbitration Act 1950. For a judicial discussion of these provisions see *President of India v. La Pintada Compania* [1985] 1 A.C. 104 (H.L.).

[57] See Anderson, R., Incidental and Consequential Damages, [1987] 7 Journal of Law and Commerce, 327, at 433.

The last type of interest is different from pre-judgment interest in "that it is not based on the amount the defendant ultimately owes but is itself an independent item of damages."[58] It usually takes the form of interest or finance charges that a bank's customer has incurred on borrowed money needed to finance other transactions, which would have been financed, but for the bank's failure to make the credit transfer on time. Whether such type of damages is recoverable as direct damages or consequential damages is a controversial matter.

Historically interest, as a separate head of damages for the late payment of money, has not been considered as such until 1952. Denning L.J. (as he then was), with whom Romer L.J. concurred, tried, in *Trans Trust v. Dunubian Trading Co. Ltd.*,[59] to rationalise the decision of the House of Lords in *London, Chatham and Dover Railway Co. v. South Eastern Railway Co.*[60] In the latter case, the House of Lords, held that unless there was an agreement or a statutory provision, interest was not recoverable by way of damages for late payment.[61] Lord Denning's attempt was based on the suggestion that the loss of interest caused by non-payment of money is "as a rule too remote".[62] However, his Lordship suggested that "when the circumstances are such that there is a special loss foreseeable at the time of the contract as the consequence of non-payment, then ... such loss may well be recoverable".[63]

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[58] Ibid, at 434-435.

[59] [1952] 2 Q.B. 297.

[60] [1893] A.C. 429.

[61] However, although Lord Herschell L.C., at 437, expressed strong sympathy with the claim to pay interest as damages for late payment of debts, he found himself bound by authorities, e.g., *Page v. Newman*, 9 B. & C. 378, and Civil Procedure Act 1833 -known as Lord Tenterden's Act-, to hold against such claim.

[62] [1952] 2 Q.B. 297, at 306.

[63] Ibid, at 306. See also per Romer L.J., ibid, at 307. This suggestion has been adopted, in fact, from Bullen & Leake's Precedents of Pleadings, 3rd ed. (1868), at 51, which has been ignored by the House of Lords in *London, Chatham and Dover Railway Co. v. South Eastern Railway Co.* itself.

The Court of Appeal in *Wadsworth v. Lydall*[64] held that the case of *London, Chatham and Dover Railway Co. v. South Eastern Railway Co.*,[65] did not rule out the recovery of interest accrued before payment of the principal sum and before the institution of proceedings if it met the requirement of the second rule of *Hadley v. Baxendale.* In that case, the defendant failed to pay all agreed sum, which forced the plaintiff to take out a mortgage in order to finance a contract to purchase some land and also incurred costs. He was awarded damages for interest charges paid on the mortgage and for his legal costs, although these followed from the defendant's failure to pay a sum of money. Brightman L.J. said:[66]

> "In my view the court is not so constrained by the decision of the House of Lords. In London, Chatham and Dover Railway Co. v. South Eastern Railway Co. ... the House of Lords was not concerned with a claim for special damages. ... The House was concerned only with a claim for interest by way of general damages. If a plaintiff pleads and can prove that he has suffered special damages as a result of the defendant's failure to perform his obligation under a contract, and such damage is not too remote on the principle of Hadley v. Baxendale ... I can see no logical reason why such special damages should be irrecoverable merely because the obligation on which the defendant defaulted was an obligation to pay money and not some other type of obligation."

Thus, his Lordship made a distinction between general and special damages. He meant by general damages those falling under the first rule of *Hadley v. Baxendale*; and by special damages, those falling under the second rule of the same case.[67] He considered *London, Chatham, and Dover Railway* case as applicable only to damages within the ambit of the first rule of *Hadley v. Baxendale*. His Lordship saw no logical reason for denying a claim for interest as special damages if according

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[64] [1981] 1 W.L.R. 598 (Ormrod and Brightman L.JJ., and Reeve J.).

[65] [1893] A.C. 429 (H.L.).

[66] *Wadsworth v. Lydall* [1981] 1 W.L.R. 598, at 603.

[67] This is, in fact, Lord Brandon's explanation in *President of India v. La Pintada Compania* [1985] 1 A.C. 104, 127 (H.L.). See Hobhouse J.'s comment, in *International Minerals & Chemical Corp. v. Karl O. Helm* [1986] 1 Lloyd's Rep. 81, 103, on Lord Brandon's explanation. See also McGregor on Damages, supra, para. 19-24. For an another interpretation, see Burrows, Remedies for Torts and Breach of Contract, 1987, at 89.

to the circumstances, the loss of interest was reasonably in the contemplation of the parties when they entered into the contract as "not unlikely" to result from the contract breach. The mere fact that such contract is for the payment of money, or that the defender's default is the failure to pay money on time, does not rule out the pursuer's claim.

The decision of the Court of Appeal in *Wadsworth v. Lydall*[68] has been approved by the House of Lords in *President of India v. La Pintada Compania.*[69] Their Lorships held that interest may be payable by way of damages under the second rule of *Hadley v. Baxendale* but not under the first rule. This approval was best illustrated by the following words of Lord Brandon:[70]

> "In my opinion the ratio decidendi of *Wadsworth v. Lydall* ... that the *London, Chatham and Dover Railway* case ... applied only to claims for interest by way of general damages, and did not extend to claims for special damages, in the sense in which it is clear that Brightman L.J. was using those two expressions, was correct and should be approved by your Lordships."[71]

Thus, the ratio of the *London, Chatham and Dover Railway Co.* case, in its new restricted form, "goes no further than to bar the recovery of claims for interest by way of general damages."[72] Accordingly, if a person claims interest as damages for late payment of money, the court will not assume that such damages flow from such delay "naturally, i.e., according to the usual course of things".[73] He must, in

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[68] [1981] 1 W.L.R. 598.

[69] [1985] 1 A.C. 104.

[70] Ibid, at 127.

[71] This decision has been followed later in *Knibb v. National Coal Board* [1986] 3 W.L.R. 895. In that case, Sir John Donaldson M.R. explained, at 899, the effect of the decision in *President of India v. La Pintada Compania* as followes: "[I]t emerges [from this decision] that there is no general common law power which entitles courts to award interest, but that if a claimant could bring himself within the second part of the rule in Hadley v. Baxendale ... he could claim special damages, notwithstanding that the breach of contract alleged consisted in the non-payment of a debt."

[72] Neill L.J. in the Court of Appeal decision in *President of India v. Lips Maritime* [1988] 1 A.C. 395, 411. This is a case which dealt with the recovery of currency exchange losses, and not interest.

[73] The first rule of *Hadley v. Baxendale* (1854) 9 Exch. 341. It seems that courts will decline to impute to the parties the knowledge that in the ordinary course of things the failure to pay money on time will result in loss of interest. Hobhouse J. in *International Minerals & Chemical Corporation v. Karl O. Helm A.G.* [1986] 1 Lioyd's Rep. 81, 104.

order to recover interest by way of damages, prove that the loss of interest was reasonably contemplated, at the time of entering into the contract to pay money, as not unlikely to result from the delay in payment.[74] Although the Court of Appeal's decision in *Wadsworth v. Lydall*, as approved by the House of Lords in *President of India v. La Pintada Compania*, has been welcomed as "establish[ing] the correctness of subsuming interest to damages",[75] it has been, on other hand, described as "remarkable inconsistency".[76]

It is argued that the traditional approach in Scotland "appears to be not to accept that such cases fall under the *Hadley v. Baxendale* rule".[77] In *Inverness Golf Club v. James Parr & Partners*,[78] the defenders, who had rendered construction services to the pursuers, i.e., an employer, allowed the cost of the works to exceed the estimated cost without instructions or consent from the pursuers. In order to meet such extra cost, the pursuers had to borrow money with interest. They sued the defenders for recovery of the interest incurred by way of damages under *Hadley v. Baxendale* principle. Lord Jauncey rejected the argument that such loss arose "naturally, i.e. according to the usual course of things" from a substantial overspend on a building contract. His Lordship thinks that it was not necessary that the employer, i.e., the pursuers, should borrow money to meet their obligations which resulted from the defenders' overspending. The employer, said Lord Jauncey:[79]

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[74] See, e.g., *The Borag* [1981] 1 All E.R. 856 (C.A.) (where the pursuers claimed an unausual amount of interest, alleging that they had to pay such amount for a guarantee provided in order to counter an arrest wrongfully brought about by the defenders. The Court of Appeal held that this particular loss was not reasonably foreseeable, but had this not been the case, the recovery of such loss would have been allowed).

[75] Mann F.A., On Interest, Compound Interest and Damages, [1985] 101 L.Q.R. 30, 34.

[76] Ibid. See also for critical analysis of the development of English law in this issue, Mann F.A., The Legal Aspects of Money, (5th ed. 1992), at 69-72 where the learned author noted, at 71, that the High Court of Australia "wisely refused to follow" recently in *Hangerford v. Walker* (1989) 84 A.L.R. 119.

[77] Murray, J., Interest on Debt, [1991] S.L.T. (News) 305, 309.

[78] Unreported case, 27 January 1987; 1987 G.W.D. 6-169 mentioned by Murray, ibid, at 309.

[79] As quoted by Murray, ibid.

> "might well have sources of finance available to him for which he did not require to pay interest. He might have a general surplus of money, albeit he was only prepared to commit a certain amount thereof to the project in question. He might have funds which he had earmarked for other less urgent projects which he could use to defray the extra cost of the project in the question. ... That being so, it cannot be said that borrowing was something which should have been foreseen by the defenders as something likely to happen in the ordinary course of things if there was a substantial overspend. It follows that the first rule in *Hadley v. Baxendale* has no application."

His Lordship rejected, too, the claim under the second part of the rule of *Hadley v. Baxendale.* He thought that according to the circumstances of the case the defenders were not aware that borrowing would be necessary to finance the overspend. It seems that had the defenders were put on notice of such losses the pursuers might have recovered under the second rule of *Hadley v. Baxendale*. There is difficulty, however, in accepting the justification of Lord Jauncey. The fact that the pursuer had sufficient funds from other resourses is irrelevant to his claim. English courts do not distinguish in awarding such losses, in these cases, between borrowing money or diverting one's money from other financial sources. In the former case, a person's loss is the interest paid to the lender, while in the latter case, the person's loss is the interest that would have been earned had he left the funds in an interest bearing account. Facing this issue, Lord Brandon in *Brandeis Goldschmidt & Co. Ltd v. Western Transport Ltd.*,[80] said:[81]

> "[it is irrelevant] whether the plaintiffs financed the purchase of the copper from their own resources or by borrowing from the bank. If they used their own resources, they would otherwise have earned by investing the moneys so used. If they borrowed from the bank, they would have to pay interest on the amount so borrowed."
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> In imputing the knowledge of interest loss to banks, courts may take account

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[80] [1981] Q.B. 864.

[81] Ibid, at 873.

of the terms of the contract between the bank and its customer and of the surrounding circumstances. This is probably the test that should be applied.[82] According to Lord Denning M.R. in *H. Parsons (Livestock) Ltd.*,[83] the test is one of remoteness. His Lordship said:[84]

> "In the case of a breach of contract, the court has to consider whether the consequences were of such a kind that a reasonable man, at the time of making the contract, would contemplate them as being of a very substantial degree of probability."[85]

This is an objective test. Ormrod L.J. in *Wadsworth v. Lydall*[86] said:[87]

> "To use the langange of objective/subjective, it is an objective test. The court has to look not at what this particular defendant knew or contemplated but what a reasonable person in his position would have contemplated."

Thus, it seems that the common law view is that interest on borrowing to meet other financial obligation caused by banks' failure to transfer funds in time does not flow directly from such failure. Thus it is not recoverable under the first rule of *Hadley v. Baxendale*. The question is whether the nature of electronic fund transfer transaction imputes a knowledge of such loss to banks so as to justify its recovery as a direct damages. On other words, can one say that banks are assumed to know that the mere delay or complete failure to transfer funds to a given payee results in the borrowing of money with interest (or loosing interest when one uses his own funds) from other resourses?

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[82] Gloag on Contracts, 2nd ed., suggests, at 697, that "a party who breaks his contract is liable for those consequences which a reasonable man, possessing the knowledge which the party had at the time of contracting, would have anticipated". This statement has been adopted by the editors of 9th ed. of Gloag and Henderson, Introduction to the Law of Scotland, at 156, para. 13-28.

[83] [1978] Q.B. 791.

[84] At 801. See also per Scarman L.J., at 807 (where his lordship made the same point in a slightly different way. He said: "The court's task, therefore, is to decide what loss to the plaintiffs it is reasonable to suppose would have been in the contemplation of the parties as a serious possibility had they had in mind the breach when they made their contract".

[85] The breach itself does not have to have been foreseeable.

[86] [1981] 1 W.L.R. 598.

[87] Ibid, at 605.

Dr. Mann argues strongly for allowing the recovery of interest as a direct loss for the late payment of money under the first rule of *Hadley v. Baxendale*. He said:[88]

> "if interest can be claimed under the second limb of the rule in *Hadley v. Baxendale* why should it not also be recoverable under the first limb, where damages are such 'as may fairly and reasonably be considered arising naturally, i.e. according to the usual course of things' from the breach? To say that interest considered as damages, is too remote is an argument which at the present time is no longer realistic or persuasive and which can only be described as an empty phrase. The modern test is whether the debtor could reasonably foresee that in the ordinary course of things the loss was likely to occur or was on the cards.[89] Who would refuse to impute such knowledge to a debtor? Who would venture to suggest that a defaulting debtor could not reasonably foresee interest as the creditor's loss flowing from the failure to pay?".

One suggests that in commercially-based EFT transactions, banks should be assumed to know that a delay or a failure to transfer funds would cause the recourse to other financial resourses to cover up the failure or the delay. Such assumption of knowledge is not unreasonable. The risk that faces banks from such approach can be mitigated by the view that it is not necessary that courts should uphold the actual amount of interest that a person has, in fact, paid for borrowing. *Miliangos v. George Frank (Textiles) (No.2)*[90] suggests that courts are not concerned with the rate of interest at which a particular plaintiff may, in fact, have borrowed money. Bristow J. said:[91]

> "The court is not concerned with the actual cost of borrowing to the individual concerned in the individual case. Depending on many variables, some people can borrow cheaper than others. The court fixes a rate applicable for plaintiffs in general."

This approach will encourage the defender to take care not to borrow with an

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[88] Mann F.A., On Interest, Compound Interest and Damages, [1985] 101 L.Q.R. 30, at 34-35.

[89] *Victoria Laundry (Windsor) Ltd v. Newman Industries Ltd.* [1949] 2 K.B. 528, 539, per Lord Asquith.

[90] [1977] Q.B. 489.

[91] Ibid, at p.495-496.

unusual high interest rate. However, the interest base rate can be taken as a criterion.

6.4.1 [a] [i] [4] Recoverability of Currency Exchange Losses.

Currency exchange losses may occur in electronic credit transfer transactions. No such losses do arise in EFTPOS and ATM transactions. The value of money may depreciates between the time at which money should have been paid and the actual time of payment where there is a delay in implementing the payer's payment order. The question is whether the aggrieved party is entitled to claim damages for the loss sustained by a subsequent variation in the currencies used.

Scrutton L.J. in *Di Ferdinando v. Simon Smits & Co.*, said:[92]

> "It occurred to me it might possibly be that subsequent variation in the exchange could be included in the damages in the nature of interest. I have been unable to find that interest by way of damages has ever been allowed to cover alteration in the exchange, and Counsel have also been unable to find any such case. I think the reason is the one I have already given - namely, that those damages are too remote. The variation of exchange is not sufficiently connected with the breach as to be within the contemplation of the parties."

Where such loss was foreseeable, it was allowed by English courts to be recovered.[93] The issue has been discussed in all judicial levels in *President of India v. Lips Maritime.*[94] In that case a Greek's vessel has been charted under a charterparty which provided that demurrage should be paid at the rate of U.S. $6,000 per day. This amount should be paid in British sterling at the exchange rate at the date of the bill of lading (clause 30 of the charterparty). The vessel completed discharge of the cargo after a considerable delay. The owners demanded the recovery, as damages for the late payment of the outstanding demurrage, the loss suffered by

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[92] [1920] 3 K.B. 409, 416. This passege was quoted by Mann in his latest edition of The Legal Aspect of Money (1992) at 293.

[93] *Ozalid Group (Export) Ltd. v. African Continental Bank Ltd.* [1979] 2 Lloyd's Rep. 231.

[94] [1988] 1 A.C. 395 (H.L.).

reason of sterling having been depreciated by the date of the award. At the arbitration level, the umpire decided that the currency exchange loss suffered by the owners was "special damage" recoverable under the second rule of *Hadley v. Baxendale*. The charterers appealed to the High Court. Staughton J. held that the umpire was wrong in law to conclude that the currency exchange loss amounted to "special damage", and he varied the award to exclude the damages element, thereby limiting the award to demurrage payable in sterling in accordance with clause 30 of the charterparty.[95] The owners appealed to the Court of Appeal. The Court of Appeal held that the currency exchange loss was recoverable as "special damage" for breach of contract and that the owners' claim for damages was not precluded by the determination of rate of exchange provision in clause 30.[96] The Court relied on the point that this clause does not apply when the paying party is in breach of contract by failing to pay within two months of completion of discharge. The charterer appealed to the House of Lords. Their Lordships restored Staughton J.'s decision beacuse:

> "[a]ll that happened was that the charterer did not pay liquidated damages for the detention of the ship at the time when the cause of action in respect of such damages occured, or indeed at any time, including the time of the umpire's award. For that non-payment the only remedy which the law affords to the owners is interest on the sum remaining unpaid".[97]

The House of Lords thinks that damages in such a case cannot be increased by the award of further damages for currency exchange losses. That is becuase "[i]n these circumstances ... claims to recover exchange losses as damages for breach of contract, whether the breach relied on is late payment of a debt or any other breach, are subject to the same rules as apply to claims for damages for breach of contract

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[95] [1985] 2 Lloyd's Rep. 180,

[96] [1987] 1 All E.R. 957

[97] [1988] A.C. 395, 425-426.

generally".[98] Thus, it seems that the House of Lords did not rule out the recovery of currency exchange losses as damages in other types of breach of contract if they are not too remote.[99] Such damages are recoverable under the second (but not the first) rule of *Hadley v. Baxendale*. Lord Mackay found that "[t]he reasoning of [the] House [of Lords] in *President of India v. La Pintada Compania Navigacion S.A.* ... makes it clear that damages other than interest may be recovered for breach of contract by late payment".[100] Whether such damages are within the contemplation of the parties at the time of initiating the transfer of funds depends on the facts of each case. Hobhouse J. in the earlier case of *International Minerals & Chemical Corp. v. Karl O. Helm*[101] thinks that "[a]ny statement about 'the ordinary course of things' or what would be within the contemplation of the 'reasonable persons' involves first making findings or assumptions about the underlying facts, the parties to the contract, the subject matter of the contract, the type of transaction involved, etc."[102] Relevant factors in such claims are the nationality and business residence of the customer, the international nature of the transaction, any previous transfers carried out by the bank to its customer and the possibility of fluctuation of the two currencies involved. The existence or absence of one or more of those factors should be judged by the "reasonable banker" in the position of the bank involved. It was held in *International Minerals & Chemical Corp. v. Karl O. Helm*[103] that currency exchange loss was recoverable in a claim in damages for a breach of a contractual obligation to pay a

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[98] [1988] 1 A.C. 395, 424.

[99] See for a critical analysis of the House of Lords' decision, Mann, The Legal Aspect of Money (1992), at 293-294 and, in particular, fn.102.

[100] [1988] 1 A.C. 395, 429.

[101] [1986] 1 Lloyd's Rep. 81.

[102] At 102.

[103] [1986] 1 Lloyd's Rep. 81.

sum of Belgian francs (12,910,922) on a particular date. Upon the defendants' failure to do so, the plaintiffs alleged that they had suffered the difference in value between the value in U.S. dollars of that sum in Belgian francs at the agreed time of payment and its value at the date of judgment. There had been a fall of approximately 40 per cent. in that value between those dates. Hobhouse J. held that a "currency exchange loss must be a claim for special damages" in the sense of the second rule of *Hadley v. Baxendale*, and "must be specifically proved".[104] His Lordship found that certain facts were, in fact, known to the defendants at the time of entering the contract. It was not important, whether or not such facts were actually known to the defendants at that case. Such knowledge would have been imputed to the defendants, if any "reasonable businessman" in the position of the defendants would have understood this to be the situation. His Lordship thought that such losses were recoverable as special damages as stated in the second rule of *Hadley v. Baxendale*. He summarised the requirements for recovery of such losses as follows:[105]

> "In my judgment, the surviving principle of legal policy is that it is a legal presumption that in the ordinary course of things a person does not suffer any loss by reason of the late payment of money. This is an artificial presumption, but is justified by the fact that the usual loss is an interest loss and that compensation for this has been provided for and limited by statute. It follows that a plaintiff, where he is seeking to recover damages for the late payment of money, must prove not only that he has suffered the alleged additional special loss and that it was caused by the defendant's default, but also that the defendant had knowledge of the facts or circumstances which make such a loss a not unlikely consequence of such default. In the eyes of law, those facts or circumstances are deemed to be special, whether in truth they are or not, and knowledge of them must be proved. Where, as in the present case, the relevant facts or circumstances are commonplace, the burden of proof will be easy to discharge and the courts may will be willing to draw inferences of knowledge; in other cases, there may be a question which would, in any event, have had to be dealt with under the second rule in *Hadley v. Baxendale*, and then the

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[104] At 104.

[105] At 104.

> burden of proof will be more significant. I do not see it as any objection to the recovery of the damages claimed in the present case that in very many other international transactions similar damages would be recoverable in the event of the default."

Although his Lordship did not see such loss as "arising naturally, i.e. according to the usual course of things" from the delay in payment, he contemplated that in most cases the knowledge of such loss will be imputed to the parties. If such circumstances are in the usual course of things to the degree that the knowledge of them by the defender is imputed, the burden of proof will be easy to discharge. But if the circumstances are not usual, i.e. special, it is the problem of the pursuer to prove that such circumstances were in the contemplation of the defender at the time of entering into the contract. In this case there is a significant role to the matters of evidence in deciding the outcome of the case. There is no readiness to accept currency exchange loss as "arising naturally" from late payment of money. Although in elctronic credit transfer transactions such losses are likely to occur, one suggests that it is difficult for banks to foresee which currency will depreciate. Thus, there should be also no presumption of knowledge of such losses to banks. A customer must prove that such losses were in the contemplation of his bank as "not unlikely" to result from a delay in the transfer of his fund at the time of delivering his payment order.

Such damages should be assessed on the basis of the difference between the exchange rate at the date when the transfer should be made and the date of the actual payment.[106] This would put the pursuer in the same position as he would have been in had his bank performed its duty to transfer the funds in time.[107] Take for

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[106] See per Lord Mackay in *President of India v. Lips Maritime* [1988] 1 A.C. 395, 427 (H.L.).

[107] Such a measure is the one applicable in breach of contracts generally as stated by Parke B., in *Robinson v. Harman* [1843-60] Eng. Rep. 383, 385; (1848) 1 Exch. 850, 855. See for other rules Santa Lucia J.S., Exchange Losses from International Electronic Funds Transfers: Time to Unify the Law [1988] 8 Northwestern Journal of International Law & Business 759, at 766-768 (discussing, *inter alia*, theories such as the breach-date rule, the judgment-date rule and the execution-date rule.)

example, a British currency exchange dealer who instructs his bank to transfer £10,000 to his account in a New York not later than 1st of October and informed his bank that such a transfer is for the purchase of American dollars at the prevailing exchange rate on 1st of October. Assume that his British bank negligently fails to execute his payment order by the time of payment. Later on 5th of October, the bank discovers the fault and sends a payment message to its customer's bank in New York which accepts the message and credits its customer's account by the equivelant American dollars at the sterling-dollar exchange rate on 5th of October. Assuming that the rate of exchange on 1st of October is £1 = $1.85, and on 5th of October is £1 = $1.75, What is then the amount of loss that the British exchange dealer has suffered from his bank's negligence? On presumption that the court found that the loss was in the contemplation of the bank as "not unlikely" to result, the loss of the currency exchange is the difference between what the British bank's customer would get in U.S. dollars on 1st of October in New York for his £10,000 and what he would get in the same place, on 5th of October for the same sterling amount. By simple calculation this is $18,500 -$17,500 = $1,000.

The situation is different where the British bank's customer in the above example instructs his bank to transfer the American dollars equivelant of his £10,000 on 1st of October to his account in New York. If the bank negligently fails to effect the transfer until 5th of October, no currency exchange damages are recoverable even if his £10,000 will worth less in American dollars on 5th of October. Interest loss for the use of the equivelant American dollars from 1st to 5th of October are recoverable. However, if the value of the American dollar has depreciated by 5th of October, the British dealer may recover damages for late delivery on the bases of the general rule

of recoverability of damages for breach of contract. The measure is the recoverability of those damages "consisting of the difference between the value of the goods at the date fixed for delivery and their value when delivered."[108]

It is no longer necessary that such award should be paid in sterling.[109] The pursuer is entitled to "select the currency in which to make his claim and it is for him to prove that an award or judgment in that currency will most truly express his loss and accordingly most fully and exactly compensate him for that loss".[110]

6.4.1 [a] [i] [5] The Trader Rule.

It is arguable whether a bank's customer, in electronic credit transfer, is entitled to damages resulted from loss to his financial reputation in case of the bank's failure to carry out the customer's credit transfer orders. Courts may award damages to compensate for injury done to the customer's credit if a bank wrongfully dishonours a cheque. There is an important distinction between trading and not-trading customers.[111] In the case of a customer, who is a trader, courts will award reasonable compensation for the assumed injury done to his credit.[112] A customer who is not

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[108] Mann, The Legal Aspects of Money (1992), at 291. See also the American case of *Richard v. American Union Bank* 253 N.Y. 166; 170 N.E. 532 (193) discussed by Mann, ibid. See for the position of the common law in the United States law, Baker & Brandel (2nd ed. 1988), at para. 29.03 [2][a][ii].

[109] Since the English case of *Miliangos v. George Frank (Textiles)* [1976] A.C. 443 (H.L.). In Scotland see *Commerzbank Aktiengesllschaft v. Large*, 1977 S.C. 375. Damages can be measured in a foreign currency and discharged in sterling. In discharging debt in foreign currency see generally, in Scotland, Prof. Wilson, The Scottish Law of Debt, (2nd ed. 1991) at par. 1.5.

[110] Per Donaldson J. in *Ozalid v. African Continental Bank* [1979] 2 Lloyd's Rep. 231, 234. His Lordship applied *Miliangos* case, supra, and *Services Europe Atlantique Sud (SEAS) v. Stockholms Rederiaktiebolag SVEA and The Despina.*, [1979] 1 Lloyd's Rep. 1 (H.L.).

[111] See Paget's Law of Banking, (10th ed. 1989), at 227-228; Ellinger, Modern Banking Law, at 310-314; Holden, The Law and Practice of Banking, Vol.I, (5th ed.), at 110-115; and Pennington, Hudson, and Mann, Commercial Banking Law, at 36-38. Ellinger, supra, at 312, questioned, whether it is still rational to hold this distinction since (i) "the demarcation between traders and other members of the community is no longer clear-cut. In addition to solicitors, accountants and money brokers, who are clearly akin to businessmen, there is the intermediary class which comprises such persons as physicians and dentists, whose reputation in financial matters is of considerable significance to their ability to obtain supplies for their surgeries."; and (ii) "the average consumer, in the present era, depends to a very substantial extent on the availability of credit".

[112] The special position of traders was recognised by the House of Lords in *Wilson v. United Counties Bank Ltd.*, [1920] A.C. 102. In that case, Lord Birkenhead L.C., after reviewing the authorities on the point, said, at 112, that:
"The ratio decidendi in such cases is that the refusal to meet a cheque, under such circumstances, is so obviously injurious to the credit of a trader that the latter can recover, without allegation of special damage, reasonable compensation for the injury done to his credit".

a trader is not entitled to such damages.[113] However, a non-trader customer is still entitled to nominal damages.[114] The rationale is that the dishonour of the cheque implies that the trader's bank, which is the entity most familiar with his financial standing, has no trust in his creditworthiness.[115] This information about the trader's financial status is communicated to the holder of the cheque since the bank is bound to write on the cheque the reason for dishonour, e.g. insufficient funds.

This rule does not directly encompass the position of a trading customer in electronic credit transfer transactions. Following the same reasonong by analogy, one would argue that the transferring bank's customer is probably not entitled to such head of damages. The payee in electronic credit transfer may not even know, in most cases, the reason for the failure to pay him. It is not necessary (even if he knows that the reason for non payment was his debitor's bank's failure to carry out a payment order) that such reason was related to the financial status of the bank's customer. Thus, the failure of the transferring bank to transfer the funds to the payee's account does not necessarily mean that the transferring bank has no trust in the payer's creditworthiness. It could be for technical reasons. In practice, even if, for example, there are no sufficient funds in the customer's account, the transferring bank will not pass this information to the payee's bank. It will refrain from sending the credit transfer order and contact its customer informing him of the reason. The payee, by no means, will

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[113] See *Gibbons v. Westminster Bank Ltd.*, [1939] 2 K.B. 882, per Lawrence J., at 888, where his Lordship said: "that a person who is not a trader is not entitled to recover substantial damages for the wrongful dishonour of his cheque, unless the damages which he has suffered is alleged and proved as special damage."

This principle was applied by the Court of Appeal in *Rae v. Yorkshire Bank Plc.*, [1988] B.T.L.C. 35, where a non-trader who was unable to prove special damage was awarded only nominal damages for the wrongful dishonour of his cheques.

[114] In the *Gibbons* case, supra, the nominal damages were fixed at £2. In *Rae* case, supra, the judge at first instance awarded £20. However, the Court of Appeal observed that £20 as nominal damages may well have been too high, but as there was no cross-appeal, the point was left open.

[115] Ellinger, Modern Banking Law, at 311.

be informed of such thing through the transferring bank. However, a counter argument is that the bank's failure to carry out its customer's payment orders promptly will harm its customer's financial reputation, e.g, not meeting his business debts promptly.

6.4.1 [a] [i] [6] The Soundness of the Applicability of Common Law Rules of Consequential Damages in EFT Transactions.

One suggests that the uncertainty surrounding the issue of consequential damages in EFT transactions may cause uneasiness in the banking circles in the United Kingdom. This is probably a problem awaiting British banks, especially in the absence of judicial explanation of the scope of the applicability of common law rules in EFT transactions. The risk that awaits British banks does not come from the recoverability of consequential damages *per se*, but from the uncertainty that surrounds the requirements of its recoverability. This comes from issues such as what constitutes an "imputed knowledge"; and what are the "special circumstances" that may put banks in contemplation of such losses. American banks were so lucky that the Appeal Court in *Evra* case reversed the trial court's decision by taking the view that "electronic funds transfers are not so unusual as to automatically place a bank on notice of extraordinary circumstances if such a transfer goes awry."[116] Comparing that decision with the *Heron II* case, one commentator thinks that "the losses suffered in *Evra* are much more 'foreseeable' than those in the *Heron II*".[117] It is such dependence on interpretation by the courts that alarms banks. Taking into account the magnitude of the money that is handled through EFT systems, e.g., CHAPS, one may imagine that banks may lose amounts of several digits for a service that cost them a

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[116] 673 F.2d 951, at 956 (7th Cir. 1982).

[117] Tyree A.L., Electronic Funds Transfer Systems - a Survey of the Legal Issues, [1984] 58 Law Institute Journal 1200, at 1205.

sum of only one digit.[118] An expected area for such uncertainty is time charterparty cases, in which a bank may fail to execute its customer's instructions to pay a hire on time facing an action for thousands if not millions of sterling pounds for consequential damages as a result of cancellation of a favourable charter. In the absence of legislation, British banks are advised to evaluate each individual payment instruction and its surrounding circumstances to protect themselves from an exposure to this big risk. However, this costs money and time; and as such will hinder the most valuable characteristics of electronic credit transfer systems: the low cost and the high speed. It is not clear whether exclusion terms to such effect in clearing or EFT payment systems rules are applicable to ordinary customers who are not party to such rules. Alternatively, banks may choose to exclude liability for such losses by inserting a term to such effect in the standard forms used for payment orders. Indeed, this is the banking practice these days. It is not clear, however, whether such exclusion is applicable to those orders delivered by computer messages, telephone or other such methods.

Moreover, customers may suffer from such a rule in certain circumstances.[119] A transferring bank's customer who has no privity of contract (in English law) with a defaulting intermediary bank may found himself unable to recover from such bank his indirect losses under *Hadley v. Baxendale*. This is probably so even if the customer provides his bank with "special circumstances" to justify recovery of consequential damages. First, such "special circumstances" may not have been passed on to the intermediary bank. Passing on such "special circumstances" to the next bank

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[118] For an economic approach to *Hadley v. Baxendale* case, see Hause L.D. (Note), An Economic Approach to *Hadley v. Baxendale* [1983] Nebraska L. Rev. 157.

[119] See for a pro-customers argument, Werner H.E., Regulation of Wire Transfers and The Recoverability of Consequential Damages [1987] Buffalo L. Rev. 743.

in the payment process is impractical and costly. This may hinder the high speed of such transfers. Second, a customer needs a contractual relationship with the defaulting bank to claim consequential damages under *Hadley v. Baxendale* rule. This is important, especially when the customer has no claim against his bank because the latter disclaims in its agreement with the customer any liability for the acts of intermediary banks.

6.4.1 [a] [ii] Damages Recoverable for Breach of Delictual Obligation.

A claim for recovery of damages could be based on breach of delictual rather than contractual duty. A bank that causes loss to a customer or a third party can be held liable to compensate such person for his loss if the requirements of delictual liability are met. Indeed, this cause of action could be the only possible claim for the recovery of such loss when the aggrieved person has no contractual relationship with the bank concerned. For example, a transferring bank's customer may sue an intermediary bank, with which he has no contractual relationship, for damages under delict if the bank negligently causes the failure or the delay of payment in a credit transfer transaction. This cause of action could prove to be vital, in particular under English law, where the transferring bank disclaims liability for other banks' failures to effect payment.[120] A bank's customer may, too, choose, for evidence, time-bar or remoteness limitations, to sue his bank for a loss suffered under delict rather than under contract. It was said earlier that banks may be found under a delictual duty of care to perform their customers' instructions properly, and according to the terms of such instructions.[121] Assuming that a bank is held liable for a breach of delictual

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[120] The pursuer, under Scots law, may still have a third party cause of action against the intermediary bank in the above example. Where he cannot satisfy the requirements of such claim, he is advised to sue under delict.

[121] See chapter two, para. 2.4.1 [a].

duty of care in a given EFT transaction,[122] what are the demages that a pursuer would be entitled to recover?

The two most likely situations in which a bank's negligence would inflict financial losses on others are (i) banks' negligent performance of services beneficial to the pursuer; and (ii) banks' negligent misrepresentation. The measure of damages applied in each of these two situations is discussed separately.

6.4.2 [a] [ii] [1] Banks' Negligent Performance of Services.

A bank may perform certain services negligently causing financial loss to others, either customers or not. It is not impossible to find a situation where a bank and a person who is not its customer are in a very close relationship which justifies the reliance of such person on bank's performance of certain services. One example is a person who pays his electricity bill through a bank which is not his bank by providing the bank with cash. One argues that, although such person is not a customer of the bank, the bank should perform such service with reasonable care. The bank's negligence in not remitting the funds to the electricity company's account, either with it or with another bank, may cause such person some loss, e.g. disconnection of the electricity supply. Such person has a close relationship with the bank which justifies his reliance on the bank to perform such service. In EFT a person need not to be a customer of the bank to instruct a credit transfer for example. If the bank fails to transfer, or delays such transfer he may suffer financial losses either direct or consequential. Regardless whether there is a contract between the bank and such

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[122] This is a starting point in any work on damages. See Burrows, Remedies for Tort and Breach of Contract (1987) at 162-163. However, for any claim of damages in delict against a bank in an EFT transaction, there must be a duty of care on the part of the bank to do what the bank fails to do, or not to do what it does, a breach of such duty by the bank and a loss to the person suing the bank which results from such breach. The loss alleged must not only caused by the bank's breach of its duty of care, but also be a loss which the law recognises and gives it a protection by an award of damages.

person to transfer the funds, one would suggest that a "special relationship" between the bank and such person exists when the bank accepts to transfer the funds. If the bank negligently fails to perform the payment order, and that causes some financial loss to such person, one suggests that he should be entitled to recover his "reasonably foreseeable" losses. The measure of damages in this is that for breach of delictual duty. That is to put the pursuer into as good a position as if the bank had performed the service using reasonable care.[123] This measure of damages is not different from the measure of damages in delict generally, i.e. to "put the [pursuer] who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation".[124] It is worth noting that in this case the assessment of damages that should be awarded for such negligence is the same as if the case were a breach of contract, i.e. to put the pursuer, so far as money can do it, in the same position as he would have been in had the contract been performed.[125] That is mainly because the delictual obligation in this case is a positive one to benefit the pursuer by performing the service non-negligently.[126] This could be applied to all cases where banks negligently fail to perform services, e.g EFT transactions, to a person who is so close in a relation to justify the existence of a delictual duty of care.

6.4.2 [a] [ii] [2] Banks' Negligent Misrepresentation.

A bank's misrepresentation is a ground for a cause of action for damages in

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[123] Generally, see Burrows, Remedies for Torts and Breach of Contract (1987) at 161.

[124] The oft-quoted words of Lord Blackburn in *Livingstone v. Rawyards Coal Co.* (1880) 5 App. Cas. 25, 39. Those words have been restated by: Viscount Dunedin in *Admiralty Commissioners v. S.S. Valeria* [1922] 2 A.C. 242, 248; Lord Wright in *Liesbosch Dredger (Owners) v. S.S. Edison (Owners)* [1933] A.C. 449, 463; Lord Scarman in *Lim Poh Choo v. Camden and Islington Area Health Authority* [1980] A.C. 174, 187.

[125] As firstly stated by Parke B., in *Rebinson v. Harman* (1848) 1 Exch. 850, 855. Cited with approval by Lord Dunedin in *Watts v. Mitsui* [1971] A.C. 277, 241; Lord Pearce and Lord Upjohn in *Czarnikow v. Koufos* [1969] 1 A.C. 350, 414 and 420 respectively. For cases restated this principle see McGregor on Damages, supra, par.11, in particular fn.40.

[126] Burrows, Remedies for Tort and Breach of Contract (1987) at 162.

delict where such misrepresentation is made fraudulently, e.g. deceit, or negligently, e.g. negligent misrepresentation.

A bank, although rarely, may fraudulently misrepresent certain facts to others, customers or not. In this case if a person is induced to enter into a contract, by fraudulent misrepresentation, he could sue the deceiver, e.g. a bank, in fraud for the recovery of his losses.[127] The measure of damages for fraudulent misrepresentation is the recovery of all losses including the unforeseeable losses, subject to them not being too remote.[128] However, it is the negligent misrepresentation which is more likely to occur in banking transactions. Until 1963, if a person negligently misrepresents (no fraud involved) certain facts to another, which results in some financial losses, he had no action for damages at all, unless he could raise it into a warranty or a collateral contract.[129] This has been changed now after the House of Lords' decision in the English case of *Hedley Byrne & Co. v. Heller & Partners.*[130] In that case, a bank, upon request, wrote to an advertising agent, who was not the bank's customer (third party) a statement about the financial standing of one of the bank's customers, with whom the advertising agent intended to do business. The careful bank replied that its customer was trustworthy in a letter which included "without responsibility on our part". Relying on such statement, the advertising agent placed advertisements for the bank's customer who went into liquidation without paying the money. In a case for recovery of damages from the bank for negligently misstating the financial standing of its client, the advertising agent failed to recover

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[127] See *Derry v. Peek* (1889) 14 A.C. 337. In Scotland, see *Manners v. Whitehead* [1898] 1 F. 171.

[128] *Doyle v. Olby (Ironmongers)* [1969] 2 Q.B. 158. This case was recently applied by the Court of Appeal in *Royscot Trust Ltd. v. Rogerson* [1991] 2 Q.B. 297.

[129] *Heilbut v. Buckleton* [1913] A.C. 30.

[130] [1964] A.C. 465. The rule of *Hedley Byrne Ltd. v. Heller & Partners Ltd.*, is also applicable in Scotland. See *John Kenway Ltd. v. Orcantic Ltd.* [1980] S.L.T. 46, per Lord Dunpark.

his "purely economic loss" which resulted from such negligent misstatement. The basis for such failure was the express disclaimer of responsibility by the bank.[131] However, the plaintiff could have succeeded in its claim if the bank had not expressly disclaimed liability. This decision suggests that a pursuer is entitled to recover "pure economic losses" if resulting from negligent statements made by a person with whom the pursuer has special relationship. This case opened the door for the recovery of one's "pure economic loss" from banks if resulted from negligently misstating certain facts. However, the case suggests that there must be a special relationship between the two parties to justify a "reliance" by the pursuer on the bank's advice or statement. The party who supplies the information must also know that his information is going to be relied upon by the other party.[132] Liability for negligent misrepresentation is governed now by statute in Scotland[133] and England.[134]

The measure of damages in this case depends on what the compensatory principle here requires. It was rightly said that as the loss sustained by the defender resulted from a false statement misleading the pursuer, the pursuer must be placed "into as good a position as if no statement misleading him had been made".[135] This is because the measure of damages for negligent misrepresentation is the delictual measure rather than the contractual measure. Thus, the aim of awarding damages in this case is not, and should not be, to put the pursuer in the position he would have

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[131] It is argued that the exclusion of *Hadley Byrne* duty should be subject to the limits of § 2(2) of The Unfair Contract Terms Act 1977. See Clerk & Lindsell on Torts (16th ed. 1989), at para. 10-28. In Scotland see Clarke, Unfair Contract Terms Act 1977: A Revolution in the Law of Contract [1979] S.L.T. (News) 26 (disclaiming liability as in *Hadley Byrne* case is not caught by the provisions of the Unfair Contract Terms Act 1977).

[132] See *Caparo Industries Plc. v. Dickman* [1990] 2 W.L.R. 358, per Lord Oliver, at 587, per Lord Bridge, at 576 (Their Lordships discussed the requirements for establishing such special relationship). See also Lord Denning M.R. in *McInerny v. Lloyds Bank* [1974] 1 Lloyds Rep. 246, at 253-254

[133] § 10 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985. Thus, the rule of *Manners v. Whitehead* has been abolished.

[134] § 2 of the Misrepresentation Act 1967.

[135] Burrows, Remedies for Tort and Breach of Contract (1987) at 150.

been in had the statement or the representation been true. Holding otherwise, would usually put the pursuer, i.e. the misrepresentee, in a better position than if no misstatement had ever been made and thus replacing the aim of damages from compensating the pursuer to punishing the defender. Three cases, at least,[136] support this argument.

First, *Esso Petroleum Co. Ltd. v. Mardon*.[137] In that case, a person was induced to enter into a contract for a lease of a petrol station from an oil company by a false statement by an experienced salesman on the company's behalf. The statement was concerning the potential throughput of petrol at that station. It was held by the Court of Appeal that the company was liable to pay damages to that person for its negligent misrepresentation. The measure of damages was not the loss of the misrepresented throughput of petrol (200,000 gallons a year), i.e. loss of bargain, but "the loss he suffered". As Lord Denning M.R put it, one "should look into the future so as to forecast what would have been likely to happen if he had never entered into the contract; and contrast it with his position as it now is, as a result of entering into it".[138]

Second, *Box v. Midland Bank Ltd.*[139] Here, a manager of one of Midland Bank's branches did mislead the plaintiff concerning his chances of getting a loan from the bank. Relying on the manager's statement, the plaintiff committed himself to other financial transactions. He suffered financial losses as a result of the

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[136] See also *Cornish v. Midland Bank Plc.* [1985] 3 All E.R. 513 (C.A.) (damages awarded for bank's negligent advice concerning the effect of the mortgage); *McInerny v. Lloyd's Bank* [1974] 1 Lloyd's Rep. 246 (C.A.); and *National Westminster Bank v. Morgan* [1985] 1 All E.R. 821 (H.L.).

[137] [1976] Q.B. 801.

[138] Ibid, at 821. Shaw L.J. agreed. However, Ormrod did not clearly adopt this approach, but his Lordship view on measure of damages is consistent with it.

[139] [1979] 2 Lloyd's Rep. 391.

inaccuracy of the manager's statement. In measuring the damages that the plaintiff was entitled to recover from the bank, the court held that the plaintiff was not entitled "to recover for loss of his bargain ... [i]nstead he ... is entitled to be put in the position he would have been in if the negligent misstatement had not been made".[140]

The last case, and the most recent, is *Royscott Trust Ltd. v. Fogerson.*[141] A dealer in motor cars misrepresented the amount of deposit that a buyer of a car should pay in its dealing with a hire purchase company. The customer reached an agreement with the dealer to buy a car on hire purchase agreement. The agreed price was £7,600 and the agreed deposit was £1,200 (less than 20% of the price). The hire purchase company had a policy of not entering into transactions in which a customer pays less that 20% of the purchase price. The dealer in its proposal to the hire purchase company stated that the total price was £8,000 and the deposit was £1,600 (20% of the price). There was no dispute that this amounted to misrepresentation, although it was not alleged that it was fraudulent. The buyer paid up to £2,774.76 and then dishonestly sold the car to a third party. He ceased to pay the hire purchase instalments and informed the company of the sale. The difference between the amount paid by the finance company to the dealer and the total amount of the instalments paid was £3,625.24. In a claim by the hire purchase company against the dealer for, *inter alia*, damages for innocent misrepresentation under § 2(1) of the Misrepresentation Act 1967, the judge assessed the damages against the dealer at £1,600 plus interest. He based his assessment on a sale of the care at a hypothetical price of £6,000, being the price for which the deposit of £1,200 actually paid would have been consistent with

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[140] Per Lloyd J., at 399.

[141] [1991] 2 Q.B. 297 (C.A.).

the finance company's policy.

On appeal by the dealer and cross-appeal by the hire purchase company, the Court of Appeal dismissed the appeal and allowed the cross-appeal holding that the measure of damages for innocent misrepresentation under § 2(1) of the Misrepresentation Act 1967, which was the tortious measure rather than the contractual measure, was the same as the measure for fraudulent misrepresentation rather than for negligence at common law. Thus the finance purchase company was entitled to recover damages in respect of all losses suffered by it as a result of the dealer's misrepresentation provided that they were not otherwise too remote.[142] The wrongful sale of the car by the customer to a third party was in any event reasonably foreseeable by the dealer causing loss to the finance purchase company. Thus, the sale was not a *novus intervenies* and did not break the chain of causation. Accordingly, the judge's order has been varied and a judgment for the hire purchase company against the delaer was granted for damages of £3,625.24 plus interest.

Thus, the hire purchase company was entitled to be placed in the position that it would have been in had the misrepresentation not been made, rather than the position that it would have been in had the statement been true.[143] This decision has taken a view contrary to a common statement expressed in a number of textbooks that

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[142] Applying *Doyle v. Olby (Ironmongers) Ltd.*, [1969] 2 Q.B. 158.

[143] See Burrows, Remedies for Tort and Breach of Contract (1987) at 150; Chitty on Contracts (26th ed.) para. 439; and McGregor on Damages, supra, par. 1745. See the recent decision of the House of Lords in *Swingcastle Ltd. v. Gibson* [1991] 2 A.C. 223 where the plaintiffs lent money to owners of a house charged to a building society in reliance on a surveyor's negligent valuation of the house. The owners fell into arrears with their repayments and become liable to a higher rate of interest. The plaintiffs subsequently took possession of the house, which they sold to a third party £6,000 less than the amount of valuation by the surveyor. They claimed damages against the surveyor for a negligent survey and obtained judgment in the county court for the sum plus interest. The Court of Appeal dismissed an appeal by the defendant. On appeal to the House of Lords, their Lordships held that "the principle was that the damages awarded should be such as would put the plaintiff as nearly as possible in the position that they would have been in if they had not sustained the wrong committed by the defendant; that in a case where, if a proper valuation had been made, the plaintiffs would not have lent the money on mortgage, they were not entitled to claim that the defendant by his negligence had deprived them of the contractual, including penal, interest that they had been entitled to recover from the owners; that the plaintiffs were entitled to be compensated at a proper rate of interest being deprived of £10,000 during an appropriate period and for their agents' and legal costs on the resale". See the headnotes of the case.

only foreseeable losses could be recovered for innocent misrepresentation.[144] This decision is a clear statement of the judicial view that the measure of damages for innocent misrepresentation is the same as that for fraudulent misrepresentation.[145]

Banks are held liable to pay damages for their negligent advice. In such case the above measure of damages in the case of negligent misrepresentation is applied. In *Cornish v. Midland Bank Plc.*,[146] Midland Bank, the defendant, had been negligent in discharging its duty to give the plaintiff proper advice concerning the effect of a mortgage signed by her; and in the way it had discharged such duty. Such negligence caused the defendant financial losses. Croom-Johnson L.J., delivering the leading judgment of the Court of Appeal affirmed the trial judge's decision in awarding the plaintiff damages for the loss that she suffered, plus interest. His Lordship said that the plaintiff's financial losses, and the interest, "flows from the defendant's negligent advice".[147]

6.4.1 [a] [iii] Reduction of Damages for Contributory Negligence.

The damages claimable from a bank may partly caused by the fault of the bank's customer himself in addition to the bank's fault. This may result from the customer's own negligence. However where such negligence does contribute to the losses of the customer the law will apportion the damages accordingly. This is statutorily stated by the Law Reform (Contributory Negligence) Act 1945. § 1(1) provides that:

"Where any person suffers damage as a result partly of his own fault and partly

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[144] Treitel (7th ed.) at 278; and Cheshire, Fifoot and Furmston (11th ed.) at 286.

[145] See the comment on the decision in [1991] 7 J.I.B.L. (News) 127. However, the court relied on the wording of § 2(1) of the Misrepresentation Act 1967 which is not applicable in Scotland.

[146] [1985] 3 All E.R. 513.

[147] Ibid, at 519. See also *McInerny v. Lloyd's Bank* [1974] 1 Lloyd's Rep. 246 (C.A.); and *National Wesminster Bank v. Morgan* [1986] 1 All E.R. 821 (H.L.).

> of the fault[148] of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility."

Once it is proven that a bank's customer is partly liable for causing the loss suffered, the court will reduce the award of damages to such extent as it thinks "just and equitable". This will be assessed according to the customer's degree of blame or blameworthiness. Denning L.J. in *Davies v. Swan Motor Co.*[149] said:[150]

> "Whilst causation is the decisive factor in determining whether there should be a reduced amount payable to the plaintiff, nevertheless, the amount of the reduction does not depend solely on the degree of causation. The amount of the reduction is such an amount as may be found by the court to be 'just and equitable,' having regard to the claimant's share in the 'responsibility' for the damage. This involves a consideration, not only of the causative potency of a particular factor, but also of its blameworthiness."

Whether damages recoverable for breach of contract can be reduced under this Act is a "controversial point".[151] The Act was passed with delictual and tortious rather than contractual liability in mind. Paull J. at first instance in *Quinn v. Burch Bros. (Builders)*[152] was prepared to accept the applicability of the Act to a contractual situation. This point was not decided on appeal. Again the judge of first instance in *De Meza and Stuart v. Apple, Van Straten, Shena and Stone*[153] applied the Act to a contract situation but the Court of Appeal left the point open. However, Neill L.J. in *A.B. Marintrans v. Comet Shipping Co. Ltd.*,[154] held that the Act was

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[148] § 4 defines "fault" as "negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence".

[149] [1949] 2 Q.B. 291 (C.A.).

[150] Ibid, at 326.

[151] As said by Roskill L.J. in *De Meza and Stuart v. Apple, Van Straten, Shena and Stone* [1975] 1 Lloyd's Rep. 498, 509 (C.A.).

[152] [1966] 2 Q.B. 370.

[153] [1975] 1 Lloyd's Rep. 498.

[154] [1985] 3 All E.R.

restricted to tortious liability.

It is suggested that since the definition of "fault" is wider in Scotland than England, there is stronger case in Scotland for saying that the Act can apply to a breach of contract.[155] This is because other liability is contemplated in the definition of "fault" in the Act. The phraseology of § 1(1) is not limited to delict or tort. Proviso (a) provides that "this subsection shall not operate to defeat any defence arising under contract". The phrase, as held by Paull J., could only relate to express contractual clauses governing the liability of the parties in the event of fault.[156] This argument can be supported by Lord Davidson's view in *Lancashire Textiles (Jersey) Ltd. v. Thomson Shepherd & Co. Ltd.*[157] that contributory negligence may be pleaded in a case of breach of contract, if such breach of contract can be described as constituting a wrongful act, breach of statutory duty or negligent act or omission as defined by the Act.

Thus, a bank can raise contributory negligence as defence against a claim for damages by its customer. The damages will be apportioned by the court depending on the degree of the customer's blame for the loss suffered. The Review Committee in its report recommended such apportionment of damages in case of unauthorised EFT provided that the court is "satisfied that the degree of negligence shown by the plaintiff is sufficiently serious for it to be inequitable that the bank should be liable for the whole amount of the ... damages".[158]

6.4.1 [b] Under U.S.A. Law.

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[155] McBryde, The Law of Contract in Scotland (1987) at para.20-27.

[156] *Quinn v. Bruch Bros (Builders)* [1966] 2 Q.B. 370, 377. See also McGregor on Damages at par.128 (where he agrees with Paull J.'s reasoning).

[157] [1986] S.L.T. 41.

[158] The Review Committee Report, supra, Recomm. No.6(1), at 155.

The situation is different under the American law. Damages recoverable for banks' failure to effect an EFT transaction is governed by legislation. The Federal EFTA has different measures of damages for different bank's failures to make an EFT in consumer-based transactions. U.C.C. § 4A regulates the measure of damages in wholesale credit transfer transactions. Before the introduction of this legislation, American Courts have utilised the measure of damages for breach of contract generally as applied in *Hadley v. Baxendale*.[159] In the absence of contract, courts have utilised the well-known concept of "reasonable foreseeability" to limit the recovery of special damages in tort actions to those which are a foreseeable consequence of the defendant's carelessness.[160] However, statutory rules have replaced these common law rules. The statutory rules differ according to whether the transaction is consumer based or commercially based one. This distinction is followed in the following discussion.

6.4.1 [b] [i] Damages Recoverable in Consumer-based Transactions.

6.4.1 [b] [i] [1] General.

EFTA adopts different measures of damages for different violations of its provisions. The application of a certain measure of damages rather than another depends on the nature of the violation of EFTA and not on the nature of the transaction. This does not mean that an aggrieved customer will neccessarily get the same amount of damages for the same violation of EFTA in all types of EFT. The same measure of damages is applicable in a certain violation of EFTA whether the

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[159] e.g., *Central Coordinates, Inc., v. Morgan Guaranty Trust Co.*, 129 Misc. 2d 804, 494 N.Y.S.2d 602 (Sup. Ct. N.Y. 1985) and *Compania Anonima Venezolana De Navegacion v. American Express International Banking Corp.*, No. 84 Civ. 2047 (PKL), W.L. 1898 (1985). See also *Evra Corp., v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982) cer. den'd, 459 U.S. 1017 (1982) where the Court of Appeals for the Seventh Circuit applied the second rule of *Hadley v. Baxendale* to deny a transferring bank's customer the recovery of consequential damages from an intermediary bank, although no contract did exist between the plaintiff and the defendant.

[160] The American leading authority is *Paslgraf v. Long Island R. Co.* 248 N.Y. 339, 162 N.E. 99 (1928).

transaction is electronic credit transfer, EFTPOS, or ATM transaction. Thus, where the discussion concerns a given measure of damages generally, it is applicable to the three commonly used EFT transactions, electronic credit transfer, EFTPOS and ATM and not restricted to electronic credit transfer. The three main violations of EFTA provisions are (i) banks' failure to make or stop an EFT; (ii) banks' failure to comply with the provisions of error resolution; and (iii) any person's failure, including banks, to comply with other provisions of EFTA generally. The measure of damages applicable in each case is discussed separately.

6.4.1 [b] [ii] [2] The Measure of Damages Applicable for Banks' Failure to Properly Make or Stop an EFT.

a- "All Damages Proximately Caused".

§ 1693h(a) provides that a bank is liable to a consumer for "all damages proximately caused" by its "failure to make an electronic fund transfer, in accordance with the terms and conditions of an account, in the correct amount and in a timely manner when properly instructed to do so by the consumer".[161] The same measure of damages is also applicable in another two situations. First, where the bank's failure to make an EFT was a result of "insufficient funds" caused by the bank's failure "to credit, in accordance with the terms and conditions of an account, a deposit of funds to the consumer's account which would have provided sufficient funds to make the transfer".[162] Second, if the bank fails "to stop payment of a preauthorized transfer from a consumer's account when instructed to do so in accordance with the terms and conditions of the account."[163]

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[161] 15 U.S.C. § 1693h(a)(1). See the exceptions for such failure in the same subsection.

[162] 15 U.S.C. § 1693h(a)(2).

[163] 15 U.S.C. § 1693h(a)(3).

The key phrase here is "all damages proximately caused". It is not defined by EFTA provisions, nor an indication is given as to the scope of recovery under such phrase.[164] "Proximate damages", however, are defined generally as "the immediate and direct damages and natural results of the act complained of, and such as are usual and might have been expected."[165] Direct or general damages are considered by definition to be "proximately caused" by the bank's failure to make an EFT.[166] Consequential damages, so long as "proximately caused" by the bank's failure to make or stop an EFT are recoverable by consumers.[167] Generally, whether any given head of consequential damages is proximately caused by the bank's failure to make or stop an EFT is a question of fact to be determined in each case.[168] The problem is, however, whether a given head of consequential damages is "proximately caused" by the bank's failure to make or stop an EFT. This is a question of law.[169] However, before a court will investigate whether a given head of consequential damages is "proximately caused" by the bank's failure to make or stop an EFT, it will consider two other related but distinct points. First, the consumer must show some causal connection, in fact, between the bank's failure to make or stop an EFT and the losses

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[164] As a matter of statutory construction courts should first look to the provisions of the statute in question itself. See Dow, Damages in EFTA, supra, at 7, citing *Howe v. Smith,* 452 U.S. 480 (1981); *California v. Sierra Club*, 451 U.S. 287, 294 (1981); *Northwest Airlines, Inc. v. Transport workers Union*, 451 U.S. 77, 91 (1981); *Diomond v. Chakrabarty*, 447 U.S. 303, 308, 315 (1980); *Brothers v. First Leasing*, 724 F.2d 789, 792 (9th Cir. 1984); *Ricci v. Ricci*, 96 N.J. Super. 214, 232 A.2d 709; and *Wisconsin Bankers Ass. v. Mutual Sav. & Loan Ass.* 96 Wis. 2d 438, 291 N.W.2d 869, 875 (1980).

[165] Black's Law Dictionary, (6th ed. 1990).

[166] See, generally, D. Dobbs, Handbook on the Law of Remedies, (1973), at 139.

[167] See Dow, Steven B., Damages under the Federal Electronic Fund Transfer Act: A Proposed Construction of Sections 910 and 915, [1985] 23 American Business Law Journal, 1, at 67 ("Using UCC section 4-402 as an analogue, the courts should construe "damages proximately caused" under EFTA section 910 [i.e § 1693h] expansively to allow the recovery of compensatory damages for a broad range of losses or injuries and should include consequential damages for pecuniary as well as nonpecuniary losses.) Hereinafter referred to as "Dow, damages in EFTA". See also Matthew Bender's Banking Law, Vol.8, supra, at 164.05[3][b] ("Proximate damages include amounts that may reasonably have arisen from the breach of duty, such as damages for injury to personal reputation.").

[168] See Stockmann, A Comparative Study, supra, at 223. U.C.C. § 4-402 explicitly provides that "[w]hether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case".

[169] See Dobbs, The Law of Remedies (1973) at 157-158; Prosser & Keeton on the Law of Torts (5th ed 1984), and 1988 Supp., para.42.

and injuries for which he seeks compensation. That is to say, the consumer's special or consequential losses or injuries must have been caused in fact by the bank's actionable failure.[170] If such losses or injuries would have occurred even in the absence of the bank's failure to make or stop an EFT, the consumer ordinarily is not entitled to recover.[171] Second, as a general rule, even if the consumer showed that his special or consequential losses or injuries have been caused by the bank's failure to make or stop an EFT, he is still under the burden of proving the amount of losses suffered with reasonable certainty.[172] Only after those two factors are satisfied, the court will consider the question, whether such actionable losses are "proximately caused" by the bank's failure to make or stop an EFT. Damages will be denied if the court found that the bank's failure was not a "proximate" or a "legal" cause[173] of the consumer's losses even if the other factors were met.

The recovery of consequential damages is always a critical issue in banking transactions. A bank which charges, for example, a few dollars for paying the insurance premium of its consumer customer's policy may find itself facing a claim of thousands of dollars if it fails to transfer the funds on time. Such a claim is usually based on the recovery of consequential losses resulting, in the above example, from the cancellation of the insurance policy. That is because any subsequent loss suffered

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[170] In a wrongful dishonour of a cheque the court in *Yacht Club Sales and Service, Inc. v. First Nat'l Bank of Idaho*, 623 P.2d 464, 101 Idaho 852 (Idaho 1980) held that even when wrongful dishonour of customer's cheque results not from mistake or inadvertence, but from wilful action of the bank, the customer must introduce evidence of damages proximately caused by bank's wrongful dishonour of its cheque in order to recover compensatory damages.

[171] See, generally, Prosser & Keeton, the Law of Torts, para.41; and Dobbs, the Law of Remedies (1973) at 148-150.

[172] See generally, Dobbs, The Law of Remedies, (1973), at 150-156.

[173] The term "proximate cause" is not the same as the "actual cause" or "causation". It is, as described by Prosser & Keeton, supra, at 300, a "method of limiting liability to those consequences which have some reasonably close connection with the defendant's conduct ... and are in themselves not so remarkable and unusual as to lead one to stop short of them." It is often called the "legal cause" to distinguish it from the "actual cause". The latter is one of causation while the former is one of legal policy. See for more detail Prosser & Keeton, The Law of Tort, supra, chapter 7; Dobbs, The Law of Remedies, supra, para.3.3; and the extensive literature cited by Prosser & Keeton, supra, para.41, at fn.1.

by the consumer would be uninsured.[174] However, if courts chose to restrict the recovery of consequential damages under § 1693h of EFTA, consumers may choose to use other methods of payment such as cheques in order to gain from the courts' expansive approach to award damages under U.C.C. § 4-402.[175] This will discourage the use of EFT systems as a new and fast method of payment.[176] However, it is likely that the American Courts will award consequential damages if "proximately caused" by the banks' failure to make or stop an EFT. This includes pecuniary and nonpecuniary losses. Such types of damages have been awarded by courts in cases of wrongful dishonour of cheques under the the same measure of damages.[177] There is probably no reason why courts should not construe the term "all damages proximately caused" under § 1693h of EFTA in the same way as they did under U.C.C. § 4-402.

b- "Actual Damages Proved".

Like the term "damages proximately caused", the term "actual damages" is not defined by the section in question, nor by EFTA in general.[178] There is also no indication in the EFTA of the scope of recovery under such term.[179] Further, it is

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[174] However, the consumer's obligation under the insurance policy to pay the premium on time, in the above example, would be suspended according to 15 U.S.C. § 1693j if the bank's failure to pay resulted from a system malfunction. This is, however, only in a system malfunction case and where the payee accepts payment by such method. It is obvious that this suspension of obligation does not cover other reasons of banks' failure to transfer funds, such as wrongful setoff.

[175] See for the recovery of damages in cases of wrongful dishonour of cheques, e.g. *Skov. v. Chase Manhattan Bank*, 407 F.2d 1318 (3d Cir. 1969); *Kendall Yacht Corp. v. United California Bank*, 50 Cal. App. 3d 951, 123 Cal. Rptr. 848 (1975); and *Murdaugh Volkswagen, Inc. v. First National Bank*, 801 F.2d 719, 2 UCC 2d 25 (4th Cir. 1986). See also e.g. White & Summers, Uniform Commercial Code, (3rd ed. 1988), para.18-4; Dow, Damages in EFTA, supra, at 52-61; Davenport, Wrongful Dishonor: UCC section 4-402 and the Trader Rule, [1981] 56 N.Y.U.L.Rev. 1117; and Holland, Analysis of the Legal Problems Resulting from Wrongful Dishonor, [1977] 42 M.L.R. 507.

[176] However, the other argument which may militate against such an expansive approach in awarding damages is that banks may increase their charges to cover such an unpredictable risk. This increase will eventually fall on consumers.

[177] See e.g., *In re Geri Zahn, Inc.*, 109 B.R. 497 (S.D.Fla. 1989) (any damages suffered by customer as proximate result); *Shaw v. Union Bank and Trust Co.*, 640 P.2d 953 (Okl. 1981) (consequential damages); *Morse v. Mutual Federal Sav. & Loan Ass'n of Whitman*, 536 F.Supp. 1271 (D.C. Mass. 1982) (damages proximately caused including mental suffering and loss of reputation); *Banjamin Franklin Sav. Ass'n v. Kotrla*, 751 S.W.2d 218 (Tex. App. 1988) (monetary damages and attorney's fees); and *Bank of Louisville Royal v. Sims*, 435 S.W. 2d 57 (Ky. 1968) (in a wrongful honour of a cheque the court held that "proximately caused damages" in effect means that a payer bank is liable for consequential damages proximately caused by wrongful dishonor of a cheque).

[178] No definition of such terms is found in 15 U.S.C. § 1693a which deals with definitions of terms used in EFTA generally.

[179] See 15 U.S.C. § 1693a (Definitions).

not defined in Regulation E nor in the Federal Reserve Board's explanation of the EFTA and Regulation E.[180] Courts may also look, in construing a statute, to analogous provisions within the same statutory framework, in particular those statutes dealing with the same subject.[181] The same measure of damages is used by other titles of Consumer Credit Protection Act.[182] Moreover, until the recent amendment of U.C.C. § 4-402, "actual damages proved" was the measure of damages for a mistaken wrongful dishonour of cheques.[183] It is argued that courts should draw an analogy between the measure of damages under § 1693h(c) of EFTA and that of the mistaken wrongful dishonour of cheques under the old version of U.C.C. § 4-402 rather than that of other titles of CCPA.[184] The measure of "actual damages proved" is used by U.C.C. § 4-402 to compensate banks' customers for wrongful dishonour of their cheques in mistaken cases. The purpose behind the enactment of § 1693h(c) of EFTA is to compensate consumers for banks' unintentional failure, which resulted from *bona fide* error, to make or stop an EFT. This is the functional equivalent of mistaken wrongful dishonour of cheques. In principle, the nature of injury

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[180] See the Federal Reserve Board's Official Staff Commentary to Regulation E and its recent amendments, 53 Fed. Reg. 11,046 (1988). The text is reproduced in Appendix B of 1991 Comulative Supp. No. 2 of Baker & Brandel, (2nd ed. 1988). It is also reproduced in Zimmer & Einhorn, The Law of Electronic Fund Transfer, vol. 1.

[181] The "*in pari materia* rule of statutory construction dictates that statutes dealing with the same subject, person, or thing should be construed with reference to each other and consistently". See Dow, Damages in EFT, supra, at 13, fn. 61 citing, e.g., *Erlenbaugh v. United States*, 409 U.S. 239 (1972); *Miami Dolphins, Ltd. v. Metropolitan Dade County*, 394 So.2d 981, 988 (Fla. 1981); *Undercofler v. L.C. Robinson & Sons Inc.*, 111 Ga. App. 411, 141 S.E.2d 847, 849 (1965); and *Gillespie v. City of Maroa*, 104 Ill. App.3d 874, 433 N.E.2d 688, 691 (1982). It has been, however, noted that it is generally not wise to place much weight on any particular rule of statutory construction because a contrary rule can easily be proffered. See Dow, Damages in EFTA, supra, at 13, fn.61; and Llewellyn, Karl, Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are To Be Construed, [1950] 3 Vand. L. Rev. 407.

[182] The Fair Credit Reporting Act, 15 U.S.C. § 1681n, and § 1681o; the Equal Credit Opportunity Act, 15 U.S.C. § 1691e; and the Fair Debt Practices Act, § 1692k; and the Truth in Lending Act, 15 U.S.C. § 1640. In addition to the recovery of certian specific damages, those titles used "actual damages sustained" as a measure of damages for recovery for any violation of the provisions of the particular act in general.

[183] The recent amendment of U.C.C. § 4-402 has repealed the distinction between mistaken and nonmistaken wrongful dishonour of cheques. See the Official Comment of the recent version of § 4-402.

[184] Dow, Damages in EFTA, supra, at 38-52.

contemplated by each section, and the reason behind the bank's failure, are the same.[185] This is not the same under the relevant sections of other titles of CCPA. The measure of "actual damages sustained" adopted by other titles of the CCPA is meant to guard against noncompliance with the provisions of these titles. The equivalent section under EFTA to these sections in these other titles of CCPA is § 1693m. More importantly, the legislative history of § 1693h of EFTA, as mentioned earlier, shows that the drafters intended that the section "would set the same standards of liability for financial institutions in EFT that now apply to checking under the Uniform Commercial Code".[186]

Using U.C.C. § 4-402 as an analogue, courts should interpret the term "actual damages proved" under § 1693h(c) of EFTA as they did in the old version of U.C.C. § 4-402. Thus, damages recoverable by a consumer for his bank's unintentional failure to make or stop an EFT, should include, in addition to direct damages, consequential damages for pecuniary and nonpecuniary losses if proved.[187] Recovery should be allowed for mental and emotional injuries if proved.[188] Moreover, recovery should be allowed, where appropriate, for the failure of the credit function of the EFT.[189] It is argued that an "approach which views the scope of recovery under the 'actual

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[185] See *Yacht Club Sales and Service, Inc., v. First Nat. Bank of North Idaho*, 623 P.2d 464, 101 Idaho 852 (1980) ("Mistaken dishonour" of cheque means wrongful dishonour done erroneously or "unintentionally", such as dishonours resulting from inadvertent bookkeeping errors and other "unintentional" employee errors); and *City Nat'l Bank of Fort Smith v. Goodwin*, 783 S.W.2d 335, 301 Ark. 182 (1990) (under statute allowing only actual damages where dishonour occurs through mistake, "mistake" is to be construed as limited to wrongful dishonour made in good faith). Those cases show that the reason for the application of the "actual damages proved" measure rather than "damages proximately caused" is the same in both mistaken wrongful dishonour of cheques, and banks' unintentional failure to make or stop an EFT.

[186] See the Senate Committee Report on Banking and Urban Affairs, Fair Fund Transfer Act, Senate Report No. 915, 95th Cong., 2d Sess., reprinted in 1978 U.S. Code Cong. & Ad. News 9403, 9417.

[187] Dow, Damages in EFTA, supra., at 74-75. Consequential damages are recoverable under the same measure of damages in the case of wrongful dishonour of cheques. See, e.g., *Kendall Yacht Corp., v. United California Bank*, 50 Cal. App. 3d 951, 123 Cal. Rptr. 848 (1975); *Skov v. Chase Manhattan Bank*, 407 F.2d 1313 (3ed Cir. 1969); *United States v. State Road Dept.*, 189 F.2d 591, 596 (5th Cir. 1951); and *First Nat. of Bellaire v. Hubbs*, 566 S.W.2d 375 (Tex. Civ. App. 1978).

[188] Recovery for mental and physical injury has been allowed for bank's wrongful dishonour of cheques. See, e.g., *Twin City Bank v. Isaacs*, 672 S.W.2d 651, 283 Ark. 127 (Ark. 1984). See also White & Summers, supra, at 783-784.

[189] Dow, Damages in EFT, supra, at 73.

damages' language of EFTA [§ 1693h(c)] more restrictively than the scope of recovery under the 'actual damages' language of UCC section 4-402 is an unjustifiable departure from the intended purpose of [§ 1693h(c)] and from the purpose of the EFTA itself".[190] Arguing for a narrative approach of § 1693h(c) would make a consumer's recovery in cases of failed EFT more restrictive than the scope of recovery in cases of wrongful dishonour of cheques. This may discourage the use of EFT as a payment system and encourage the use of cheques.

However, it is argued that "actual damages proved" under § 1693h(c) "will largely be confined to out of pocket pecuniary loss, absent a very clear showing of wanton and wilful violation of the EFT Act which resulted in palpable physical distress."[191] One cannot ignore the fact that the structure of § 1693h of EFTA shows two different measures of damages for different violations of EFTA provisions. Subsection (a) of that section allows a consumer to recover "all damages proximately caused" by his bank's failure to make or stop an EFT other than those resulted from a *bona fide* error. In the latter type of failure, subsection (c) allows the consumer to recover "actual damages proved". This indicates that the Congress intended to create a dichotomy between these two measures of damages. This is apparent from the wording of § 1693h and from the legislative history of the EFTA.[192] This argument, however, is not based on an interpretation of the scope of the "actual damages" measure, but on the view that there must be an intent to make a "dichotomy" between

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[190] Ibid, at 74.

[191] Fox, K. H., Another Step Toward The Cashless Society? The 1978 Federal Electronic Fund Transfer Act, [1980] 18 American Business Law Journal 209, at 220. Hereinafter referred to as "Fox, Cashless Society".

[192] See Fox, Cashless Society, supra, at 220. During the Congressional consideration of the EFTA, statements in a congressional committee report indicated that there was an intent to distinguish between "proximate damages" and "actual damages". See Senate Committee on Banking and Urban Affairs, Fair Fund Transfer Act, Senate Report No. 915, 95th Cong., 2nd Sess., reprinted in 1978 U.S. code Cong. & Ad. News 9403, at 9417. *C.f.* Dow, Damages in EFTA, supra, at 31-35, and 73-78.

"actual damages proved" and "damages proximately caused" measures. There is no doubt about such intention. Indeed, in a recent case that dealt with an interpretation of another issue in EFTA, the court held that "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."[193] However, this does not necessarily mean that the "actual damages proved" measure is confined to "out of pocket pecuniary loss" as argued by the restrictive interpretation approach.[194]

But, the question that remains is; how can one reconcile the expansive construction of the "actual damages proved" measure with the statutory language of § 1693h and the Congress' intent as explained by courts? This view acknowledges that "the concept of actual damages was intended to be somehow more restrictive than the concept of proximate damages".[195] This can be reconciled on the basis that "punitive damages" and "presumed damages" are not recoverable under the "actual damages" measure, but are recoverable under the "proximately caused damages" measure.[196] "Punitive damages" are recoverable when there is, *inter alia*, an intent to cause the loss to consumers, and with the knowledge that such action was wrongful. Indeed, it is the absence of "intent" behind the bank's failure to make or stop an EFT that introduced the "actual damages proved" measure as an exception to the general measure of "damages proximately caused" in other types of failure.[197] Moreover, a

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[193] *Kashanchi v. Texas Commerce Medical Bank, N.A.*, 703 F.2d 936 (5th Cir. 1983); and *Abyaneh v. Merchants Bank*, 670 F. Supp. 1298 (M.D. Pa. 1987). This holding in relation to EFTA is merely stating the law of statutorily construction generally. See *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972).

[194] Fox, Cashless Society, supra, at 219-221.

[195] Dow, Damages in EFT, supra, at 76.

[196] Ibid, at 74-75.

[197] With an exception of bank's failure to make an EFT caused by acts of God and technical malfunction, where no damages are recoverable. See U.S.C. § 1693h(b).

survey of the measures of damages in all titles of CCPA reveals that it is a general trend to award either punitive damages or statutory ones in one section. And, since no statutory damages are awarded in § 1693h, it is expected that a consumer may be entitled to such damages under the "damages proximately caused" measure, but not under the "actual damages proved" measure since the latter is only applied if the bank's failure "was not intentional".[198] The other distinction between the two measures of damages is that "presumed damages" are not allowed under § 1693h(c) without proof. However, it is arguable that such damages are recoverable under § 1693h(a) without proof. It is argued that by limiting damages to "actual damages proved" for mistaken dishonour, the former U.C.C. U.C.C. § 4-402 abolished what is called the "trader rule" in mistaken dishonour cases, and retained it in nonmistaken dishonour cases.[199] However, even if the language of § 1693h(a) encompasses the recovery of "presumed damages" under the "trader rule" it is doubtful that such interpretation has any practical effect. This is so, because EFTA is a consumer protection act which does not cover business activities in the large sense of the term.[200]

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[198] Punitive damages are not recoverable, too, under the old version of U.C.C. § 4-402 in cases of mistaken wrongful dishonour. See, e.g., *Casco Bank & Trust Co. Bank of New York*, 584 F.Supp. 763 (D.C.Me. 1984) (punitive damages not recoverable unless bank's action was morally culpable or motivated by malice); *Hamilton County Bank v. Hinkle Greek Friends Church*, 478 N.E.2d 689 (Ind. App. Ct. 1985); *Luxonomy Cars, Inc., v. Citibank, N.A.*, 408 N.Y.S.2d 951, 65 A.D.2d 549 (1978); *City Nat. Bank of Fort Smith v. Goodwin*, 783 S.W.2d 335, 301 Ark. 182 (1990) (punitive damages was not awarded in absence of bad faith. Banks confusion of identities of two individuals with same first and last names which resulted in dishonouring of cheques); and *Twin City Bank v. Issacs*, 672 S.W.2d 651, 283 Ark. 127 (1984).

[199] This is the view adopted by White & Summers, 1988, supra, at 778-779, despite the Official Comment 3 of the former U.C.C. § 4-402, which rejects the "defamation *per se*" rule. The recent amendment of § 4-402 deletes in subsection (b) the reference to "mistake". The view of White & Summers has been mentioned by the official Comment of the recent § 4-402. It is setteled now both by the recent amendement of § 4-402 and its Official Comment that no presumed damages are recoverable. In particular, subsection (b) of § 4-402 by deleting the reference to "mistake" precludes any inference that § 4-402 retains the "trader rule".

[200] See the definition of "consumer" in 15 U.S.C. § 1693a(5). See also *Kashanchi v. Texas Commerce Medical Bank, N.A.*, 703 F.2d 936 (5th Cir. 1983); and *Abyaneh v. Merchants Bank*, 670 F. Supp. 1298 (M.D. Pa. 1987) (explaining, *inter alia*, the definition of "consumer" under EFTA).

6.4.1 [b] [i] [3] The Measure of Damages for Specified Error Resolution Violations.

A consumer, whose bank fails to comply with specified error resolution requirements is entitled to recover "treble" the "actual damages sustained by such consumer as a result of such failure".[201] The two situations that trigger the application of the measure of treble damages are:[202]

(i) Where a bank fails to provisionally recredit a consumer's account within ten busines-days after receiving notification of the error; and the bank either "did not make good faith investigation of the alleged error", or "did not have a reasonable basis for believing that the consumer's account was not in error".

(ii) Where a bank "knowingly and willfully concluded that the consumer's account was not in error when such conclusion could not reasonably have been drawn from the evidence available to the [bank] at the time of its investigation."

It is suggested that the relationship between § 1693h (providing for proximate damages for bank's failure to make or stop an EFT) and § 1693f(e) (providing for treble damages for bank's failure to resolve errors) "is not entirely clear".[203] It is argued that a customer may recover under both sections for the same bank's failure in appropriate circumstances.[204] Suppose that a bank fails to make an EFT because of insufficient funds in the consumer's account resulted by the bank's failure to credit, on time, a deposit to the consumer's account. The consumer is entitled to "all proximate damages caused" by such failure.[205] He is also entitled to "treble" the

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[201] 15 U.S.C. §§ 1693f(e) and 1693m(a)(1).

[202] 15 U.S.C. § 1693f(e).

[203] Matthew Bender's Banking Law, Vol.8, 1992 Supp., supra, at para. 164.05[3][c].

[204] Ibid.

[205] 15 U.S.C. § 1693h(a)(2).

"actual damages sustained" by him if the failure to credit the consumer's account was the result of the wilfull and knowing conduct of the bank.[206] If this view is correct, it is unjust to punish banks twice for the same fault. This, however, is open to courts to decide.

6.4.1 [b] [i] [4] The Measure of Damages Applicable for Bank's failure to Comply with EFTA's Provisions.

a- The General Rule.

Except for an error resolved in accordance with error resolution procedures under § 1693f and a bank's failure to make or stop an EFT under § 1693h, any person's noncompliance with any provision of EFTA entitles the aggrieved consumer, in an individual action, to "any actual damages sustained" by him as a result of such noncompliance, in addition to an amount not less than $100 nor more that $1,000.[207] The statutory limit increases in a class action to no more that "the lesser of $500,000 or 1 per centum of the net worth of the defendant".[208] Moreover, this measure of damages encompasses, in a successful action, "the costs of the action", together with "a reasonable attorney's fee as determined by the court".[209]

The provision of civil liability is a common feature of the titles of the CCPA. There is a provision in each title of the CCPA for the recovery of at least the "actual damages sustained" as a result of the violation of any provision of the particular title. § 1681n of the Fair Credit Reporting Act ("FCRA") provides that a consumer is entitled to "any actual damages sustained" by him, an amount of punitive damages as

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[206] 15 U.S.C. § 1693f(2). This example was given to support the argument raised above. See Matthew Bender's Banking Law, Vol.8, 1992 Supp., at para. 164.05[3][c].

[207] 15 U.S.C. § 1693m(a).

[208] 15 U.S.C. § 1693m(a)(1)(B).

[209] 15 U.S.C. § 1693m(a)(3).

the court may allow, and in the case of a successful action the costs of the action together with a reasonable attorney's fees, if the violation of title's provisions was wilfully. In case of negligent noncompliance with the provisions of the title, a consumer is entitled to recover all the damages recoverable under the wilful noncompliance except the punitive damages.[210] § 1691e of the Equal Credit Opportunity Act ("ECOA") provides, in part, that "[a]ny creditor who fails to comply with any requirement imposed under this [title] shall be liable to the aggrieved applicant for any actual damages sustained by such applicant acting either in an individual capacity or as a member of a class." An amount not greater than $10,000 can be awarded as a punitive damages in addition to any actual damages sustained.[211] § 1692k of the Fair Debt Collection Practices Act ("FDCPA") provides that "any debt collector who fails to comply with any provision of this [title] with respect to any person is liable to such person in an amount equal to the sum of- (1) any actual damages sustained by such person as a result of such failure"; (2) an additional amount of not more than $1,000 in the case of any action by an individual; or, in the case of a class action, an amount not more than the lesser of $500,000 or 1 per centum of the worth net of the debt collector; and (3) the costs of the successful action, together with a reasonable attorney's fee as determined by the court. However, a debt collector may not be held liable for such damages if he "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to

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[210] 15 U.S.C. § 1681o.

[211] 15 U.S.C. § 1691e(b) (ECOA). However, in the case of a class action, the total amount recoverable should not exceed the lesser of $500,000 or 1 per centum of the net worth of the creditor. Punitive damages are not applicable if the creditor who fails to comply with ECOA is a government or a governmental subdivision or agency. See 15 U.S.C. § 1691e(b).

avoid any such error".[212] § 1640 of the Truth in Lending Act provides that any creditor who fails to comply with the Act with respect to any person is liable to such person in an amount equal to the sum of "any actual damage sustained by such person as a result of the failure". Such a creditor is also entitled to recover statutory damages, the amount of which depends, *inter alia*, on whether it is an individual or class action and the costs of any successful action together with a reasonable attorney's fee as determined by the court.

This shows that it is a general policy of the Consumer Credit Protection Act to allow the consumer aggrieved by a violation of the given title of CCPA to recover, at least, "any actual damages sustained". This measure of damages is mainly introduced to ensure the compliance with the provisions of the different titles of the CCPA.

b- The Scope of Recovery.

It is suggested that courts may rely on the judicial constructions of the damages provisions in other titles of the CCPA as an appropriate analogues for determining the scope of recovery under § 1693m of EFTA.[213] Several reasons support this proposition. First, like other titles, EFTA is part of the CCPA. The rules of statutory construction support the use of damages provisions in other titles as a guidance for the construction of EFTA damages provision.[214] Second, such construction would promote uniformity between the different titles of the CCPA since all of them create federal rights to consumers. This uniformity would not be achieved by relying on state law. Third, the structural and functional similarity between §

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[212] 15 U.S.C. § 1692k(c).

[213] Dow, damages in EFT, supra, at 19.

[214] See Dow, Damages in EFTA, supra, fn.61 and the authorities cited therein.

1693m of EFTA and other civil liability provisions in CCPA titles shows that this section was modelled on these other provisions.[215] Fourth, in construing provisions of the CCPA, courts have typically looked at analogous provisions in the CCPA. This is, in particular, the case in damages provisions. As a matter of judicial precedent, the court in *Greene v. Rash, Curties & Ass.*,[216] in construing the damages provisions under FDCPA, has discussed *Millstone v. O'Hanlon Reports, Inc.*,[217] which was a case for the recovery for mental anxiety alone under the FCRA. Thus, it is essential to discuss the scope of recovery for noncompliance with the relevant titles of the CCPA as interpreted by courts in order to shed some light on the scope of recovery under EFTA.

The noncompliance with the provisions of the FCRA, whether wilful or negligent, allows the aggrieved consumer to recover, at least, the "actual damages sustained" by such consumer as a result of the noncompliance. The courts have equated "actual damages" under FCRA with the term "compensatory damages", as distinct from "punitive" or "exemplary" damages.[218] The courts have construed the term "actual damages" under FCRA in an expansive way. Consumers have recovered damages for a vast area of out-off-pocket losses under "actual damages". A consumer recovered the increase on his insurance premiums which was caused by a false credit report by a credit reporting agency as actual damages.[219] A consumer who had to leave his employment in order to meet with a reporting agency as a result of its

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[215] Dow, Damages in EFTA, supra, at 19-21.

[216] 89 F.R.D. 314 (D.C.Tenn. 1980).

[217] 383 F.Supp. 269 (D.C.Mo. 1974), aff'd 528 F.2d 829 (8th Cir. 1976).

[218] *Rasor v. Retail Credit Co.*, 554 P.2d 1041, 87 Wash. 2d 516 (1976) ("actual damages" allowable under FCRA are not limited to out-of-pocket losses but, rather, generally encompass all the elements of compensatory awards). *C.f.*, *Franks v. Thomason*, 4 Banker. 814 (N.D. Ga. 1980) (where the court equated the term "actual damages" under FCRA with the term "general damages" without explanation why such narrative approach was taken).

[219] *Rasor v. Retail Credit Co.*, 554 P.2d 1041, 87 Wash.2d 516 (1976).

refusal to disclose information about him was entitled to recover travel expenses and lost wages or time off from work as actual damages.[220] Damages have been awarded for mental and emotional injuries under the civil liability provisions in FCRA. In an action against a credit reporting agency under FCRA civil liability provision, an amount of $8,000 was awarded as actual damages sustained for embarrassment and humiliation as a result of a consumer reporting agency negligently giving an inaccurate mortgage report on plaintiff. The court's view that such an amount was not excessive has been affirmed by the Appeal Court of the Sixth Circuit.[221] However, an award of $100,000 in compensatory damages arising from a credit bureau service's negligent violation of FCRA provisions was held to be excessive. The case was remitted with a condition that possible damages payable should not exceed $25,000 in the absence of evidence that a consumer suffered any out-of-pocket expenses and in view of realistic levels of consumer's humiliation and embarrassment.[222] The plaintiff in *Rasor v. Retail Credit Co.*,[223] was awarded $5,000 for loss to her personal reputation caused by a consumer credit report. Damages also awarded for mental anguish and loss of sleep and nervousness under FCRA.[224] Moreover, damages for future injuries of this nature is recoverable if sufficient evidence is supplied.[225]

It is noted that courts did not presume the recovery of any damages. Any

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[220] *Millstone v. O'Hanlon Reports, Inc.*, 383 F.Supp. 269 (D.C.Mo. 1974), aff'd 528 F.2d 829 (8th Cir. 1976). This case implied that a consumer may recover his medical expenses as actual damages if caused by willful violation of FCRA provisions.

[221] *Bryant v.TRW, Inc.*, 487 F.Supp. 1234 (D.C.Mich. 1980), aff'd 689 F.2d 72 (6th Cir. 1982). See also, *Thompson v. San Antonio Retail Merchants Ass.*, 682 F.2d 509 (C.A.Tex. 1982) (even when there is no out-of-pocket expenses, humiliation and mental distress constitute recoverable elements of damage).

[222] *Pinner v. Schmidt*, 805 F.2d 1258 (5th Cir. 1986), rehearing denied 812 F.2d 1405, *cer. den'd.* 107 S.Ct. 3267, 3276, 97 L.Ed.2d 766, 780.

[223] 554 P.2d 1041, 87 Wash.2d 516 (1976).

[224] *Millstone v. O'Hanlon Reporters, Inc.*, 383 F.Supp. 269 (D.C.Mo. 1974), aff'd 528 F.2d 829 (8th Cir. 1976).

[225] *Bryant v. TRW, Inc.*, 487 F.Supp. 1234 (D.C.Mich. 1980) aff'd 689 F.2d 72 (6th Cir. 1982).

actionable loss should be proved.[226] This requirement has been relaxed in actions for the recovery of mental and emotional losses.[227] The plaintiff in such actions can succeed in his action if he shows that there is a causal connection between the defendant's noncompliance with the FCRA and the losses for which damages are sought.[228]

A creditor who does not comply with the provisions of ECOA is liable, at least, to the aggrieved applicant for any "actual damages sustained" by the applicant. Out-of-pocket monetary losses have been recovered as actual damages under § 1691e of ECOA.[229] Moreover, non-pecuniary losses such as harm to consumers' financial reputation, e.g. creditworthiness, was held to be a compensable item under § 1691e of ECOA.[230] Damages have been awarded for embarrassment, humiliation and mental distress caused by a denial of credit.[231] The recovery of such non-pecuniary losses is not presumed. Like the case in FCRA, actionable losses or injuries must be proved.[232]

A debt collector that fails to comply with the provisions of FDCPA is liable for any "actual damages sustained" by the debtor concerned. The courts interpreted the term "actual damages" in an expansive way as they did in FCRA and ECOA. Out-of-

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[226] See *Bryant v. TRW, Inc.*, supra; and *Rasor v. Retail Credit Co.*, supra.

[227] *Ackerley v. Credit Bureau of Sheridan, Inc.*, 385 F.Supp. 658 (D.C. Wyo. 1974) (where it was said that this type of actual damage does not need to be proved, only that it not be speculative).

[228] In *Bryant v. TRW*, supra, the jury's instructions required a finding that damages were proximately caused by the defendant's act. In *Rasor v. Retail Credit Co.*, supra, the court required that the compensable items of damage be the natural consequences of the defendant's acts.

[229] *Fischl v. General Motors acceptance Corp.*, 708 F.2d 143 (5th Cir. 1983); and *Anderson v. United Finance Co.*, 666 F.2d 1274 (9th Cir. 1982).

[230] *Shuman v. Standard Oil Co. of California*, 453 F.Supp. 1150 (D.C.Cal. 1978).

[231] Ibid. See also, *Fischl v. General Motors acceptance Corp.*, supra; and *Anderson v. United Finance Co.*, supra.

[232] See *Sayers v. General Motors Acceptance Corp.*, 522 F.Supp. 835 (W.D.Mo. 1981); and *Shuman v. Standard Oil Co.*, supra. However, in *Sayers* case, supra, at 841, the mere testimony of the plaintiff that she suffered embarrassment and humiliation was sufficient to support an award of actual damages.

pocket pecuniary losses are recoverable as actual damages.[233] Moreover, courts awarded damagers for emotional distress and anguish.[234]

Having discussed the scope of the recoverable damages under the relevant titles of the CCPA, one should now discuss what are the recoverable heads of damages for the noncompliance with the provisions of EFTA.

If the courts were to adopt the same construction of the term "actual damages" as it was interpreted under other titles of CCPA, they should generally allow damages for a vast area of losses and injuries caused by the violation of the different provisions of the EFTA. These should include out-of-pocket pecuniary losses such as banks' service charges, and other expenses, as well as non-out-of-pocket losses including mental and emotional injuries. It it suggested that no special restrictions should be imposed on the recovery of consequential damages.[235] In fact, most of the damages sought by consumers under EFTA would be classified as consequential. The denial of the recovery of consequential damages by courts would mean, in practice, a severe restriction on the scope of recoverable damages available to consumers under EFTA.[236]

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[233] *Harvey v. United Adjusters*, 509 F.Supp. 1218 (D.C.Or. 1981). It seems that there are not many reported cases on this issue to support this proposition, probably because of the nature of the potential losses between the debtor and the debt collector, or because of the failure to prove the loss sustained. See for the latter reason, *Carrigan v. Central Adjustment Bureau*, 502 F.Supp. 468 (D.C.Ga. 1980). See also Dow, damages in EFTA, supra, at 30.

[234] *Venes v. Professional Services Bureau, Inc.*, 353 N.W.2d 671 (Minn. App. 1984) (debt collector threatened debtors and attempted to collect interest not owed to underlying creditor); *Carrigan v. Central Adjustment Bureau, Inc.*, supra, (debt collector contacted debtor after being notified to cease further communication).

[235] Dow, Damages in EFTA, supra, at 32.

[236] Take for example, an error by a bank to credit a consumer wages to his account. If the consumer informs his bank about the error, the bank is bound to provisionally recredit his customer's account within ten days by the amount alleged to be in error until the bank finishes its investigation. Assume that the bank fails to do so. By not doing so, the bank violates EFTA, and is liable to pay damages under § 1693m. The consumer in this example will be left without money for his basic living expenses. He may suffer consequential losses such as cancelling his insurance policy, or even his lease. It is argued that such a consumer should recover his consequential losses under the term "actual damages". Dow, Damages in EFTA, supra, at 34. Arguing otherwise would in practice diminish the EFTA's aim as a consumer protection legislation. *C.f.* Miller & Scott, Commercial Paper, Bank Deposits and Collections, and Commercial Electronic Fund Transfers, [1982] 38 Bus. Law. 1129 (where it is argued that allowing consequential damages would discourge banks from handling EFT services since "no bank would handle for $3.25 a transaction entailing potential liability in the millions of dollars," at 1129, fn.22). This was, too, the view of the court in *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, *cer. den'd.*, 103 S.Ct. 377 (7th Cir. 1982). The answer to the above counter argument is that the transaction in the above case, which the learned writers have relied on, is a commercially-based transaction and not

There are many potential violations under EFTA which entitle consumers to recover damages under § 1693m of EFTA. These include, but are not limited to, the following violations:[237] failure to provide a consumer with adequate documentation of the EFT;[238] failure to provide a consumer with a periodic statement of account;[239] improper issuance of cards and other means of access;[240] failure to disclose, in a readily understandable language, the terms and conditions of EFT at the time when a consumer contracts for an EFT;[241] failure to notify a consumer, in writing,[242] of any change in any term or condition of his account at least twenty one days prior to the effective date of that change unless a security risk requires the delay of such notification;[243] failure to send a notice of credit to a consumer in a preauthorised EFT, either a positive one when the credit is made as scheduled, or a negative one when no credit is made as scheduled;[244] and unauthorised disclosure

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a consumer-based transaction. Consequential damages in the latter type of transactions do not reach figures like those in commercially-based transactions. EFTA was basically enacted to deal with accounts that are used primarily for personal, family, and household purposes. Although, a business and commercial losses may result under EFTA, such losses are likely to be restricted to a small family business. Moreover, consequential losses are held to be recoverable in the cases of wrongful dishonour of cheques although banks customers pay small charges for such service comparing with the risk that banks face in such cases, e.g., consequential damages.

[237] See for the scope of "failures to comply" with EFTA provisions, *Bisbey v. National Bank*, 793 F.2d 315, 253 U.S.App.D.C. 244 (D.C.Cir., 1986). There the United States Court of Appeals for District of Columbia Circuit has clarified the relationship between those bank's failures to comply with EFTA that trigger the application of civil liability (§ 1693m) and those that trigger other measures of damages, e.g., treble damages, § 1693f(f). The court held that "under the plain terms of the Act, civil liability attaches to all failures of compliance with respect to any provision of the Act, including section 908 [§ 1693f]. An examination of other provisions of the Act supports this analysis. We note, for example, that section 908(e) specifies certain egregious violations of section 908 which would result in an award of treble damages, such as a failure to provisionally recredit a consumer's account while simultaneously failing to perform a good faith investigation. The singling out of these particular violations and their focus on willful unlawfulness for an award of treble damages suggests that other failures to comply with the statute in the application of section 908 give rise to standard civil liability." Ibid, at 317-318.

[238] 15 U.S.C. § 1693d(a).

[239] 15 U.S.C. § 1693d(c).

[240] 15 U.S.C. § 1693i.

[241] 15 U.S.C. § 1693c(a).

[242] *Bisbey v. D.C. National Bank*, 793 F.2d 315, 253 U. S. App. D. C. 244 (D.C.Cir. 1986) (oral notification of the result of an error investigation did not satisfy this requirement, and the defendant was held liable under 15 U.S.C. § 1693m).

[243] 15 U.S.C. § 1693c(b). See *Feinman v. Bank of Delaware*, 728 F.Supp. 1105 (D.Del. 1990), aff'd 909 F.2d 1475 (3rd Cir. 1990).(A bank may implement a change in the terms or conditions of the consumer's account without prior notice to the consumer concerned when such change was immediately neccessary for security of the consumer's account, e.g., not to overdraw the account without prior arrangement. Thus, failure to send notice in such circumstance was held to be not actionable under § 1693m). However, if such change is made permanent, subsequent notification is required. See 15 U.S.C. §§ 1693c(b) and 1693c(a)(3).

[244] 15 U.S.C. § 1693d(b).

of confidential information concerning the consumer's account to third parties.[245] Although the above violations are usually committed by banks, it is not necessary for a damages' claim under § 1693m that a violation should be committed by a bank. A consumer is entitled to recover under the measure of damages described in § 1693m if his employer, for example, conditioned his employment on opening an account with a given bank in order to remit his wages electronically to that bank.[246]

A consumer is entitled, if successful in his action under § 1693m, to recover the costs of the action together with a reasonable attorney's fee determined by the court.[247] By analogy with the recovery of attorney's fees under the other titles of the CCPA, one suggests that, in determining the reasonable attorney's fees recoverable under § 1693m of EFTA, courts should consider, *inter alia*, time and labour required, skill required, customary fee, whether fee was fixed or contingent, time limitations, amount involved and results obtained, experience, reputation and ability of attorney, undesirability of case, nature and length of professional relationship with client, and awards in similar cases.[248] It is not necessary that reasonable attorney's fee should

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[245] See 15 U.S.C. § 1693(c)(9).

[246] See 15 U.S.C. § 1693k which prohibits the compulsory use of EFT.

[247] *Bisbey v. D.C. National Bank*, 793 F.2d 315, 253 U.S. App.D.C. 244 (D.C.Cir. 1986). It was held in *Perez v. Perkiss*, 742 F.Supp. 883 (D.Del. 1990) that plaintiff was not barred from recovering reasonable attorney's fees under FDCPA merely because he was a member of legal services plan and services rendered on his behalf might have been provided without charge. However, it must be noted where an action was unsuccessful, the bank will be entitled to recover reasonable attorney's fees provided that the consumer's unsuccessful action was brought in "bad faith or for purposes of harassment". See 15 U.S.C. § 1693m(f). It is suggested that the "possibility of attorney fees being awarded to a successful defendant institution may be a mild deterrent to litigation." See Huber, S., Bank Officer's Handbook of Government Regulation, (2nd ed. 1989), at para. 22.05[c]

[248] *Smith v. Chapman*, 436 F.Supp. 58 (D.C.Tex. 1977), aff'd 614 F.2d 968 (where successful plaintiff in action under the Truth-in-Lending Act has been awarded $3,500 as reasonable attorney's fee to be recovered from defendant, where attorney's, whose practice was primarily limited to consumer law, spent approximately 100 hours on the case, which involved several novel questions requiring an anusual amount of research, and plaintiff recovered the maximum amount allowable). See also *Bryant v. TRW, Inc.*, 689 F.2d 72 (C.A.Mich. 1982) (where it was held in an action under FCRA that calculation of fees in terms of hours of service is fairest and most manageable approach to awards of attorney fees of $13,705, calculated on hourly rate basis. The court refused to reduce the amount of the fees on theory that fees should be calculated on contingent basis); *Pinner v. Schmidt*, 617 F.Supp. 335 (D.C.La. 1985) (where a consumer agency in violation of the FCRA was found liable for award of $27,400 in attorney's fees computed as follows: 142 hours at $100 per hour, $5,000 for difficulty of case, $700 for skill in trial work, and $7,500 for amount involved and results obtained); and *Bhandari v. First Nat. Bank of Commerce*, 808 F.2d 1982 (5th Cir. 1987), 812 F.2d 936, on rehearing, 829 F.2d 1343 (where it was held that, in determining attorney's fees under ECOA, the district court was required to analyse time spent, claimed hourly rate, and degree of success in action; it could not rely on figures plucked from settlement negotiations).

Generally, American Courts have established rules for determining what is meant by "reasonable attorney's fees". The

be less than the amount of "actual damages" awarded.[249]

§ 1693m(b) of EFTA provides that courts should consider in determining the amount of damages payable to an individual consumer, among other things, the frequency and presistence of noncompliance, the nature of such noncompliance and the extent to which the noncompliance was intentional. In the case of a class action, courts should consider in addition to the above factors, the resources of the defendant and the number of persons adversely affected.

It is noted that the courts are uniform in requiring proof of loss or injury as a prerequisite for recovery under FCRA, ECOA, and FDCPA. Such evidentiary standards are relaxed when the damages sought are for mental or distress or other injuries which are not easily measurable. This standard should, by analogy, be extended to § 1693m of EFTA.[250] The recovery of "actual damages" is not a prerequisite for the recovery of the additional amount of the statutory damages under § 1693m of EFTA.[251] In *Bisbey v. D.C. National Bank*,[252] the United States Court

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Supreme Court and several circuit courts have established certain guidelines in determining the amount of the fees to be awarded. See for what is commonly known as the Lindy-Grinnell formula for awarding reasonable attorney's fees, Matthew Bender's Banking Law, Vol.8, 1992 Supp., at para. 164.05[3]f] and the cases cited thereon.

[249] *Bryant v. TRW, Inc.*, 689 F.2d 72 (C.A.Mich. 1982) (where in a successful action under FCRA plaintiff has been awarded $13,705 as attorney's fees, while recoverable actual damages was $8,000). However, it is important to note that if the plaintiff fails in his action he is not entitled to recover attorney's fees.

[250] Dow, Damages in EFTA, supra, at 34-35.

[251] It seems that there are no reported cases under EFTA to support this proposition. However, this is how courts construed the position in relation to the other CCPA titles which have the same scheme of damages. See under FDCPA, *Harvy v. United Adjusters*, 509 F.Supp. 1218 (D.C.Or. 1981) (to require that pecuniary damages be suffered as prerequisite to award of statutory damages would reduce effectiveness of FDCPA); and *Baker v. G.C. Services Corp.*, 677 F.2d 775 (9th Cir. 1982). Under the Truth-in-Lending Act, 15 U.S.C. § 1601 et seq, which provides for a measure of damages for civil liability similar in principle to that of EFTA, the courts consistently held that a finding of actual damages is not a prerequisite to the awarding of the additional damages. See, e.g., *Brown v. Marquette Sav. & Loan Ass.*, 686 F.2d 608 (7th Cir. 1982); *Dryden Budke's Arrow Fin.*, 630 F.2d 641 (8th Cir. 1980); *Postow v. OBA Fed. Sav. & Loan Ass.*, 627 F.2d 1370 (D.C.Cir. 1980); *Dzadovsky v. Lyons Ford Sales*, 593 F.2d 538 (3rd Cir. 1979); *Hinkle v. Rock Spring*, 538 F.2d 295 (10th Cir. 1976); *Redhouse v. Quality Ford sales*, 511 F.2d 230 (10th Cir. 1975); *Kramer v. Marine Midland Bank*, 557 F.Supp. 999 (S.D.N.Y. 1984); *Valentine v. Influential Sav. & Loan Ass.*, 572 F.Supp. 36 (D.C.Pa. 1983); *McCoy v. Salem Mfg. Co.*, 74 F.R.D. 8 (D.C.Mich. 1976); *Standish v. Hub Motor Co.*, 149 Ga. App. 365, 254 S.E.2d 416 (1979); *Lowery v. Fin. america*, 32 N.C.App. 174, 231 S.E.2d 904 (1977); *Smith v. Greater Houston Bank*, 580 S.W.2d 165 (Tex. Civ. App. 1979); *Davis v. Werne*, 673 F.2d 866 (C.A.Minn. 1982); *Frazee v. Seaview Toyota Pontiac, Inc.*, 695 F.Supp. 1406 (D.C.Conn. 1988). It should be noted that it is the policy of the CCPA that where a title awards punitive damages, it does not award a statutory damages. Thus, since EFTA provides for the recovery of additional statutory damages, in addition to "any actual damages sustained", it is analogous to the Truth-in-Lending Act and FDCPA which award statutory damages. No analogy has been made with FCRA and ECOA, so long as this point is concerned, since both of them do not award statutory damages, but instead provide for punitive damages in addition to the "actual damages sustained".

of Appeals held National Bank liable to a consumer customer for violating EFTA by giving an oral, rather than written, explanation of the results of investigation of the consumer's inquiry as to duplication of a preauthorised transfer of funds from her account; and by failing to inform the consumer of her right to request reproductions of documents relied on in properly concluding that there was no error.[253] The court awarded the conaumer statutory damages including attorney's fees for this technical noncompliance, although the consumer conceded that she had suffered no damage.

c- Exceptions and Defences.

The general rule discussed above has some exceptions. A person, including a bank, that satisfies one of these exceptions is entitled to use it as a defence against an action for damages by a consumer even if it does not comply with the provisions of EFTA. These exceptions are:

i. Inadvertent Errors.

§ 1693m(c) of EFTA provides that:

> "Except as provided in section 1693h of this title, a person may not be held liable in any action brought under this section for a violation of this subchapter if the person shows by a preponderance of evidence that violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to aviod any such error."

A bank that seeks such defence must establish that its noncompliance with the concerned section of EFTA (i) was not intentional; (ii) resulted from a *bona fide* error; and (ii) occurred notwithstanding the maintenance of procedures reasonably adapted to aviod the error concerned.[254] It is suggested that the last requirement represents

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[252] 793 F.2d 315, 253 U.S. App.D.C. 244 (D.C.Cir. 1986).

[253] In violation of 15 U.S.C. § 1693f(d).

[254] Matthew Bender's Banking Law, Vol.8, 1992 Supp., at para. 164.05[4][a].

"the most difficult element of the defence to establish".[255] It is noted that this requirement under other CCPA's titles has been construed narrowly by courts.[256] It was held under FDCPA that where a debt collector established that violation of the act was not intentional but did not establish that violation was a result of a bona fide errors of its agent, debt collector was liable.[257] By analogy with these titles, one expects that even if the noncompliance with EFTA's provisions was not intentional, and resulted from a *bona fide* error, courts will insist that the bank must show that it has reasonably adapted procedures to avoid such error.[258] Moreover, courts may find it is insufficient for a bank that does not comply with EFTA's provisions to prove that it maintained reasonable procedures to avoid the violation of the provisions of EFTA.[259] It was held that failure to offer sufficient training to employees amounted to not maintaining "procedures reasonably adapted to avoid any such error".[260]

ii. Good Faith Conformity.

§ 1693m(d) of EFTA exempts banks from liability for noncompliance with its provisions if the act or omission constituting such noncompliance was made in good faith conformity with Regulation E, any official interpretation of the Federal Reserve Board or any model clauses or forms adopted by the Federal Reserve Board.[261] It

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[255] Ibid.

[256] See Dow, Damages in EFTA, supra, at 35. For what constitutes *bona fide* error, see para. 4.2.2 [b] [i] [2].

[257] *Bingham v. Collection Bureau, Inc.*, 505 F.Supp. 864 (D.C.N.D. 1981).

[258] See *Mirabel v. General Motors Acceptance Corp.*, 537 F.2d 871 (7th Cir. 1976) (procedures adapted to detect errors were insufficient, thus the defence was not available although the noncompliance was not intentional as a result of *bona fide* error); and *Bingham v. Collection Bureau, Inc.*, 505 F.Supp. 864 (1981) (where a debt collector failed to satisfy the requirements of a similar defence under FDCPA because although the noncompliance was proved to be not intentional, no evidence was established that the violation was a *bona fide* error).

[259] *Carrigan v. Central Adjustment Bureau, Inc.*, 494 F.Supp. 824 (D.C.Ga. 1980) (A debt collection agency did not maintain procedures reasonably adopted to avoid an error of having further communication with a consumer who had sent a letter directing the agency to cease any further telephone communication with him, when an employee of the agency made a telephone call with the consumer to pay the debt).

[260] *Mirabel v. General Motors Acceptance Corp.*, 537 F.2d 871 (7th Cir. 1976)

[261] 15 U.S.C. § 1693m(d)(1).

is not clear whether the bank's noncompliance needs to be caused by its reliance on such rules in order to be entitled to the defence of good faith conformity. It is suggested that there is "no requirement ... under the E.F.T.A. or Regulation E that a financial institution must actually have relied on Regulation E or an interpretation issued thereunder in order to assert this defense."[262]

A bank is also exempted from liability for nonconformity with EFTA's provisions concerning disclosure in proper forms, if the bank "utilized an appropriate model clause issued by the Board".[263] This is a fair defence to banks, since it is unrealistic to shoulder banks with liability for the faults of the Federal Reserve Board. Thus, where a bank adopts and uses an appropriate model clause issued by the Board, which is found by courts to be invalid or in nonconformity with EFTA, the bank is exempted from liability.

This defence is available to banks even if the rule, regulation, or model clause that the bank has relied on is subsequently amended, rescinded or invalidated provided that the act or omission concerned was in conformity with such rule, regulation or model clause prior to its amendment, rescission or its subsequent invalidity.[264]

iii. Corrective Measures.

A bank can escape paying damages under § 1693m for noncompliance with the provisions of EFTA if it takes four corrective measures prior to the institution of an action for damages under § 1693m. These are: (i) notifying the consumer concerned of the noncompliance with the given provision of EFTA; (ii) ratifying the situation by complying with such provision; (iii) making the "appropriate adjustment to the

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[262] Matthew Bender's Banking Law, Vol.8, 1992 Supp, at para. 164.05[4][b].

[263] 15 U.S.C. § 1693m(d)(2).

[264] 15 U.S.C. § 1693m(d).

consumer's account"; and (iv) paying "actual damages, or where applicable, damages in accordance with section 1693h of this title."[265]

This defence is in fact to allow banks that discover an undisputed noncompliance with a given provision of EFTA to remedy the situation and thus save paying statutory damages and legal costs. It is expected that banks will not utilise such defence unless they are sure, beyond doubt, that the case is a losing one. That is because of the requirements that a bank must satisfy to utilise such defence, in particular, the payment of actual or proximate damages whichever is applicable. Potential bad publicity could be a reason for settling things outside courts by utilising this defence.

iv. Prescription.

An action for damages under § 1693m of EFTA prescribes "within one year of the date of the occurrence of the violation" of the provision concerned.[266] This one year limit is not dependable on the amount of damages in controversy. It is not always obvious when such violation starts. An example of this difficulty is where an error occurs in periodic statements mailed on a continuing basis. Does the prescription period run from the date of the occurrence of the violation in the bank's premises or rerun each time a periodic statement containing such error is mailed to the consumer.[267] What about failure to disclose information? Is it a continuing violation? It was held that failure to disclose information contrary to the Truth-In-Lending Act was not a continuing violation.[268] It is suggested that this holding could be, by

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[265] 15 U.S.C. § 1693m(e).

[266] 15 U.S.C. § 1693m(g).

[267] See Matthew Bender's Banking Law, supra, at para. 164.05[4][e].

[268] *Kristainsen v. John Mullins & Sons, Inc.*, 59 F.R.D. 99 (E.D.N.Y. 1973).

analogy, extended to EFTA.[269]

6.4.1 [b] [ii] Damages Recoverable in Commercially-based Transactions.

The recoverable damages for the receiving bank's breach of its execution duties under § 4A-302 depend on the nature of the bank's violation of its duties. Three possible violations are expected under the provisions of Article 4A. These are (i) the receiving bank's breach of its duty to execute payment orders pursuant to an express agreement or a funds transfer rule; (ii) the receiving bank's breach of its duty to execute properly; and (iii) the receiving bank's duty to execute timely.[270]

6.4.1 [b] [ii] [1] The Measure of damages for the Receiving Bank's Failure to Execute.

Since American banks are under no duty to accept a payment order unless they are contractually bound to do so by an express agreement[271] or a funds transfer system rule,[272] no damages are recoverable for failure to accept and execute such orders.[273] However, if a receiving bank entered into such an agreement, it incurs a contractual obligation based on the agreement and may be held liable for breach of contract if a failure to execute violates that agreement.[274] Where a receiving bank is bound by a fund transfer system rule to execute payment orders transmitted over the system, its failure to execute such payment orders constitutes a breach of that rule.[275] Losses suffered by a customer could be direct or indirect.

a- Direct Damages.

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[269] Matthew Bender's Banking Law, supra, at para. 164.05[4][e].

[270] This is the division made by § 4A-305. However, a duty to execute timely is included within the scope of the bank's duty to execute properly. It is probably the different type of losses expected that is behind such distinction.

[271] U.C.C. § 4A-212.

[272] The Official Comment 3 of U.C.C. § 4A-209.

[273] U.C.C. § 4A-212.

[274] The Official Comment 3 of U.C.C. § 4A-209.

[275] Ibid.

Article 4A, understandably, does not specify a measure of damages for a receiving bank's failure to execute a payment order contrary to a fund transfer system rule. This is left to the rules of the transfer system used. In FedWire system, for example, the payee's Reserve bank must indemnify the payer's Reserve bank for any loss or expense sustained as a result of the failure of the payee's Reserve bank to exercise ordinary care or to act in good faith.[276] In implementing the provisions of Article 4A, Subpart B of Regulation J states that a Federal Reserve bank may provide interest compensation for not implementing a payment order.[277]

However, where the receiving bank's failure to execute was made contrary to an express agreement between the bank and its sender, § 4A-305(d) provides for the measure of damages applicable. That subsection reads in full as follows:

> "If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable."

Thus, a customer is entitled to recover losses that directly caused by the bank's failure to execute his payment orders. These are (i) losses of interest;[278] (ii) expenses in the funds transfer; (iii) incidental expenses; and (iv) reasonable attorney's fees under certain circumstances.[279] The rate of interest payable may be determined by prior agreement between the transferring bank and its customer, or by applicable EFT

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[276] 12 C.F.R. § 210.38(c) (1985).

[277] 12 C.F.R. § 210.32 (1991). This was part of the Federal Reserve Board's comprehensive revision of Regulation J to make it consistent with Article 4A. This was effective since January 1, 1991.

[278] It should be noted that where a bank receives a payment order from a customer that is not bound to execute it must reject such order. See U.C.C. § 4A-210. Failure to do so exposes the bank to the payment of interest on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is cancelled pursuant to § 4A-211(d) (i.e. five days) or the day the sender receives notice or learns that the order was not executed. The final day of the period is counted as an elapsed day.

[279] U.C.C. § 4A-305(e).

system rule.[280] In the absence of a contractual rate or EFT system rule, the Federal Funds rate of interest applies.[281] Courts have considered different factors in awarding reasonable attorney's fees generally. These include, *inter alia*, time and labour and skill required, customary fee, whether fee was fixed or contingent, time limitations, amount involved and results obtained, experience, reputation and ability of attorney, "undesirability" of case, nature and length of professional relationship with client, and awards in similar cases.[282] The customer loses no principal sum, since its bank has completely failed to effect the transfer. However, if the bank, for one reason or another debits its customer's account by the amount of transfer, this amount is recoverable either as damages or under the provisions of Article 4A.[283]

b- Consequential Damages.

Where the bank is bound under an express agreement to execute a payment order, indirect losses caused by its failure to do so are not recoverable by its customer unless the bank had previously agreed expressly and in writing to be liable for such losses.[284] This approach rules out the applicability of the second rule of *Hadley v. Baxendale*. Thus, even if the bank is aware that its failure to carry out the payment order will cause its customer a substantial amount of loss, it will not be held liabile for consequential damages unless it expressly agreed in writing to be liable for such losses. This approach reflects the view that imposition of consequential damages on banks for commission of an error is not justified.[285] The leading common law case

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[280] U.C.C. § 4A-506(a).

[281] U.C.C. § 4A-506(b).

[282] By analogy with the factors that courts have considered as important in determining the amount of such head of damages in other statutes. See fn. 248 supra.

[283] The most important remedy under Article 4A provisions is the "money-back guarantee rule" of § 4A-402(c).

[284] U.C.C. § 4A-305(d).

[285] The Official Comment 2 of U.C.C. § 305.

on consequential damages in EFT transactions is *Evra Corp. v. Swiss Bank Corp.*[286] The defendant, the Swiss Bank, was an intermediary bank in a funds transfer originated by Evra. Although Swiss Bank had received a payment order from Evra's bank on its telex machine, it never processed this message either because it was not printed as the telex machine had run out of paper or because the massege was lost within the bank. The failure to execute the $27,000 payment order caused the cancellation of a valuable ship charter worth $2.1 million in lost profit. The trial court of the Northern District of Illinois held Swiss Bank liable on the negligence theory for breaching its duty of care to "institute a system for logging messages to insure that diverted messages (messages intended for other departments) were not lost or mishandled".[287] Thus, the court awarded Swiss Bank all the lost profits and costs as damages suffered.[288] On the crucial issue of foreseeability, the court held that "[t]he fact that the plaintiff was transferring funds by wire rather than through the mail was sufficient to alert Swiss Bank to the importance of the transaction,"[289] and that "Swiss bank, as a major international bank, could reasonably foresee that failure to act promptly upon receipt of such telex message could result in substantial damage to a customer of the bank."[290] Relying on *Hadley v. Baxendale*, the Court of Appeals of Seventh Circuit reversed on the basis, *inter alia*, that "consequential damages will not be awarded unless the defendant was put on notice of the special circumstances giving rise to them."[291] Swiss Bank may have known that the originator was paying a

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[286] 522 F.Supp. 820 (N.D. Ill. 1981), rev'd on Appeal, 673 F.2d 951 (7th Cir. 1982), *cer. den'd* 103 S.Ct 377 (1983).

[287] 522 F.Supp. 820, at 829 (N.D. Ill. 1981).

[288] Ibid.

[289] 522 F.Supp. 820, at 833 (N.D. Ill. 1981).

[290] Ibid.

[291] Per Posner J. in *Evra* case, 673 F.2d, at 955-956 (7th Cir., 1982) citing *Hadley v. Baxendale*.

shipowner for a hire of vessel but did not know that a favourable charter would be lost if the payment is delayed. The Appeal Court noted that "[e]lectronic payments are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer goes awry."[292]

If *Evra* case and later cases that affirmed its line[293] are taken to suggest that consequential damages are recoverable if the culpable bank has notice of particular circumstances giving rise to the damages, they do not provide, it is submitted, an acceptable solution to the problem of banks' liability for consequential damages in EFT transactions.[294] The drafters of Article 4A suggest that even if notice is received by higher management personnel, who could make an appropriate decision whether the risk is justified by the price, liability based on notice would require evaluation of payment orders on an individual bases. "This kind of evaluation is inconsistent with the high-speed, low-price, mechanical nature of the processing system that characterizes wire transfers."[295] Moreover, imposing consequential damages on banks for the relatively low cost of the transfer ignores the reality that bank's customers are in the best position to evaluate their own risks and protect against loss by allowing ample time for the transfer and then insuring that the payee received the funds. The drafters of Article 4A thinks that such precausions are often the most effective and the least expensive.

Thus, Article 4A adopts another approach to the recovery of consequential

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[292] Ibid, at 956.

[293] See *Central Coordinates, Inc., v. Morgan Guar. Trust Co.*, 129 Misc. 2d 804, 494 N.Y.S.2d 602 (Supp. Ct. N.Y. 1985); *Gatoil (U.S.A.), Inc. v. Forest Hill State Bank*, 1 U.C.C. Rep. Serv.2d 171 (D.Md. 1986); and *Compania Anonima Venezolana De Navegacion v. American Express International Banking Corp.*, No. 84-2047 Civ. (PKL), W.L. 1898 (S.D.N.Y. 1985).

[294] The view taken by the drafters of Article 4A. See the official Comment 2 of U.C.C. § 305.

[295] The Official Comment 2 of U.C.C. § 4A-305.

damages instead of the uncertain common law rule of *Hadley v. Baxendale*.[296] This approach is based on an insurance attitude. Additional damages, which include consequential damages, may only be recovered if, and to the extent, previously agreed upon by the parties in an express written agreement.[297] This is a sound policy since those customers who want to have a no-loss transfer may negotiate that with their bank without affecting the ability of EFT industry to effect payment at low cost and high speed. Such transfers are expected to be the exception and not the rule. It also respects the need of some customers, who are able to pay the price for a no-loss guaranteed fund transfer service. Banks are not harmed by allowing the recovery of consequential damages under these conditions since it is likely that the willing banks will price such kind of transfers proportionally to the risks undertaken. However, banks may find pricing such transfer difficult because of the unavailability of relevant statistics.

Subpart B of Regulation J, which as a Federal Regulation preempts Article 4A provisions, states that generally a Federal Reserve bank shall not agree to be liable to a sender, receiving bank, beneficiary, or other Federal Reserve bank for consequential damages.[298] This does not seem to prevent a commercial bank from reaching an express written agreement with its customer to be held liable for additional damages. However, this bank does not have a right of recourse against the Federal Reserve Bank if the transfer was implemented *via* FedWire system.

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[296] Supra. See Danzig, Hadley v. Baxendale: A Study in the Industrialization of the Law, [1975] 4 Journal of Legal Studies, 249 (the applicability of Hadley to the liability under a contract for the transmission of messages has always raised problems); Thevenoz L., Error and Fraud in Wholesale Funds Transfers: U.C.C. Article 4A and the UNCITRAL Harmonization Process, [1991] 42 Alabama L. Rev. 881 (the common law of Evra case and later cases as regards allocation of consequential losses in EFT transactions is considered both uncertain and unsatisfactory).

[297] See U.C.C. § 4A-305(d) as to the recovery of additional damages in the case of bank's failure to execute a payment order pursuant to an express agreement to execute. See also U.C.C. § 4A-305(c) for the same requirements for the recovery of additional damages, including consequential damages, in cases of bank's late or improper execution of a payment order.

[298] 12 C.F.R. § 210.32 (1991).

Where a customer reaches such an agreement with his bank to recover additional damages, he is not entitled to recover attorney's fees. The rationale given by the drafters of § 4A-305 is that "there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of damages which may or may not provide for attorney's fees."[299]

6.4.1 [b] [ii] [2] The Measure of Damages for the Receiving Bank's Improper Execution.

It is discussed earlier that a receiving bank, other than a beneficiary's bank, is under a duty to execute payment orders properly.[300] If the receiving bank, in a credit transfer transaction, improperly executes a payment order, contrary to its obligations under § 4A-302, it is liable to compensate its sender for losses caused by such improper execution.[301] § 4A-305(b) provides for a measure of damages for such improper execution.[302] This measure of damages is applicable where the improper execution results in either of the following cases. First; where the improper execution results in a noncompletion of the funds transfer. Second; where the improper execution results in a failure to use an intermediary bank designated by the originator. Third; where the improper execution results in issuance of a payment order that does not comply with the term of the payment order of the originator. The losses sustained by the sender could be direct or indirect.

a- Direct Damages.

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[299] The Official Comment 4 of U.C.C. § 4A-305.

[300] See the receiving banks' liability to execute properly in chapter two, para. 2.4.1 [b] [ii] [2]; and U.C.C. § 4A-302 (Obligations of Receiving Bank in Execution of payment Order).

[301] U.C.C. § 4A-305(b).

[302] Although strictly speaking, a delayed funds transfer constitutes an improper execution of a payment order, a different measure of damages is applicable to this special case of improper execution under Article 4A. See U.C.C. § 4A-305(a) (Late Execution).

The measure of damages adopted by § 4A-305(b) allows the recovery of the following direct damages: (i) the expenses of the funds transfer; (ii) the incidental expenses; and (ii) the interest losses.[303] Where the improper execution results in a delay in payment to the beneficiary in addition to one of the other results mentioned above, interest cannot be recovered twice; once for delay and again for failure to take the required action.[304] Reasonable attorney's fees are also recoverable if a demand for recovery of the other three heads of direct damages is made and refused by the bank before an action for recovery is brought by the sender.[305]

To prevent reduction of direct damages recoverable by banks' customers, U.C.C. § 4A-305(f) makes null any agreement between a bank and its customer to reduce these damages. Thus, the heads of damages listed above are the minimum that a sender of a payment order is entitled to recover for its bank's improper execution of its payment orders. This is an exception to the general policy of Article 4A which allows variation of its provisions by agreement, or EFT system rule.[306]

b- Consequential Damages.

A sender of a payment order may suffer consequential damages as a result of its bank's failure to execute properly. Following its policy over the recovery of consequential damages, Article 4A requires the express written agreement of the culpable bank to allow such damages.[307] Thus, whatever losses are caused by the bank's improper execution of payment orders, no consequential damages are recoverable without the express written agreement of the culpable bank; and to the

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[303] For the rate of interest applicable, see U.C.C. § 4A-506.

[304] U.C.C. § 4A-305(b). See Baxter & Bhala, Proper and Improper Execution, supra, at 1465.

[305] U.C.C. § 4A-305(e).

[306] U.C.C. § 4A-501(a).

[307] U.C.C. § 4A-305(c).

extent of that agreement. The policy behind such approach is the same as that discussed under the measure of damages for banks' complete failure to execute payment orders.

It must be noted that the bank's improper execution of a payment order, which triggers the recovery of the above direct and consequential damages, must result from the bank's breach of its duties to execute payment orders under § 4A-302. This is usually caused by some fault or error at the part of the bank. Thus, where the noncompletion of payment has resulted from an unauthorised payment order, the measure of damages discussed above is not applicable. The customer's remedies for unauthorised fund transfer is governed by § 4A-202. Moreover, where the noncompletion has resulted from a beneficiary's bank's refusal to accept the payment order, this measure of damages is not applicable too. In this case, the customer is entitled to be refunded its principal sum and interest thereon under the "money-back guarantee rule".[308]

6.4.1 [b] [ii] [3] The Measure of Damages for Delayed Transfer.

A receiving bank may breach its duties under § 4A-302 causing a delay in payment to the beneficiary. Whether, or not, payment is late is determined by whether the amount of the payment order is made payable to the beneficiary at his bank on the payment date.[309] If the amount of the payment order is made payable to the beneficiary but only after the specified payment date, the beneficiary will lose the use of money for the period of delay. The originator may suffer consequential losses such as those illustrated by *Evra* case.[310] Whether the originator is entitled to recover its

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[308] U.C.C. § 4A-402(c).

[309] U.C.C. § 4A-401 (Payment Date).

[310] Supra.

losses, either direct or consequential, depends on the measure of damages applicable.

a- Direct Damages.

§ 4A-305(a) provides for the measure of damages applicable to a delay in completion of a funds transfer resulting from the receiving bank's breach of its execution duties under § 4A-302. The only head of recoverable direct damages under this measure is interest. The receiving bank "is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution."[311] This amount of damages is payable to either the originator or the beneficiary. The normal practice is to compensate the beneficiary's bank so that it can compensate the beneficiary by back-valuing the payment by the number of days of delay.[312] This will put the payee in the same position that it would have been in had the funds transfer been completed on the payment date.[313] It is understandable that the bank is not liable to the originator for its expenses in the funds transfer and for incidental expenses since non is lost. The transfer is completed but late than its payment date.

Reasonable attorney's fees are also recoverable under certain circumstances.[314] These are recoverable only (i) if a demand for compensation is made and refused before an action is brought on the claim;[315] and (ii) no other additional damages are expressly agreed upon.[316]

b- Consequential Damages.

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[311] U.C.C. § 4A-305(a). For the rate of interest applicable, see U.C.C. § 4A-506.

[312] The Official Comment 1 of U.C.C. § 4A-305.

[313] Ibid.

[314] U.C.C. § 4A-305(e).

[315] Ibid.

[316] The Official Comment 4 of U.C.C. § 4A-305. The recoverability of additional damages is discussed in the next section.

The second rule of *Hadley v. Baxendale* as to the recovery of consequential damages is overruled by § 4A-305(c). No additional damages, including the consequential damages are recoverable unless the receiving bank that cases the delay as a result of its improper execution of the payment order expressly agreed in writing to be liable for such damages. The scope of recovery is determined by the terms of the express written agreement. The policy behind such approach has ben discussed under the measure of damages for the receiving banks' failure to execute payment orders.[317]

Two preconditions must be met for the application of the above measure of damages. First; the funds transfer should be completed by the late payment to the beneficiary. If payment is not made, this measure of damages is not applicable. The sender will be refunded its principal sum with interest thereon pursuant to the "money-back guarantee rule".[318] Second; the reason for the delayed transfer must be caused by the receiving bank's breach of its execution duties under § 4A-302. This will normally result from the receiving bank's failure to comply with either the execution date term, the payment date term or both.[319]

6.4.2 Damages Recoverable from Beneficiary's Banks.

6.4.2 [a] Under U.K. Law.

A beneficiary's bank normally acts, in credit transfers, as an agent of the beneficiary in receiving payment. It receives the payment order and credits the beneficiary's account by the amount of the payment order according to the transferring bank's or the intermediary bank's instructions. In doing so, it acts as a collecting bank.

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[317] See para. 6.4.1 [b] [2] [i] (Consequential Damages).

[318] U.C.C. § 4A-402(c).

[319] See U.C.C. §§ 4A-301 (Execution Date) and 4A-401(Payment Date).

It is liable under its contractual relationship with the beneficiary to take reasonable care in receiving the payment order and to credit his account by the amount of the order. If the bank negligently fails to do so, it may cause its customer loss. One example is where the beneficiary's bank negligently fails to acknowledge the receipt of a payment message transmitted *via* CHAPS. This means that such payment message will not be included in the settlement of payment messages between member banks that day. In effect no payment on that day will be made to the beneficiary. It is suggested that such loss "is likely to be limited to the amount which would have been credited to the customer if the intended payment had been properly completed. The customer's loss will be the amount of the payment he does not receive or, if the payment is in fact made later, his loss will be the use of that money (that is, the interest) for the period of delay."[320] This loss is reasonably contemplated by the two parties as not unlikely to result from the beneficiary's bank failure to properly receive the payment order, and credit the payment to the beneficiary's account.

A beneficiary, however, may suffer indirect losses. He may need the money immediately to enter into a tender, for example. The beneficiary's bank's negligence in taking the necessary steps to receive the payment order and credit the funds to the beneficiary's account on time may cause the beneficiary to lose the chance to win such tender. The question is whether the beneficiary is entitled to recover such losses and other similar losses from his bank. It is clear that such losses are consequential ones and not direct. As such, they are not recoverable unless the bank is aware in advance that if it fails to receive and credit the beneficiary's account by such an

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[320] Arora, Electronic Banking and The Law, at 74.

amount, the beneficiary will lose such a particular transaction.[321] Thus, if the beneficiary were to recover his consequential damages he has to inform his bank of the "special circumstances" surrounding the funds transfer, so the bank will be aware of the potential loss that it might suffer if it does not carry out its customer's instructions properly. However, the knowledge of the beneficiary's bank's need not always be actual. It could be an imputed knowledge.[322]

6.4.2 [b] Under U.S.A. Law.

The two main obligations of a beneficiary's bank when it accepts a payment order is to "pay"[323] the amount of the order to the beneficiary and, in certain circumstances, to "notify" the beneficiary of receipt of the payment order.[324] A beneficiary's bank is, generally, under no obligation to "accept" a payment order unless it is bound by an agreement to accept a payment order or deemed to have accepted it.[325] However, if the beneficiary's bank "accepts," or deemed to have "accepted" the payment order, it is under an obligation to "pay" the amount of the order to the beneficiary.[326] "Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business

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[321] This is the second rule of *Hadley v. Baxendale*, supra, which is applicable to such situations because the relationship between the beneficiary and his bank is contractual. Thus, if the bank breaches such contractual relationship by not collecting payment to its customer, the remoteness rule under *Hadley* case will apply. See also Arora, A., Electronic banking and the Law, at 74, where it is said that "if the intended payee [in an electronic credit transfer] informs the receiving bank [i.e., the beneficiary's bank] in advance that the expected payment is essential for the conclusion or carrying out of a transaction, or that the intended payee will suffer additional loss if payment is not received and credited promptly, it could be argued that he may recover the amount of the loss he actually suffers if payment is not completed because of the receiving bank's negligence or the defective condition of its equipment for which it is responsible."

[322] *Victoria Laundry* case, supra. See the discussion of this point under the damages recoverable from receiving banks. See also *Trans Trust SPKL v. Danubian Trading Co.* [1952] 2 Q.B. 297 (C.A.) (where the Court of Appeal allowed the recovery of lost profits caused by a breach of contract, since the circumstances of that contract indicate that such losses were in the contemplation of the parties when they entered into that contract).

[323] See for the circumstances in which a beneficiary is paid or deemed to be paid U.C.C. § 4A-405.

[324] U.C.C. § 4A-404(a) and (b).

[325] U.C.C. §§ 4A-212 (no duty to accept) and 4A-209(b)(1), (2) and (3) (when a beneficiary's bank accepts or deemed to have accepted a payment order).

[326] U.C.C. § 4A-404(a) (obligation of beneficiary's bank to pay beneficiary and when payment is due).

day of the bank, payment is due on the next funds-transfer business day."[327]

If a payment order, accepted by the beneficiary's bank, instructs payment to an account of the beneficiary, "the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date."[328] If the payment order does not instruct payment to an account of the beneficiary, notification is not obligatory unless the order requires such notification. If notice is required by the payment order, it may be given by first class mail, or "any other means reasonable in the circumstances".[329] The beneficiary's bank's failure to give notice as required obliges it "to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank."[330] This is the only head of direct damages recoverable from the beneficiary's bank for its failure to give notice of credit to the beneficiary as required.[331] However, "[r]easonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim."[332]

Consequential damages are not recoverable as a general rule from the beneficiary's bank for its failure to pay the beneficiary. However, there is only one exception to this general rule. A beneficiary who demands payment of the amount of the accepted payment order by his bank is entitled to recover any consequential damages caused by the bank's refusal to pay provided that the beneficiary has notified

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[327] U.C.C. § 4A-404(a).

[328] U.C.C. § 4A-404(a).

[329] U.C.C. § 404(b).

[330] U.C.C. § 404(b).

[331] Ibid.

[332] Ibid.

his bank of the "particular circumstances that will give rise to [such] consequential damages as a result of nonpayment".[333] This notice should state "the general type or nature of the damages that will be suffered as a result of the refusal to pay and their general magnitude".[334] It is not a requirement that a beneficiary's bank should have notice of the "exact or even the approximate amount of damages, but if the amount of damages is extraordinary the bank is entitled to notice of the fact."[335] The bank's only defence to escape paying consequential damages under these circumstances is to prove that it did not pay "because of a reasonable doubt concerning the right of the beneficiary to payment."[336] A beneficiary's bank cannot vary the measure of damages for its failure to "pay" the beneficiary by agreement or a funds-transfer system rule.[337]

It is not clear whether a beneficiary is entitled to recover interest on the amount of the payment order if he demanded payment but failed to give the bank notice of such damages, or to satisfy its requirements. The "notice of particular circumstances" is required and intended for the recovery of consequential damages. It is inconsistent with the policy of Article 4A if the recovery of interest is conditional on giving a notice of such loss to the beneficiary's bank if it refuses to pay the amount of payment order after demand. Holding otherwise would unjustly enrich the beneficiary's bank since it has accepted the payment order but refused to pay. Accordingly, the bank will have the use of the amount of the payment order. It is in the same section that a beneficiary needs not to give a notice of loss of interest to his

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[333] U.C.C. § 4A-404(a).

[334] The Official Comment 2 of U.C.C. § 4A-404.

[335] Ibid. See for an example modelled after the facts of Evra case with some modifications, the Official Comment 2 of U.C.C. § 4A-404.

[336] U.C.C. § 4A-404(a).

[337] U.C.C. § 4A-404(c).

bank in order to recover it, when the bank fails to give notice of the receipt of the payment order.[338] Moreover, this is probably not even covered by the measure of damages provided for in § 4A-305(a). There, it is stated that if the receiving bank's failure results in a delay in payment to the beneficiary, the bank is obliged to pay interest to the originator or the beneficiary for the period of delay. This delay, however, is a result of the receiving bank's failure to execute timely. The question here is a beneficiary's bank's failure to receive or take the required steps to effect the credit as instructed. The receiving bank, of course, is not liable to pay interest in this case if it does not breach its duties. The beneficiary will lose, at least, the use of money for the period of delay. He should recover such loss as a direct damages, which results "naturally" from his bank's breach of its duties.[339]

However, it appears that the measure of damages adopted by Article 4A in case of beneficiary's bank's failure to pay the beneficiary is preempted by Regulation CC of the Federal Reserve System.[340] § 229.10(b)(1) of Regulation CC provides that funds in electronic fund transfers should be made available to the beneficiary not later than the next business day of their receipt.[341] A bank that fails to comply with the the next-business day availability rule is liable for any "actual damages" that its customer has suffered.[342] Thus, one suggests that the beneficiary is entitled to

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[338] Compare the recovery of interest under subsections (a) and (b) of U.C.C. § 4A-404.

[339] Under the first rule of *Hadley v. Baxendale*, supra.

[340] 12 C.F.R. § 229.10-21 (1990). See U.C.C. § 4A-107 and Official Comment 1 of U.C.C. § 4A-404. The Expedited Funds Availability Act, 12 U.S.C. §§ 4001-4010, as a federal law, preempts state law, including U.C.C. See 12 U.S.C. § 4007. For an analysis of the interaction between state and federal law as to funds availability in general, see Huber, S. Bank Officer's Handbook of Government Regulation, (2nd ed. 1989 with 1991 Supp.), at para. 19.02[5]. For a comment on the relation between beneficiary's bank's liability to pay the beneficiary under Article 4A and its interaction with banks' liability to make funds available to customers under Regulation CC, see Felsenfeld C., Strange Bedfellows for Electronic Funds Transfers: Proposed Article 4A of the Uniform Commercial Code and the UNCITRAL Model Law [1991] 42 Alabama L. Rev. 723, at 743 ; Rapson D., Resolution of Loss Allocation and Liability Issues under Article 4A, ALI-ABA Course of Study, The Emerged and Emerging New Uniform Commercial Code, C664 ALI-AbA 57, at 10, referred to by WESTLAW, Database JLR.

[341] Payment is "received" when the beneficiary's bank has received both (i) "payment in actually and finally collected funds"; and (ii) "information on the account and amount to be credited". See Regulation CC, 12 C.F.R. § 229.10(b)(2) (1990).

[342] 12 C.F.R. § 229.21(a) (1990).

recover any "actual damages" sustained by his bank's failure to make funds available on next business day of receiving the amount of payment order. Thus, where the beneficiary's notice to his bank informing it that he will suffer consequential losses if not paid on time, does not meet the requirement of § 4A-404(a), he can obtain the "actual damages" sustained by such failure according to Regualtion CC. It is arguable that where a beneficiary can successfully meet the requirement of a claim for the recovery of consequential damages, this claim should be allowed to supersede the federal claim under Regulation CC. The objective of the federal funds availability rules is to promote early availability. Thus, it is said that "[s]tate requirements supersede federal law where they require funds to be available at an earlier time. In all other respects, the federal law preempts state law, including UCC".[343] It is not clear whether this preemption is strictly concerned with "time", and thus does not include offering a customer more generous measure of damages.

6.5 Damages Recoverable in EFTPOS & ATM Transactions.

6.5 [a] Under U.K. Law.

Since EFTPOS and ATM cards are issued according to an account agreement between the bank and its customer, the terms of this agreement should be applied first in any claim of damages for breaching any term of such agreement. Banking practice indicates that banks do not expressly disclaim liability for their failure to perform their obligations under such agreement. However, they usually disclaim liability for any failure by any other party to accept or honour their cards. This is important in EFTPOS transactions, since it means that banks disclaim liability for retailers' refusal to accept their cards. In addition, they may disclaim liability for any failure to perform

[343] Huber S., Bank Officer's Handbook of Government Regulation, (2nd, ed. 1989), at 19.02[5].

their obligations under the conditions of use of their cards if such failure arises directly or indirectly from an electronic system malfunction.[344] Such disclaimers may include the recovery of damages resulting from such failure.

If no measure of damages is found in the customer-banker agreement for the use of the card in question, one should look to the general principles of the common law, since no statute in U.K. governs EFT transactions. The recourse to common law is important since the Code of Good Banking has failed to offer banks' customers any measure of damages for losses caused by banks' breach of their agreements with customers.[345] The relationship between the bank and its customer in EFTPOS transactions is contractual. The failure of the bank to perform its contractual obligations under the banker-customer agreement may amount to a breach of an express or implied contractual term. Therefore, a customer who sustained a loss as a result of his bank's breach of an express or an implied term in his account agreement is entitled, so far as money can do it, to be placed in the same situation with regard to damages as if that term had been performed.[346] This is subject to the remoteness principle of *Hadley v. Baxendale.* It is difficult to predict what type of damages a customer may recover from his bank if the latter wrongly inserted the customer's name in the "black list" of cards.[347] The practical effect is that a customer will be denied access to his funds by the use of card in question. There is no direct authority

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[344] This is, for example, the situation in the agreement between The Royal Bank of Scotland and its customers to use Highline Card which may be used as an EFTPOS card, i.e. the SWITCH card. See in particular terms 10 and 11 of the Highline card request issued by The Royal Bank of Scotland, Leaflet code RB104 2/90.

[345] § 18.2 of the Code of Good Banking provides that "[c]ard issuers' liability will be limited to those amounts wrongly charged to customers' accounts and any interest on those amounts." This is, one suggests, unsatisfactory solution for two reasons, at least. First, the Code adds nothing to what the customer is already entitled to under common law. A bank is not entitled to debit its customer's account unless it has authority to do so. Second, There are other situations where a bank may breach the account agreement with its customer, e.g., mistaken denial of cash withdrawal by the use of an ATM card.

[346] See, in contracts generally, Parke, B. in *Robinson v. Harman* [1843-60] All E.R. 383, at 385; (1848) 1 Exch. 850, at 855.

[347] This is a list of cards that will not be accepted. Such list usually includes stolen, lost, counterfeited cards.

on the point. The customer usually loses no funds. Nor does he lose the use of such funds. However, a customer may suffer an indirect loss. One example is a customer who wants to buy a reduced item from a boutique, but by the wrongful insertion of his card's number in the "black list" sent to that boutique, he was denied access to his only available method of payment at the time. If he, next day, bought the same item after the end of the sale's period for a higher price, can he claim the difference in the payment from his bank? Clearly, this is a consequential damage. A customer is not entitled to recover such damages unless they are in the contemplation of the bank and its customer at the time when the customer signed his application of the EFTPOS card.[348] This is, however, in most if not all cases wishful thinking for bank's customers. The same thing can be said to a customer who has been denied cash by using his ATM card as a result of an error in his bank's computer if that cash denial resulted in losing a bargain. Nominal damages, however, may be awarded.

A customer whose EFTPOS card is refused by a retailer only because of a wrongful instruction from the customer's bank may suffer embarrassment and probably a loss of reputation. The question is whether such customer is entitled to claim such losses from his bank. Its is clear that EFTPOS transactions are different from electronic credit transactions as far as the personal contact between the creditor and the debitor is concerned. The payee in electronic credit transfer transactions does not, usually, know the reason for the bank's failure, or delay, to transfer the funds. Thus, he is not, in most cases, in a position to infer from the non timeous transfer, or the complete failure to transfer, that the payer's bank has no trust in his debtor's creditworthiness. However, this is not the case in EFTPOS transactions. A retailer who

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[348] According to the remoteness rule of *Hadley v. Baxendale*, supra.

has been advised not to accept a given person's card on the ground of insufficient funds, for example, is reasonably expected to assume that such person (who may be a customer of the retailer too) has some financial problems. It may also be assumed that his bank is unwilling to provide him with an overdraft or financial cover since it has no trust in his credit. Thus, if the bank's customer, in fact, has sufficient funds in his account, but his bank, without justifiable reason, passes his card to retailers as invalid while it is, in fact, valid, one may argue that he should be awarded damages for his loss of reputation. The common law rule is that non-trader customers are not entitled to recover damages in such cases for the wrongful dishonour of their cheques.[349] Trading customers are presumed to be injured by the wrongful dishonour of their cheques, so courts will award them reasonable compensation for such injury to their credit.[350] One suggests that the extent to which damages resulting from loss of reputation can be recovered in EFTPOS transactions is probably restricted by the trader rule. If the recovery of such damages in EFTPOS transactions were to be seen by courts as analogous to recovery for wrongful dishonour of cheques, the trader rule cannot be excluded from such analogy. This means that damages for loss of reputation in EFTPOS transactions are unlikely to be awarded by British courts since most of EFTPOS transactions are conducted by non-trader consumers.

The measure of damages applicable for breach of delictual obligation discussed under credit transfer transactions is applicable in EFTPOS and ATM transactions where the action is raised outside the terms and conditions of the account agreement. The doctrine of contributory negligence is applicable as well.

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[349] Per Lawrence J. in *Gibbons v. Westminster Bank Ltd.*, [1939] 2 K.B. 882, at 888; [1939] 3 All E.R. 577, at 579. See also para. 6.4.1 [a] [i] [5] (The Trader Rule).

[350] Per Lord Birkenhead in *Wilson v. United Counties Bank Ltd.*, [1920] A.C. 102, 112.

6.5 [b] Under U.S.A. Law.

EFTPOS and ATM transactions constitute electronic fund transfer as defined in § 1693a(6). As such, a bank is liable for "all damages proximately caused" by its failure to make an EFTPOS or an ATM transaction in accordance with the terms and conditions of the consumer's account in the correct amount and in a timely manner.[351] If the bank's failure to make an EFTPOS or ATM transaction "was not intentional and which resulted from a bona fide error", the consumer will recover the "actual damages proved" as a result of such failure.[352] No damages are recoverable if such failure was a result of malfunction or an act of God.[353] However, if the failure was caused by an act of God, the bank must show "by a preponderance of the evidence that its action or failure to act resulted" from such an act.[354] It must also show that it "exercised reasonable care to prevent such occurrence, and that it exercised such diligence as the circumstances required".[355] Moreover, if the bank's failure was caused by a technical malfunction, the bank cannot escape paying damages unless it shows "by a preponderance of the evidence that its action or failure to act resulted" from such technical malfunction which was known to the consumer at the time he attempted to initiate the transaction concerned.[356] Thus, where a message on an ATM screen reads "Temporarily Out of Service" and yet a consumer inserts his card in the ATM attempting a withdrawal of cash, the bank is not liable for failure to effect the withdrawal if the ATM retained the card.

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[351] 15 U.S.C. § 1693h(a).

[352] 15 U.S.C. § 1693h(c).

[353] 15 U.S.C. § 1693h(b).

[354] Ibid.

[355] 15 U.S.C. § 1693h(b)(1).

[356] 15 U.S.C. § 1693h(b)(2).

The discussion of recoverable damages for noncompliance with EFTA and for noncompliance with specific error resolution provisions under consumer-based transactions in electronic credit transfers is applicable as well in EFTPOS and ATM transactions.

SUMMARY AND CONCLUSION

Despite the obvious importance of electronic fund transfer as a method of payment, no comprehensive body of law exists in the United Kingdom to govern the rights and duties of parties to such transfers. The Bills of Exchange Act 1882, which was a comprehensive codification of existing law on bills of exchange, of which cheques are an example, does not apply to EFT transactions. The definitional characteristics of bills of exchange and promissory notes restricted the scope of the Act to such instruments. Common law has established some certainty in the nature of banker-customer relationship and the circumstances in which that relationship is created and terminated. Certain implied terms have been added by courts to such a relationship whenever express contract fails to address such matters. Although traditionally the banker-customer relationship relies most on implied contract, express contract is the rule in EFT transactions. This is more obvious in payment cards transactions such as EFTPOS and ATM. It is the rule that the use of such cards is governed by an express contract. These express contractual agreements are not restricted to the banker-customer relationship, but also exist between the various parties involved in the payment process. Since it is impractical to negotiate individualised contracts with the bank for each transaction, banks usually have their own standardised form contracts. It is highly unlikely that such contracts would adequately cover all of the possible exigencies that may be associated with a single EFT transaction. On the contrary, such contracts are drawn up by banks with the view of relieving them from liability. A selection of banks' terms and conditions of use of EFT payment cards, conducted by the Review Committee, discloses that in most cases

such terms are drafted to relieve banks from liability.[1] Customers have no real protection if things go wrong. It is noted that the Unfair Contract Terms Act 1977 "was not designed to apply to 'conditions of use' contracts and, as a result, fails to provide EFT consumers with adequate and uniform protection".[2]

Given the importance of corporate electronic credit transfer as a method of payment in today's commercial world one would assume that the rules governing such transfer would be highly developed and clearly allocating the risks accompanying such transfer between the parties involved. Unfortunately, no such rules do exist in the United Kingdom. There is no equivalent to Article 4A of U.C.C. in the United Kingdom. The Code of Good Banking is only applicable to personal customers. There is, however, a reliance on the clearing rules of the electronic fund transfer system used. It was said that such rules are usually not comprehensive and do not apply to disputes between a bank and its customer. These rules cover limited aspects of fund transfer transactions. A large number of important issues are not governed by such rules. They are usually drafted to regulate the rights and duties of the participant banks in the clearing system. As such, banks' customers are usually third parties to such agreements with the effect that such rules are, arguably, inapplicable to them. For example, CHAPS Clearing Rules are procedural in nature and failed to address some important issues such as measures of damages for not performing payment orders as instructed. There is a lack of clear and uniform set of rules at the banker-customer level. Private contracts do not usually cover all issues that may arise in each single transaction and may fail to allocate significant risks among the parties. They are, in

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[1] The Review Committee Report, supra, at para. 9.22; and Appendix F of that Report.

[2] As pointed out by one consultee to the Review Committee, ibid.

most cases, designed to protect banks' interest. Not all corporate customers have the bargaining power to negotiate individualised contract with their banks.

As a response to the Review Committee Report recommendations, a Code of banking practice entitled "Good Banking" was finally produced by the British Bankers' Association, the Building Societies Association and the Association for Payment Clearing Services. This Code aims to "set[] out the [minimum] standards for good banking practice to be observed by banks, building societies and card issuers when dealing with personal customers in the United Kingdom."[3] Although this Code has contributed to solving some of the problems arising from the use of payment cards, it falls short of addressing some other important issues. Apart from its restricted scope to personal customers only and its non-binding characteristic, it does not address electronic credit transfer transactions. Issues such as time of payment, irrevocability, stop payment, liability for wrongful denial of service, recoverability of damages for banks' breach of their duties under the Code are not addressed by the provisions of the Code. The most that a customer may recover from a bank under the Code is "those amounts wrongly charged to customers' accounts and any interest on those amounts". No other damages are recoverable from a bank for its failure to make an EFT transaction properly. Unlike the American EFTA, no mandatory error resolution procedure is offered. This is left to each bank to "have its own internal procedures for the proper handling of customers' complaints."

The American experience shows that although there were comprehensive bodies of law applicable to other types of payments, such laws often were not appropriate to apply directly or by analogy to EFT transactions in view of the unique

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[3] Preface of the Code of Good Banking (1991).

characteristics of such transactions.[4] It is not only the uncertainty of law that forced legislation in the United States but also the policies that such legislation was intended to achieve. Article 4A is drafted to preserve high-speed and low-cost method of funds transfer. The risk of loss is allocated in a manner to preserve such characteristics and to give certain incentives to the party in the best position to avoid the loss. That is so because of the awareness of the economic significance of fund transfer, especially the commercially-based one. On the other hand, EFTA was enacted as a consumer protection legislation to protect the "individual consumer rights" in EFT transactions. Thus, both consumer and commercial EFT transactions in the United States are statutorily regulated.

Despite a pre-legislation American decision to the contrary,[5] it is submitted that a "payment order" is merely a mandate from a sender, who is usually a bank's customer, to a bank to make a credit or a debit transfer. In particular, it does not constitute a negotiable instrument, nor a creation of trust funds, nor assignation. However, although U.C.C.§ 4A-103(a)(1) defines a "payment order" to effect a credit transfer as "an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay or to cause another bank to pay a fixed or determinable amount of money to a beneficiary ...", Article 4A explicitly excludes the notion of agency between the bank and the sender of the payment order. Under U.C.C. § 4A-212, "[a] receiving bank is not the agent of the sender or beneficiary of the payment order it accepts". A payment order under Article 4A provisions is construed as a "request" from a sender to a bank, which must be accepted before that bank

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[4] See the Official Comment of U.C.C. § 4A-102. The American law applicable to cheques and negotiable instruments is generally found in Article 3 and Article 4 of the Uniform Commercial Code.

[5] *Delbrueck & Co. v. Manufacturers Hanover Trust Company* (1979) 609 F.2d 1047, 1051 (payment order through CHIPS constitutes assignment).

becomes liable to execute it. One suggests that although such a bank is not an agent of that sender in executing the order, the notion of mandate is not precluded once the bank accepts the order. What happens is that a bank is instructed and authorised to make the transfer, which is what a mandate is about. The rights and obligations of the parties involved in the transaction are statutorily and contractually based.

English courts held that such payment orders are governed by the agency rules. It was held that a "payment order" in a credit transfer transaction is "to be regarded simply as an authority and instruction, from a customer to its bank, to transfer an amount standing to the credit of that customer".[6] It was noted by another case that the effect of a "payment order" carried out through CHAPS was to "direct the paying bank to debit the paying customer's account with £x (plus any charges) and to transfer the £x to the credit of the payee's account at another bank and to do so by means of an electronic device".[7] This approach, in principle, is consistent with the Draft UNCITRAL Model Law on International Credit Transfers and the UNCITRAL Legal Guide on Electronic Funds Transfers.[8]

However, § 53(2) of the Bills of Exchange Act may cause some uncertainty as to the legal nature of a debit transfer order under Scots law. Although, it is argued that this section is not applicable to EFT transactions, it is not clear whether Scottish courts will follow such interpretation. This problem may arise, in particular, in EFTPOS transactions where a purchaser signs a duplicate sale slip leaving one copy with the payee to be presented for payment to the purchaser's bank. If § 53(2) is to be applicable to EFTPOS transactions, a Scottish bank that has insufficient funds in

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[6] *Royal Products Ltd. v. Midland Bank Ltd.*, [1981] 2 Lloyd's Rep. 194, 198 per Webster J.

[7] *R v. King and Others* [1991] 3 All E.R. 705, 709 per Lord Lane.

[8] See p. 12.

its customer's account to meet an EFTPOS payment demand should attach the available funds (*pro rata* if more than one EFTPOS transaction are made) until either: (i) the sale slip or a demand by electronic means is re-made because the purchaser has sufficient funds attached or otherwise; (ii) the retailer relinquish its claim to the attached funds; (iii) five years have expired; or (iv) a judicial settlement is reached. Scottish banks usually transfer the attached funds to suspense account till one of the above four situations occurs. This shows that such uncertainty is unsatisfactory for Scottish banks, and for customers, too, under certain circumstances. The Review Committee suggested a statutory solution by abolishing the "funds attached principle" in relation to negotiable instruments other than cheques.[9] Since this principle is a well-established principle in Scots law and such recommendation has not been accepted by the Government, one recommends a specific statutory exception to EFTPOS transactions from such a principle.

British banks are under no duty to accept a payment order unless they are contractually bound to do so. It is argued that the banks' duty to repay customers their funds (on demand in England) does not embody transferring funds by electronic means to another bank's account. However, it is admitted that, in practice, banks would usually accept such funds transfer payment orders. American banks are also under no duty to accept a payment order to make a wholesale wire transfer unless bound by an express agreement or by a funds-transfer system rule. However, a receiving bank that is contractually bound to accept its customer's payment orders is in breach of such agreement if it refuses to execute such orders.[10] Thus, a payment order needs to be

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[9] the Review Committee Report, supra, recommendation 7(10).

[10] U.C.C. § 4A-212. See also U.C.C. § 305(d) (the measure of damages applicable in such failure).

accepted by the bank concerned before it could be held liable for failure to execute it. Acceptance occurs when the receiving bank executes the payment order. The beneficiary's bank accepts the payment order when it "pays" the beneficiary or "notifies" him of receipt of the order or that his account has been credited. It also accepts the payment order when it receives payment of the entire amount of the payment order; or at the opening of the next funds-transfer business day following the payment date if the bank had a withdrawable credit balance to cover such payment. An American bank that decides not to execute a given payment order despite having on the execution date a withdrawable credit balance in an authorised account should, generally, notify the sender of the unaccepted payment order of such decision. Where a receiving bank suspends payment, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payment. The situation is different under EFTPOS and ATM transactions. Both in the United Kingdom and the United States, banking practice shows that customers' payment orders to make an EFTPOS or an ATM transaction should be accepted so long as they comply with the terms of the customer's account agreement. Customers are issued with payment cards to be used according to an express set of terms and conditions of use. A customer who uses his card without breach of such terms and conditions is entitled to such service.

Under British law, the transferring bank in a credit transfer transaction carries out its customer's payment order as an agent. It was held in *Barclays Bank Plc. v. Quincecare Ltd* that "it is implied term of the contract between the bank and the customer that the bank will observe reasonable skill and care in and about executing the customer's orders".[11] The doctrine of strict compliance as applied in confirmed

[11] [1988] 1 F.T.L.R. 507, 517.

documentary credit cases is not applicable in electronic credit transfer transactions.[12] In effecting a fund transfer, a bank should give careful consideration to the competing factors on either side; and then on the fair balance between them it must refrain from executing a payment order if and for so long as it is put on inquiry in the sense that the bank has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of its customer.[13] The transferring bank is liable to conform with its customer's payment order. This usually takes place by issuing another payment order to the next bank in the payment process that conforms with the customer's payment order. Where a correspondent bank is needed, the transferring bank must take reasonable care in selecting a reliable correspondent. Unless contractually agreed otherwise, the transferring bank is liable for the acts of its correspondent.[14] It seems that British courts would, generally, reject the imposition of a duty of care in delict in credit transfer transactions since the bank and its customer are in a contractual relationship.[15]

There is no difference in common law between the transferring bank's position in the British and United States law. Courts held that the transferring bank in a credit transfer transaction acts as its customer's agent.[16] Like the case under the British law, the transferring bank under the United States law must comply with its customer's instructions and carry them out with reasonable care and skill. It was held that such bank must, in particular, transfer the right amount as instructed, to the right payee on

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[12] Webster J. in *Royal Products Ltd v. Midland Bank Ltd* [1981] 2 Lloyd's Rep. 194, at 199.

[13] Ibid. This test has been approved by the Court of Appeal in *Lipkin Gorman v. Karpnale Ltd* [1989] 1 W.L.R. 1340.

[14] *Royal Products Ltd v. Midland Bank Ltd* [1981] 2 Lloyd's Rep. 194.

[15] *Tai Hing Cotton Mill Ltd v. Liu Chong Hing Bank Ltd* [1986] A.C. 80, 107; [1985] 2 All E.R. 947, 957 (P.C.) per Lord Scarman.

[16] See, e.g., *Central Coordinates, Inc., v. Morgan Guaranty Trust Company*, 129 Misc. 2d 804; 494 N.Y.S.2d 602 (Sup. Ct. 1985).

the right time. However, the transferring bank's liability in EFT transactions is now statutorily governed in the United States law. In consumer-based transactions, a bank is liable for its failure to make a credit transfer transaction in accordance with the terms and conditions of the consumer's account. In particular, EFTA requires the bank to make the transfer in "the correct amount" and in "a timely manner" if properly instructed to do so by the consumer. The bank is liable to compensate its customer for his losses as a result of such failure. The measure of damages applicable depends on whether or not the failure was not intentional. Such liability is based on contract; namely the terms and conditions of the account agreement between the bank and the consumer. In commercially-based transactions, the agency theory of the common law has been explicitly rejected by U.C.C. § 4A-212 as was mentioned above. That section provides that a receiving bank "owes no duty to any party to the funds transfer except as provided in this Article [Article 4A of the U.C.C.] or by express agreement." The main duty of the receiving bank that accepts to execute a payment order under Article 4A is to issue, on the execution date, a payment order that complies with the sender's payment order to the next bank in the payment process.[17] This liability is based on contract, since a bank must accept the sender's payment order before it becomes liable to carry it out properly. The material terms that the receiving bank must, generally, comply with include the amount of the payment order, the payment date, the execution date, the beneficiary, the beneficiary's bank, the intermediary bank where designated, the funds-transfer system and the manner of transmission.

An intermediary bank is normally in a contractual relationship with the transferring bank. Like the transferring bank, it is under a duty to issue a payment

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[17] U.C.C. § 4A-302.

order to the payee's bank in compliance with the transferring bank's payment order. If the transferring bank complies with the terms of the originator's payment order, the transferring bank's payment order to the intermediary bank should be "a mirror image" of the originator's payment order to the transferring bank. However, an intermediary bank may fail to execute the payment order properly. Its position as to the transferring's or originator's bank is analogous to that of the latter to its customer, the originator. Its liability to the transferring bank depends on the contractual terms of their correspondent agreement. No substantial difference is noted between the American and British law in this point. The question is whether the intermediary bank is directly liable to the originator. Under English law, the privity of contract militates against such liability.[18] The *jus quaesitum tertio* justifies, in principle, such claim under the Scots law. What is needed, however, for such claim to succeed is that Scottish Courts find that the correspondence agreement between the transferring bank and the intermediary bank confers an irrevocable *favorem* on the transferring bank's customer. Pre-legislation common law cases in the United States suggest that such correspondence agreements confer a direct benefit on the transferring bank's customer.[19] The benefit found was that a proper transfer of the funds will not cause the transferring bank's customer any loss. Further, it was held that the transferring bank's customer did not need to be even named in the correspondence agreement since it was evident that he fell within the group designated to benefit from such agreement.[20] In another case, the transferring bank's customer was allowed to directly

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[18] *Royal Products Ltd. v. Midland Bank Ltd* [1981] 2 Lloyd's Rep. 194; and *Calico Printers' Association Ltd. v. Barclays Bank Ltd.* (1931) 145 L.T. 51 (C.A.).

[19] See *Securities Fund Services, Inc., v. American National bank and Trust Company of Chicago*, 542 F. Supp.323 (N.D. Ill., 1982).

[20] Ibid, at 329.

sue an intermediary bank for its negligence in handling his payment order although no privity of contract did exist between them.[21]

Under the British law, a beneficiary's bank receives the payment order and credits the beneficiary's account by the amount of the order as, generally speaking, an agent for the beneficiary. This is so in the normal circumstances where the beneficiary is a customer of the bank and is aware of the transfer to his account. The bank is under a duty to collect such payment by the most expeditious means and to use proper skill in doing so. Its failure to do so does not only constitute a breach of its customer's account agreement but also a breach of its correspondent agreement with the transferring bank or the latter's correspondent. The absence of privity of contract may preclude the transferring bank's customer or the transferring bank (where there is an intermediary) from suing the beneficiary's bank directly for the breach of its duties under the funds transfer. The doctrine of *jus quaesitum tertio* may justify such an action under Scots law. The beneficiary's bank may be subjected, by agreement, to a duty to notify the beneficiary of the receipt of the payment order and/or the credit of his account by the amount of transfer. A funds-transfer system rule may oblige the beneficiary's bank to acknowledge receipt of the payment order.[22] Under the American law, a beneficiary's bank, like any receiving bank, is under no duty to accept a payment order unless it is bound to do so by an agreement.[23] It does not receive funds as an agent of the beneficiary.[24] Its liability is based on the provisions of Article 4A and any express agreement with the beneficiary.[25] Under

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[21] *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982).

[22] British banks that accept payment through CHAPS are under a duty to acknowledge receipt of the payment order. See CHAPS Clearing Rules (1985), Rule 4(c).

[23] U.C.C. § 4A-212.

[24] U.C.C. § 4A-212.

[25] Ibid.

Article 4A, if it accepts a payment order it is under two main duties. First, the obligation to "pay" the amount of the payment order received to the beneficiary. Second, the obligation to "notify" the beneficiary if such notification is required by the terms of the payment order or any other agreement, or if payment is made to an account of the beneficiary.

A bank that issues an EFTPOS card to a customer is liable to honour its customer's EFTPOS transactions if they satisfy the terms and conditions of the use of such card. Banking practice, both in the United Kingdom and the United States, shows that an express agreement is usually entered into to cover the use of such cards. The customer must have sufficient withdrawable funds in his account and comply with the terms and conditions of the use of such card. A bank that wrongly denies its customer such service should be liable for breach of the terms of its account agreement with such customer. This is expected where a bank wrongly includes the customer's name in the "black list" of cards that are out of use for one reason or another. The retailer's bank is liable for its customer, i.e., the retailer, according to the terms of their agreement. This bank usually acquires the retailer and enters into an agreement with him. The common terms of such agreement is that the retailer must only accept valid EFTPOS cards and must verify the purchaser's signature against a specimen on the card if this method is used. The retailer's bank, on the other hand, must credit the retailer's account by the amount of all valid EFTPOS transactions and reimburse itself by collecting such amount from the purchasers' banks; or merely collect such amount from the purchasers' banks, whichever is agreed upon. The American law differs from the British in its statutory recognition of such obligations under EFTA provisions.

A bank that issues an ATM card to a customer must honour the transactions

made by such card if the card is used according to the terms and conditions of its use. Like the case of EFTPOS cards, banks usually enter into an express agreements with their customers when they provide them with ATM cards. Banks' failure to make an ATM transaction would usually take the form of a denial of service. Where an ATM is out of service and such fact is advertised to customers, banks are not expected to be held liable for denial of service. That is because, it is unusual for banks to guarantee, in their agreement with customers, that a specific machine will be in service all the time. However, a bank that denies a specific customer certain service in particular without justifiable reason contrary to their agreement should be held liable for breach of that agreement. A bank may be held liable for "denial of cash" on demand through an ATM if the bank breaches its funds' availability rules by not allowing such service on ATMs while it had the required time to do so according to its funds' availability rules. The Code of Good Banking requires British banks to provide customers with details of "when funds can be withdrawn after a cheque or other payment has been credited to the account".[26] The United States law distinguishes between an intentional and unintentional failure to make an EFT transaction. This presumably includes "denial of cash" through an ATM. American banks, however, must inform consumers in advance of any change in the terms of their account agreements. One exception to such notification in advance requirement is where such change "is immediately necessary to maintain or restore the security of an electronic fund transfer system or a consumer's account".[27] In *Feinman v. Bank of Delaware*, the court found that the "denial of cash" through an ATM was

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[26] § 10.1 of the Code of Good Banking (1991).

[27] 15 U.S.C. § 1693c(b).

"immediately necessary to maintain ... a consumer's account" since the plaintiffs had overdrawn their account in the past and will do so in the future.[28] The risk comes from the fact that it is impossible for banks to reverse an ATM cash withdrawal transaction to restore a positive balance after the ATM cash withdrawal takes place.

Banks' failure to make an EFT transaction properly may not necessarily result from a breach of agreement but may result from a technical malfunction in the system used. Banking practice suggests that banks usually disclaim liability for such failures. This takes the form of an express clause in the banker-customer agreement. Under the British Code of Good Banking a card issuer is liable for "the full losses incurred" by a customer as a result of "faults" in "the machines, or other systems used".[29] However, a card issuer is not liable if the malfunction "was obvious or advised by a message or notice on display".[30] This is restricted to consumer's payment cards transactions only. Under the United States law, a bank is not liable, in consumer-based transactions, for its failure to make an EFT transaction if it "shows by preponderance of the evidence" that its failure has resulted from "a technical malfunction which was known to the consumer at the time he attempted to initiate an electronic fund transfer or, in the case of preauthorized transfer, at the time such transfer should have occurred".[31] A bank is also not liable in consumer-based transaction for its failure to make an EFT if it "shows by a preponderance of the evidence" that such failure has resulted from "an act of God or other circumstances beyond its control, that it exercised care to prevent such occurrence, and that it exercised such diligence as the

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[28] 728 F. Supp. 1105, 1113 (U.S. Dis., 1990).

[29] § 18.1(c) of the Code of Good Banking (1991).

[30] Ibid.

[31] 15 U.S.C. § 1693h(b)(2).

circumstances required".[32]

Since payment orders constitute a mandate, they are capable, in principle, of being countermanded before being executed. A general rule of thumb is that the initiator of a payment order cannot unilaterally countermand his payment order after the completion of payment. The time period between instructing a bank to make a funds transfer and implementing such instructions is largely reduced by the introduction of technology in most EFT transactions. An instantaneous transfer of funds is common nowadays in EFT systems, especially in commercially-based transactions. A distinction should be made between the time at which the instruction to transfer becomes irrevocable and the time at which the payment is completed no matter how the period is short. The first concept concerns the inability to stop or countermand a payment order before it reaches the beneficiary's bank, while the latter concept concerns the time at which the title to the funds subject to the transfer unconditionally passes to the beneficiary as a matter of right. Although this is not necessary the case in each fund transfer, the time at which the payment order becomes irrevocable may coincide with the time of completion of payment. The relationship between the irrevocability and completion of payment is that "at whatever point of the payment process a payment instruction becomes irrevocable, it cannot be later than the point of legal completion of payment".[33] A customer may lose the right to countermand his payment order some time earlier than the time of completion of payment. Although, countermanding a payment order could prove impractical in some payment systems once the payment order is accepted or released by the transferring

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[32] 15 U.S.C. § 1693h(b)(1).

[33] The Review Committee Report, supra, at para. 12.03.

bank, a customer usually loses such right the moment the transfer of funds becomes irrevocable, either as a matter of practicality or as a rule of law.

In credit transfer transactions, finality of payment means the time at which the title to the amount of the payment order is unconditionally transferred from the transferring bank's customer to the beneficiary as a matter of right. British courts distinguish between two situations; in-house transfers and inter-bank transfers. In the former case, the time of payment is the time at which the bank decides to make the appropriate adjustment of the creditor's and debtor's accounts.[34] It was held in *Momm v. Barclays Bank International*,[35] that payment had been completed when the "decision" to transfer the funds was irrevocably taken by the bank by setting the appropriate computer process in motion.[36] In the latter case, two situations should be distinguished. First, where the transferring bank credits an account of the beneficiary's bank with it by the amount of the transfer and notifies the beneficiary's bank of such credit; and instructs it to credit the beneficiary's account by the same amount, the payment is complete once such credit notification is received, and verified by the beneficiary's bank.[37] Where the transferring bank or its correspondent does not credit an account of the beneficiary's bank with it but authorises it to debit an account with it by the amount of the payment order for the benefit of the beneficiary, the payment is final when the beneficiary's bank accepts such unconditional autherisation and instructions to credit the payee's account. Under CHAPS transfers, the payment is complete when the beneficiary's bank sends the transferring bank a "Logical

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[34] *The Brimnes* [1973] 1 W.L.R. 386; [1973] 1 All E.R. 769, *aff'd* [1975] 1 Q.B. 929 (C.A.).

[35] [1976] 3 All E.R. 588.

[36] See in particular, ibid, per Kerr J., at 598.

[37] *The Effy* [1972] 1 Lloyd's Rep. 18; *The Zographia M.* [1976] 2 Lloyd's Rep. 382; and *The Royal Products v. Midland Bank* [1981] 2 Lloyd's Rep. 194.

Acknowledgment". That is the time at which the beneficiary's bank decides to accept the CHAPS payment order and thus is bound to give the same day value to the beneficiary.[38]

Under the United States law, payment is final in wholesale credit transfer transactions when the beneficiary bank accepts the payment order.[39] That occurs at the earliest of the following times. First, when the bank "pays" the beneficiary.[40] This depends on whether the bank is crediting an account of the beneficiary or not. If the bank is crediting an account of the beneficiary, payment is made when the beneficiary is notified of the right to withdraw the credit, the bank lawfully applies the credit to a debt of the beneficiary, or the amount of the order is otherwise made available to the beneficiary.[41] However, if the beneficiary's bank is not crediting an account of the beneficiary, the time when payment is made is governed by principles of law that determine when the beneficiary's bank obligation to pay the beneficiary is satisfied.[42] Second, when the beneficiary's bank notifies the beneficiary of the receipt of the order or that the account of the beneficiary has been credited with respect to the order provided that such notification is not accompanied by a statement providing that the funds may not be withdrawn or used until receipt of payment from the sender.[43] Third, when the beneficiary's bank receives payment of the entire amount of the sender's order.[44] Fourth, at the opening of the next funds-transfer business day of the beneficiary's bank following the payment date of the order if, at that time, the amount

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[38] See CHAPS Clearing Rules (1985), Rule 4(c).

[39] U.C.C. § 4A-404(a).

[40] U.C.C. § 4A-209(b)(1).

[41] U.C.C. § 4A-405(a).

[42] U.C.C. § 4A-405(b).

[43] U.C.C. § 4A-209(b).

[44] U.C.C. § 4A-209(b)(2). For payment of the sender's obligation, see U.C.C. § 4A-403(a).

of the payment order is "fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later".[45]

In EFTPOS transaction, the time of completion of payment depends on whether the EFTPOS scheme used is Off-Line or On-Line scheme. In On-Line EFTPOS schemes, payment is irrevocable when the purchaser encodes in his PIN authorising the transfer of funds from his account to the retailer's account. The entry of the purchaser's PIN automatically debits the purchaser's account and credits the retailer's account. Completion of payment here is no different, in principle, from that in credit transfer transactions. If both the purchaser and the retailer bank with one bank, it is the decision of that bank to adjust its customers' accounts that marks the completion of payment. Where the retailer and the purchaser bank with different banks, it is the purchaser's bank's decision to accept paying the retailer or reimbursing the retailer's bank for paying the retailer that marks the completion of payment. In Off-Line EFTPOS schemes, the transfer of funds from the purchaser's account to the retailer's account does not occur as soon as the purchaser signs the sale slip. In the absence of authority, one suggests that completion of payment occurs when the purchaser's bank accepts to honour the demand from the retailer's bank to debit the purchaser's account by the amount of the purchase and transfers the funds to the retailer's bank for the benefit of the retailer. The purchaser's bank may credit an account of the retailer's bank with it and informs it of such credit. It may authorise the retailer's bank to debit

[45] U.C.C. § 4A-209(b)(3).

an account maintained by it with the retailer's bank by the amount of purchase.

Stop payment is a well-known common law concept in traditional methods of payment. As payment orders in EFT transactions is construed as a mandate, a person is entitled to countermand his payment order before its execution provided that a bank is given reasonable time to act upon such countermand instructions. Under British law, it was held in cheque's cases that to be effective, a countermand instruction must be brought to the conscious knowledge of the bank; constructive knowledge is not sufficient. It should be served on the branch where the payment order is originally given. It should not be ambiguous; and must contain sufficient information to allow the bank identify the payment order intended to be stopped. A bank that pays over a stop payment order does so at its peril. As such it has no authority to debit its customer's account unless such customer ratifies such debit. However, if such transfer confers a benefit on the transferring bank's customer, the bank is entitled to be subrogated to the beneficiary's rights against its customer, the payer. Under the United States law, stop payment is also a well-known concept in traditional methods of payment, e.g. cheques. In EFT transactions, the position depends on whether the EFT transaction subject to stop payment order is a consumer or a commercially based transaction. In the former type, stop payment is only permitted in "preauthorized transfer" transactions. A bank that fails to stop a "preauthorized transfer from a consumer's account when instructed to do so in accordance with the terms and conditions of the account" is liable for "all damages proximately caused" by such failure. If the bank's failure to stop such transfer "was not intentional and which resulted from a bona fide error", the bank will be liable for "actual damages proved",

"notwithstanding the maintenance of procedures adapted to avoid any such error".[46] EFTA fails to provide the bank that fails to stop a preauthorised transfer with the right of subrogation. One suggests that to permit subrogation in the case of failure to stop a cheque and not provide for it in consumer-based transactions is unreasonable. In commercially-based transactions, U.C.C. § 4A-211 allows a sender to cancel or amend its payment order in certain circumstances. As a general rule, a sender of a payment order has a unilateral right to cancel or amend its payment order as long so a communication or notice of cancellation or amendment "is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order".[47] Where the bank fails to observe a properly delivered cancellation order, it is obliged to compensate the sender of such order by refunding the amount of transfer if already credited to the sender's account plus interest.[48] The bank, however, may recover from the paid person to the extent allowed by the law of mistake and restitution. Cancellation after acceptance of a payment order is not permitted unless the receiving bank that accepts the order agrees or a funds-transfer system rule allows.[49] A payment order that has been accepted by the beneficiary's bank cannot be cancelled or amended unless the original payment order was issued in execution of an unauthorised payment order or as a result of a mistake.[50] However, if an accepted payment order is cancelled "the acceptance is nullified and no person has any right or obligation based on the

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[46] 15 U.S.C. § 1693h(c).

[47] U.C.C. § 4A-211(b).

[48] U.C.C. § 4A-402(d).

[49] U.C.C. § 4A-211(c).

[50] U.C.C. § 4A-211(c)(2).

acceptance".[51] That means that each party to the transfer should be returned to the *status quo ante*. The beneficiary's bank, at the end of the payment process, "is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution".[52]

Although stop payment is theoretically possible in Off-Line EFTPOS schemes, banking practice in the United Kingdom shows that customers are deprived of such right by contractual disclaimer. It is a usual clause in any EFTPOS account agreement that a customer irrevocably authorises his bank to debit his account for all EFTPOS valid transactions. There are no rules for reversibility of EFTPOS payment under the British law. Stop payment and reversibility of EFTPOS transactions under the United States law proved to be the most controversial issue during the drafting of EFTA. It is noted that allowing stop payment or reversibility would give EFTPOS card users "a degree of protection against merchants who would sell defective goods or others whose goods or services are less than the consumer feels he was promised in the bargain".[53] This argument was rejected since allowing reversibility would expose retailers to nonpayment for some time, and thus may discourage the use of such method of payment by retailers. Thus no such right is allowed in EFTPOS transactions in the American law.

Payment made under an error of fact is recoverable, generally, under the British law, from the beneficiary and, to certain extent, from the beneficiary bank. The appropriate action under Scots law is "repetition", and payment under a mistake of fact in England. Recovery of such payment from the beneficiary's bank is analogous with

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[51] U.C.C. § 4A-211(e).

[52] U.C.C. § 4A-211(c)(2).

[53] NCEFT Final Report, at 50.

the recovery of such a payment from an agent who collects for his principal. This means that such bank is not liable if it pays such funds, in good faith, to its customer. Error in payment orders is usually a unilateral error, which is committed by the sender of such an order without the knowledge of its bank. Generally, for an error to be operative, it must be essential and either induced or mutual.[54] Thus, since it is unlikely that the sender's bank would induce the alleged error, one suggests that the bank should be entitled to debit the sender's account if, without knowledge of such error, it carried out the erroneous payment order as it has received it. The risk of recovering such erroneous payment from the beneficiary or his bank should fall on the sender of the payment order. However, where the bank is aware of the error in its customer's payment order before it executes such order, it should not be entitled to rely on the objective interpretation of the customer's intent, with the result of loosing the mandate to debit the customer's account for the erroneous payment. It should bear the risk of recovering such payment from the beneficiary or his bank under the common law and equity principles.

The allocation of loss in erroneous payment orders in wholesale wire transfers under the United States law, depends on whether, or not, the parties to the transfer have agreed on a "security procedure" to detect errors in payment orders. If no "security procedure" for the detection of error has been agreed upon; and an error has occurred in the initiation or amendment of the payment order the sender bears the risk of loss, provided that the transfer is completed.[55] It is the sender's responsibility to describe exactly the beneficiary or the beneficiary's bank, to mention a smaller or

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[54] See McBryde, The Law of Contract in Scotland, 1987, at paras. 9-30 to 9-39 and the cases cited therein.

[55] U.C.C. § 4A-402(c).

larger amount than its debt, or to delay the issuance of its payment order. If its instructions are inaccurate, it bears the risk of loss.[56] However, a bank and its sender may agree on a "security procedure" to detect errors in payment orders. The mere compliance by the sender with such an agreed upon "security procedure" excuses it from liability for any error in the payment order provided that (i) the bank has failed to comply with such procedure; (ii) the error which occurred would have been detected had the bank complied with the agreed upon "security procedure"; and (iii) the error which occurred must be either a transfer of a greater amount including duplicate orders or a transfer to an unintended beneficiary. The burden of proof is on the sender.[57] To succeed in its action in shifting the risk of loss resulting from its error to its receiving bank, the sender must "prove" that it or a person acting on its behalf has complied with the "security procedure" agreed upon, its receiving bank has not complied with that procedure and that the error would have been detected had the bank complied with that procedure.[58] If the sender successfully met the burden of proof, it is not obliged to pay the order to the extent of the error committed. The drafters of Article 4A were looking for rules that do not unduly hinder the high speed and the efficient handling of electronic funds transfer. The primary object seems to be the prevention of loss in the first place. Thus, Article 4A provisions, generally, allocate error's losses to the cheapest-cost loss avoider rather than on the basis of loss spreading, or loss imposition theories. That object explains the preference for introducing security procedures for the detection of error. A party to a transfer who

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[56] See Thevenoz L., Error and Fraud in Wholesale Funds Transfers: U.C.C. Article 4A and the UNCITRAL Harmonization Process, [1991] 42 Alabama L. Rev. 881.

[57] U.C.C. § 4A-205(a)(1).

[58] U.C.C. § 4A-205(a)(1).

does not agree on a security procedure, or agrees but fails to comply with it, bears, as a general rule, the loss for such failure or non compliance. Moreover, Article 4A adopts procedures to minimise losses on a last-clear-chance basis.[59] That is evidenced where the sender proves that it, or its agent, did comply with the agreed upon security procedure, but the receiving bank has failed to comply with it causing the non detection of an erroneous payment order. In this case, although the sender may have been negligent in transmitting its erroneous payment order, the risk of loss is put on the bank on a last-clear-chance theory. U.C.C. § 4A-205(b) provides for the circumstances under which the risk of loss could be shifted back to the sender on a last-clear-chance theory. Under that subsection, where the sender is not liable to pay its receiving bank all or part of its erroneous payment order, the receiving bank may reshift the risk of loss back to the sender if it can "prove" that the sender, after notification of the erroneous payment order is sent to it, has failed (i) to exercise ordinary care to discover the error with respect to the order; and (ii) to advise the bank of the relevant facts within a reasonable time not exceeding ninety days after the sender received the bank's notification. The burden of proof in this case is the bank's. Failure to prove such requirements releases the sender from liability.

The situation is different where the error occurs in the execution process of a payment order. The common errors are overpayment and payment to a wrong beneficiary. Under the British law, where a customer delivers to his bank an unambiguous correct payment order, the bank must conform to its terms. A bank that deviates therefrom does so at its peril. The practical result is that a bank is not entitled

[59] See the Official Comment 2 of U.C.C. § 4A-205 of the U.C.C. The last clear chance theory means that "if the defendant has the last clear opportunity to avoid the harm, the plaintiff's negligence is not a 'proximate cause' of the result". See W. Prosser, Handbook of the Law of Torts (4th ed., 1971) § 66, at 427.

to debit its customer's account with an overpayment or an amount paid to a wrong beneficiary. This common law rule is imposed on banks regardless the method of payment used. Where the beneficiary's name and his account number do not identify the same person, a bank should seek further clarification from its customer if it discovers such discrepancy before executing such order. The position is not clear in the British law if a bank that is aware of such discrepancy pays on the basis of either one with the result of payment made to the wrong beneficiary. Policy considerations militate in favour of considering the bank liable since any reasonable bank would expect that payment to a wrong beneficiary is likely to occur. Moreover, the bank is in a better position to prevent the loss from occurring. The bank should be entitled, and may be liable, to return the payment order indicating that the name and account's number identify different persons. Where the bank is not aware of such discrepancy, one suggests that it should be excused from liability if it pays on the basis of account's number rather than the beneficiary's name if such payment turns out to be made to the wrong beneficiary. Bank's accounts are expected to be unique in contrast with names. Moreover, in an electronic payment, banking practice shows that banks rely heavily on numbers and codes when sorting and routing out funds transfer. A high speed, reliable and inexpensive EFT system would clearly be enhanced by allowing banks to rely on account numbers and codes rather than names. A bank that is not entitled to debit its customer's account by erroneous payment is entitled, generally, to recover from the beneficiary or, to certain extent, from the beneficiary's bank. Such recovery is based on "repetition" in Scots law and payment under a mistake of fact in English law. Shouldering the bank with the risk of recovery in such circumstances is based on the view that such bank has the last clear chance to avoid

the erroneous transfer. Allocating losses and risks on the ground of such policy will give incentive to the party in a better position to avoid such losses to do so. The same incentive is given to a customer who commits an error in his payment order.

Once again, the United States law has different approach to errors committed by banks during the execution of payment orders. Banks' liability depends on whether the EFT transactions is a consumer or commercially based transaction. In consumer-based transactions, a bank is under a duty to investigate errors according to a mandatory error resolution procedures. A consumer must notify his bank of the alleged error for such procedures to be triggered. This notification should be made within sixty days of the date on which the bank transmitted the documentation showing the error. One salient feature of the error resolution procedure is that a bank is under a duty, in certain circumstances, to provisionally recredit the consumer's account by the alleged erroneous amount and allow the consumer full use of such amount during the investigation process. The bank must notify the consumer after recrediting occurs. Depending on the result of the investigation, the bank is required to take certain steps to implement such result. However, a consumer who is not satisfied with the result of the bank's investigation still has his substantive rights to sue the bank in a court of law. The error resolution procedure is introduced as a consumer protection measure, so consumers need not go to court each time they discover an error in their EFT transactions. Where an erroneous EFT transaction has not been resolved by error resolution procedures, a bank could be held liable to pay "actual damages proved" if the error alleged was not intentional and resulted from *a bona fide* error. Other types of error may lead to liability for "all damages proximately caused" by such an error. Banks, however, are excused for errors caused by technical malfunction or acts of

God. In commercially-based transactions, the rule is that a bank that erroneously executes a payment order is liable to its sender for the results of such error. Thus, a bank that erroneously executes its sender's payment order by transferring a greater amount is not entitled to debit its sender's account by the overpayment. The sender, however, is under a duty to exercise ordinary care to determine, on the basis of information available to it, that the order was erroneously executed. If the sender discovers an error, it should notify its bank of the relevant facts within a reasonable time not exceeding ninety days after the bank's notification to the sender of the fact of the transfer. Failure to do so, deprives the sender of claiming interest on the refundable erroneous amount for the period before the bank learns of the error occurred. The sender's failure to discover and notify its bank of an error in its account within one year of the bank's notification of a debit entry in such an account terminates the sender's right to the erroneous amount transferred.[60] A bank that commits an error in executing a payment order causing payment to a wrong beneficiary is not entitled to debit its sender's account. Where the payment order identifies the beneficiary by its name and its account number, the beneficiary's bank's liability for paying to either one if it turns out later to be the wrong beneficiary depends on the knowledge of that bank of the existence of the discrepancy. If the bank is not aware of such discrepancy, it is entitled to rely on the account number as the proper identification method of the beneficiary. Thus if the bank, in this case, pays according to an account number, which turns out later to be the wrong beneficiary, the bank is still entitled to be paid for such transfer. That is because, unless the beneficiary's bank is aware of such discrepancy, it is under no duty to determine

[60] U.C.C. § 4A-505.

whether the name and number refer to the same person. The justification given for such a rule is that imposing such a duty on the beneficiary's bank would cost time and money and thus the benefit of a high speed electronic transfer would be lost.[61] If the bank relies only on the beneficiary's name, it will be liable to reimburse its sender if such payment was made to the wrong beneficiary. However, where the beneficiary's bank is aware of the discrepancy between the beneficiary's name and its account number, it should withhold payment. Nobody has the right to such payment as beneficiary; and the payment order cannot be accepted. If the bank, nevertheless, pays either to the account number or the name which turns out to be the wrong beneficiary, the bank does so at its peril. Originators, that are banks, are assumed to be aware that the beneficiary's bank may rely on account numbers in payment while originators that are not banks should be informed about such policy by their banks. The latters cannot be held to bear the loss resulting from such presumption. Payment orders that instruct payment to a nonexistent or unidentifiable beneficiary or account number cannot be accepted; and no payment should be made to any person or account number.

Since EFTPOS and ATM transaction are EFT transactions subject to EFTA, the rules of error discussed earlier under consumer-based transactions are applicable to errors in EFTPOS and ATM erroneous transactions in the United States law. In the United Kingdom, the Code of Good Banking has failed to address this problem despite the existence of Part B which is entitled "Customers and their Cards". Instead, the Code has a general rule requiring card issuers to have their "own internal procedure for the proper handling of customers' complaints". This should include informing customers how to file a complaint; and what further steps are available to them if they

[61] See the Official Comment 2 of U.C.C. § 4A-207.

believe that the complaint has not been dealt with satisfactorily by the card issuer. This leads, in the absence of any contractual agreement, such as in an account agreement, to the applicability of the agency rules holding that a bank is not entitled to debit its customer's account for an erroneous amount. Payment made under an error of fact is, generally, recoverable under common law and equity principles. It is clear that users of payment cards in United Kingdom are less protected comparing with their American counterparts.

Authorisation of banks to conduct banking transactions on behalf of their customers is one of the crucial issues in the banker-customer relationship. Banks' liability for unauthorised EFT transaction depends on whether such transaction is an electronic credit transfer transaction on one hand or an EFTPOS or an ATM transaction on the other hand. In the United Kingdom, common law states that a bank is only entitled to debit its customer's account if it has an authority to do so; and only if it conforms with the terms of such authority. However, where a bank debits its customer's account on the basis of an unauthorised credit transfer, the customer is entitled under common law to raise (i) a claim of declaration that the bank was not entitled to debit his account; (ii) a claim for repayment of the principal sum that the bank debited to the customer's account following a demand for repayment of such sum; and a similar claim of the interest on that sum; or (iii) a claim for damages for breach of an account agreement to repay the principal sum and interest thereon.[62] A customer may ratify an unauthorised credit transfer. Where the reason behind unauthorisation is forgery, it is submitted that such transaction cannot be ratified, but can be adopted. Where there is no ratification or adoption of an unauthorised credit

[62] *National Bank of Commerce v. National Westminster Bank* [1990] 2 Lloyd's Rep. 514.

transfer, the bank may seek other defences. A customer may be found liable for facilitating a forgery or under a duty to minimise losses by informing the bank of any unauthorised transfers in his account as soon as he becomes aware of it. A bank may plead that its customer is personally barred (or estopped under English law) from asserting that the bank is not entitled to debit his account. There is also the equitable defence of *Liggett's* case where a bank is entitled in equity to debit its customer's account if the unauthorised transfer has conferred a benefit on that customer and to the extent of that benefit. One example is where the unauthorised transfer has discharged a customer's debt. Finally a bank that fails to debit its customer's account may still recover from the beneficiary under equitable doctrines such as repetition under Scots law and money had and received under English law. Tracing funds under equity is a possible action under English law to recover money paid to a beneficiary who is not entitled to receive it.

The question in EFT transactions is whether the traditional methods of authentication and the allocation of loss relied on in other methods of payment are applicable in EFT transactions. Although certain procedures are commonly used by banks to authenticate customer's instructions, such as passwords, call-back methods, etc., it is noted that "no satisfactory technique has yet been evolved, which enables those instructions [i.e., EFT instructions] to be personalised in the way paper-based debit transfer instructions have up to now been personalised by the customer's signature on a cheque".[63] In most cases agency principles give banks very little protection in the case of unauthorised payment orders in EFT transactions. Taking into account the introduction of the new methods of authentication where no personal

[63] The Review Committee Report, at para. 10.02.

contact exists between the bank and its customer, and the large amount of commercial payment orders, a prudent bank will be unwilling to accept a payment order unless it has assurance that the order is that of its customer. This usually comes through an agreement between the bank and its customer on certain security procedure according to which customer's payment orders will be tested. Unlike the case under the United States law, there is no safeguards for the quality of such procedures under the British law. In addition to other requirements, a security procedure for verifying payment orders in EFT transactions should be "commercially reasonable" under Article 4A of U.C.C. Moreover, payment orders may be transmitted to the bank by electronic means. Thus, a bank may be required to act on the basis of a message that appears on a computer screen. Common law concepts of authority of agent to bind principal are not helpful. Banks will be in a dilemma as to whether, or not, they should execute such payment orders. It is difficult to determine the identity or the authority of the person causing such a message to be sent. The bank in this case is not relying on the authority of any particular person to act for the purported sender. This case is not analogous to paying a cheque by the drawee bank on the basis of a forged cheque. Banks usually rely on the security procedure employed to test that the payment order received is that of a given customer rather than on the concept of authority. Thus, it may be rather misleading to talk of authorisation where a security procedure is employed. Verification is probably the right term to be used in such circumstances. A given payment order may pass a security procedure adopted by an agreement between the bank and the sender but still unauthorised. That is where there is a fraud by a third party who has no connection to either the bank or the sender. Although British banks, in practice, agree with their customers on the employment of such

systems, there are no statutory rules according to which losses will be allocated. In addition, there are no minimum security requirements that a British bank must satisfy before imposing its security procedure on most customers. Under the current law, it is up to the banks and the clearing or payment systems to take whatever measures they think are sufficient to protect the authenticity of payment orders and the integrity of the payment system. For example, CHAPS Clearing Rules require "[m]essages passing over the interbank network will be encrypted in accordance with the Code of Conduct for Encryption."[64] Another procedure adopted by the same payment system provides that "[p]ayment messages will be authenticated by the Payer Settlement Bank and Tested by the Payee Settlement Bank in accordance with the Code of Conduct for Authentication."[65]

Banks' liability for unauthorised credit transfer under the United States law depends on whether the transaction is a consumer or commercially based transaction. The United States law differs from the British law in its detailed regulation of such unauthorised transactions; and in allocating the loss resulting from such transactions according to certain policies. In commercially-based transactions, the allocation of loss depends on whether the parties have agreed on the use of a "security procedure". If no security procedure is agreed upon, the loss will be allocated according to the general principles of agency law. A sender is only liable if its bank is authorised to make the credit transfer or the sender is otherwise bound by its payment order under the law of agency. Authorisation can be actual or ostensible. A sender may ratify an unauthorised payment order. If the sender does not authorise the transfer of funds or

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[64] Rule 10(b) of CHAPS Clearing Rules (1985).

[65] Rule 10(c) of CHAPS Clearing Rules (1985).

is not bound by it under the law of agency the bank is not entitled to debit its account by the amount of the transfer. The bank, however, may recover from the beneficiary under the law of mistake and restitution. This is a common law approach and is similar to the one in place now in the United Kingdom. However, the approach of the United States law is not that straightforward when the parties agreed on the use of a "security procedure" to test the authentication of customer's payment orders in wholesale credit transfer transactions. Where the method of authentication is the use of passwords or electronic codes readable on a computer screen, it is difficult to verify them according to the common law concepts of authority and agency law. That is because such methods may suppress the natural relation between the payment order and the issuer. A payment order that is verified pursuant to an agreed upon security procedure is effective as the order of bank's customer, whether or not authorised by such customer, if (i) the security procedure used was "a commercially reasonable method of providing security against unauthorized payment orders", and (ii) "the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer".[66] A customer, however, may reshift the risk of loss to his bank if he proves that the unauthorised order was not caused, directly or indirectly, by him, any body entrusted by him, or by a third party who obtained information from a source controlled by him. A bank that is found liable for unauthorised transfer must refund its customer the amount transferred without authority and interest thereon. However, a customer is not entitled to interest on the amount refundable if he fails to exercise ordinary care in

[66] U.C.C. § 4A-202(b).

determining that the order was not authorised and fails to notify the bank of such facts. The notification must be made within a reasonable time not exceeding ninety days after the date of receiving information from the bank showing a debit in the customer's account with respect to the order. This failure does not affect the recovery of the principal sum transferred.

In EFTPOS and ATMS transactions, the commonly used method of authentication both in the United Kingdom and the United States is a plastic debit card with a magnetic strip used in conjunction with a PIN or a signature. The policies behind allocation of loss resulting from unauthorised EFTPOS or ATM transactions are different from those in commercially-based credit transfer transactions. EFTPOS and ATM transactions are usually consumer-based transactions. Losses resulting from unauthorised consumer-based credit transfer transactions are allocated by EFTA in the same way as those of unauthorised EFTPOS and ATM transactions. In the United Kingdom, the Code of Good Banking governs allocation of loss in unauthorised EFTPOS and ATM transactions. The authentication system used in EFTPOS and ATM transactions (debit card and PIN) is not out of the reach of fraudsters. Some new fraudulent schemes were discovered in the United States in ATM transactions. In the United Kingdom sending unsolicited cards is prohibited. A request for new cards should be made in writing unless it is a replacement of a lost or expired card; and banks should issue PINs separately from cards. Customers should be told of their responsibility to take care of their cards and PINs in order to prevent fraud. Where a customer's card is lost or stolen, his PIN is known by someone else, or his account included an item which seems wrong, he must notify his bank "as soon as reasonably practicable" after he learns of the relevant facts. The customer's liability is capped to

£50 or the actual amount lost whichever is less if the unauthorised transaction was made before the bank has been notified of the relevant facts leading to the loss. After a customer notifies his bank that "his card has been lost or stolen or that someone knows or may know [his] PIN", the bank will be liable for "the full losses incurred" as a result of "all transactions not authorised by the customer".[67] However, where such losses are proven to be caused by a customer's fraud he is liable. If such loss is caused by a customer's gross negligence he may be held liable. The burden of proving fraud and gross negligence or that a card has been received by a customer is on the bank.[68] In any case, banks' liability is limited to "those amounts wrongly charged to customers' accounts and any interest on those amounts".[69] This restriction rules out the recovery of any consequential damages.

Unsolicited cards are also prohibited under the United States law. The term "unauthorised electronic fund transfer" is statutorily defined in § 1693a(11) of EFTA as "an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate such transfer and from which the consumer receives no benefit ...". Banks' liability for unauthorised EFTPOS and ATM transactions has three tiers. First, if a customer notifies his bank of the compromise of his debit card or PIN within two business days of learning of such event the bank will be liable for $50 or the amount of the transaction whichever is less. Second, if a customer notifies his bank within sixty days of learning of the compromise of his card or PIN his liability will not exceed $500. Third, a customer is liable for all losses incurred if he fails to notify his bank within sixty days of the transmittal of any

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[67] § 18.1(b) of the Code of Good Banking (1991).

[68] § 18.5 of the Code of Good Banking (1991).

[69] § 18.2 of the Code of Good Banking (1991).

periodic statement showing the unauthorised transaction. The negligence of the customer is irrelevant. To hold its customer fully liable for all losses incurred, a bank must prove that the transaction was authorised by such customer. If the transaction was held to unauthorised the bank must also prove the conditions of imposing this limited liability on its customer. Evidence by a credible witness was favoured by American courts over a computer printout.

Since the banker-customer relationship in EFT transactions is contractual, the measure of damages applicable, in absence of contractual agreement to the contrary, is that applicable in breach of contract generally. Thus, where a bank breaches its account agreement with a customer to make an EFT transaction or fails to carry out customer's instructions properly the customer should be put on the same position he would have been in had the bank performed its account agreement and customer's instructions properly. This is subject to the remoteness test as laid down by *Hadley v. Baxendale* and the later cases. Under the United States law statutory measures of damages are applicable. In consumer-based transactions, a bank is liable for "all damages proximately caused" by its failure to make an EFT transaction or stop a "preauthorized transfer from a customer's account". Where the bank's failure to make an EFT was not intentional and which resulted from a bone fide error, the bank is liable for "actual damages proved" notwithstanding "the maintenance of procedures reasonably adapted to avoid any such error".[70] Banks are relieved from liability for failure to make an EFT transaction if such failure was a result of technical malfunction or acts of God under certain circumstances. Treble damages (three times the actual damages proved) are recoverable for banks' failure to meet certain

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[70] 15 U.S.C. § 1693h.

requirements of error resolution procedures in consumer-based EFT transactions. Where a bank violates EFTA's provisions, it could be held liable for "any actual damages proved" as a result of such failure in addition to statutory damages. In commercially-based credit transfer transactions, different measures of damages are applicable in different situations. The general policy is that an aggrieved party usually recovers his principal sum and interest losses thereon. Consequential damages are only recoverable in certain specific situations upon an express written agreement of the bank concerned.

It is argued that the situation concerning the recoverability of consequential damages under the British law for banks' failure to make a credit transfer properly (including in particular delayed transfer of funds) is unsatisfactory both to banks and customers. Under common law, consequential damages are not recoverable unless they were in the contemplation of the bank when it received the payment order. The bank should have notice of the special circumstances leading to such losses at the time of being instructed to effect the transfer. Concerning the customers, a notice of such "special circumstances" to the transferring bank does not mean that other banks in the payment process are in notice of such "special circumstances". Transmitting such notice to each bank in the payment system is clearly too cumbersome a requirement for a method of payment designed to operate quickly and at low cost. Thus, where the transferring bank disclaims liability for negligence of such banks (and this is common banking practice), the customer may fail to recover consequential damages from an intermediary bank for its failure, for example, to effect the transfer in time. Arguing that a customer should guard against such eventuality by instructing his bank long before the time of payment required ignores the reality of the business world where

commercial customers are justified economically in keeping their funds in use (at least earning interest) to the last possible moment. They are also justified to rely on such advanced payment systems that claim to efect payment, for example, on the same day.[71] Concerning banks, the knowledge of such "special circumstances" leading to the recovery of consequential damages could be an imputed knowledge and is not necessarily to be actual.[72] The uncertainty resulting from the interpretation of such terms may cause banks thousands if not millions of pounds. Had the U.S. Court of Appeals for the Seventh Circuit affirmed the judgment of the District Court of Illinois in *Evra* case the Swiss Bank, as an intermediary bank in that case, could have lost $2.1 million in lost profits and approximately $16,000 in arbitrators and attorneys fees. The question as to the recoverability of consequential damages there was simple: was the mere fact of choosing telex rather than mail to effect the payment sufficient to alert the bank of the importance of the transfer to the bank's customer, which would put such bank in notice that its failure to act promptly would result in substantial damages to that customer? The District Court held that transferring funds by telex rather than by mail "was sufficient to alert the Swiss Bank to the importance of the transaction," and that "Swiss Bank, as a major international bank, could reasonably foresee that failure to act promptly upon receipt of such a telex message could result in substantial damage to a customer of the bank."[73] Relying primarily on *Hadley v. Baxendale*, the Court of Appeal reversed the decision because the special circumstances which created potentially massive damages were not communicated to

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[71] e.g., Rule 2(b) of CHAPS Clearing Rules provide that payment must be "an irrevocable guaranteed unconditional sterling payment for same-day settlement."

[72] See e.g., *Victoria Laundry* case, supra, at 539-540; and *Diamond v. Campbell-Jones* [1961] Ch. 22, at 35-36 per Buckley J. See also McGregor on Damages, (15th ed.), at para. 258; and McBryde, the Law of Contract in Scotland, at para. 20-62.

[73] *Evra corp. v. Swiss Bank Corp.*, 522 F. Supp. 820, 833 (N.D. Ill. 1981).

the bank; and that "electronic funds transfers are not so unusual as to automatically place a bank on notice of extraordinary circumstances if such transfer goes awry."[74] Ironically, the fees paid to carry out such transaction were only as little as U.S. $3.25.

This example shows the risk awaiting British banks if the uncertainty concerning this issue is not clarified by some sort of express regulations. This uncertainty is increased by the lack of any rule in the main British high-value payment system, i.e., CHAPS. Although transferring banks usually disclaim liability for consequential damages by contract, and so do other banks in the payment system, it is not clear whether such exclusion term in the correspondence agreement between an intermediary bank and a transferring bank will be enforceable against a transferring bank's customer who is suing an intermediary either under a *jus quaesitum tertio* doctrine (in Scots law) or under negligence.

There is, however, a fair and balanced way out of such dilemma to both the British banks and their corporate customers. A form of regulation should be passed in which banks are not to be held liable for consequential damages resulting from failure to make a credit transfer properly even if the bank has sufficient notice of the special circumstances that may lead to the occurrence of such damages unless the recovery of such damages is expressly agreed in writing by the bank subject to liability. This view is a balance between two extreme views. First, the view in which banks are not to be held liable for consequential damages. According to this view banks' customers become the *de facto* insurers of their banks' mishandling of their payment orders. The customers' inability to recover their consequential losses means that banks are effectively shielded from any substantial liability. Customers will have

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[74] *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 956 (7th Cir. 1982), cert. den'd, 103 S.Ct. 377 (1983).

to pay for their banks' faults and errors which they have absolutely no control over, and cannot effectively minimise such faults and errors. The another extreme view is to allow recovery of consequential damages and protect against that possibility by means of insurance. Such insurance coverage is not impossible to arrange. Indeed, Lloyds of London has offered to insure FedWire, CHIPS and SWIFT against loss from fraud caused by non-system employees. The obvious disadvantage here is that banks will offset their cost by increasing the price they charge for undertaking a credit transfer transaction. Such policy could make the EFT method of payment an expensive one; and thus may discourage its use and development. Under the suggested solution, it is up to the customer using this method to decide whether the payment of an extra amount is necessary and economically justified taking the nature and the time constrains of the particular transaction. Only he is in a position to weigh things up. Another advantage for the adoption of this view is that the ordinary transactions will go through the system at its high-speed, low-cost being not affected by this rule. The only shortcoming of this view is that it could prove difficult for banks to negotiate and price such special service. This suggestion is mainly based on the position of Article 4A concerning this point.

The last question that should be answered in this conclusion is whether in the light of the discussion of the current law in EFT transactions in the United Kingdom, new rules are needed. This question was raised by the Review Committee in it Report.[75] It was recommended that new rules for new technology were needed.[76] The same question was raised in the United States before legislation was introduced

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[75] See the Review Committee Report, at paras. 9.13 to 9.17 (arguments against new rules) and paras. 9.18 to 9.28 (arguments for new rules).

[76] Ibid, at paras. 9.29 to 9.31.

there.[77] The main argument against the introduction of new body of law to govern EFT transactions is that both paper-based transactions and EFT transactions are only methods to transfer funds from one person to another. The difference in the medium that funds are transferred through does not affect the parties' rights and obligation since the aim in every payment system is to get funds through from one person to another. According to this argument, the existing rules can be adapted to solve problems arising specifically in EFT transactions.[78] It is also argued that "pragmatism and common prudence must caution strongly against new law at this point in time. Electronic banking is in its infancy; inflexible legislation could stifle it. It should be allowed to develop in response to market needs: the need, or otherwise, for new law will become apparent when the systems have reached maturity, as happened with paper-based payment systems."[79] The case against the introduction of new rules to EFT transactions suggests that where the common law and other payment systems rules fail, private contracts between the parties will always fill the vacuum. The Unfair Contract Terms Act 1977 and the competition between banks will guard against unreasonable and unfair terms.

However, there are several powerful arguments for the adoption of a new independent body of law to govern EFT transactions. The new rules are needed not to govern problems resulting from the purpose of the EFT transactions but from the method of achieving such purpose. Thus, the conceptual argument raised above "could be said to miss the point."[80] One major problem in EFT transactions is how to

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[77] See, e.g., Feldman, Alan R., Electronic Funds Transfer, Practising Law Institute, New York, 1978, at 32-36.

[78] The Review Committee Report, supra, at para. 9.14.

[79] Ibid at para. 9.16.

[80] Ibid, at para. 9.19.

authenticate customer's instructions. Although in both a cheque and a computer-based instruction the purpose could be to transfer funds to a given payee, the method of authentication in each transaction is completely different and raises different legal problems. The Bills of Exchange Act 1882 does not apply to EFT transactions since its scope of application is restricted by conceptual definitions which are not applicable to EFT transactions. It was enacted with a paper-based transaction in mind. Although it is said that private contracts, including the rules of clearing and payment systems, may fill the legal vacuum, it is shown in the thesis and elsewhere[81] that most of such contracts are inadequate and drafted to protect the interest of the powerful banks. It is also shown that the rules of clearing and payment systems are procedural and do not address major legal issues. Another concern about the private contract mechanism is that such mechanism may not operate properly in the EFT environment because of the fear of a natural monopoly which might emerge to structure the risks resulting from EFT transactions. This monopoly may arise as the result of assigning risks internally to achieve efficiencies of both cost and operation. There are also those parties who might be affected by EFT transactions but who are not parties to such contractual arrangements. Finally, clear express regulation may advocate certain desired policies. Parties to EFT transactions could be given incentives to prevent and guard against common risks such as fraud and errors. Failing to prevent a loss from occurring, a rule may either distribute the loss according to the degree of fault or allocate the loss to the party that has the last clear chance to prevent such loss from occurring but failed (may be negligently) to do so. Under any arrangement, wherever

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[81] See Appendix F of the Review Committee Report. This appendix shows a selection of the terms and conditions of payment cards offered by the major banks. It discloses that such terms and conditions are drafted to shield banks from any substantial liability for their own errors.

commercial disputes occurs between banks and their corporate customers, certainty of result is more important than the ambiguity of traditional litigation. As one American judge put it: "[i]n commercial relationships known risks can be priced or shifted to others; if disputes arise, a bright line rule results in faster, easier settlements."[82] There is no such bright line rule under common law in EFT disputes under the British law.

It is probably advisable to leave payment cards outside any regulation since they are regulated by the recently introduced the Code of Good Banking. It is very early to decide whether this Code would succeed in solving problems in payment cards transactions and in reducing the pressure on the Office of the Banking Ombudsman. Thus, the scope of such regulation would be restricted to electronic credit transfer whether consumer-based or commercially-based transactions. The United Kingdom may utilise the experience of the United States in wholesale credit transfer legislation. The provisions of Article 4A could be looked at in the light of the British interests. Moreover, there is the fresh UNCITRAL Model Law on International Credit Transfers which could be looked at from a local perspective. The United Kingdom is already have a representative in the Working Group. If the United Kingdom were to adopt such Model Law, all international credit transfers, including electronic ones, conducted by British banks would be governed by an independent set of rules while internal credit transfer transactions would remain subject to private contracts and common law rules.

It is clear that this area of law needs more research and writing to clarify some difficult legal point as a result of the introduction of the new technology in banking

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[82] Davis J. in *Bradford Trust Company of Boston v. Texas American Bank-Houston*, 790 F.2d 407, 409 (5th Cir. 1986).

circles. Further research may undertake survey studies on the terms of the standard agreements offered by banks to customers, either in payment cards or in corporate credit transfer. The satisfaction of consumers with banks' services in this area, especially resolving disputes over error, for example, or authentications procedures may provide a good area for research. The success or failure of the new Code of Good Banking in practice may also be investigated.

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