Electronic Funds Transfer Systems Practice and the Law

Comment by

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I was reflecting on my way down here this morning that business men don't seem to like lawyers very much at times. The reason becomes clear at a gathering like this where business men are talking about a new venture. Although some problems are foreseen, the mood is basically optimistic. But you call in a pack of lawyers and immediately it is gloom and doom, because the good lawyers begin to look for what can go wrong in the arrangements and focus their attention on those sorts of matters. The practical lawyers attempt to re-arrange the structure so that the problems can be avoided, but once you let the academics in, well, it is the bitter end.

I think that nowhere is this more true than in a discussion of payment systems. By its very nature, for a payment system to exist at all it must have a phenomenally high rate of success. Look, for example, at the cheque system in Australia which reportedly clears something more than a thousand million cheques a year, and although it is difficult to know exactly how many go wrong, certainly as a percentage the number that go wrong is infinitesimal.

I have taught commercial law for some years and it's a real bumper year for a commercial law teacher when we get three or four cases reported concerning cheques that have gone wrong. Even if there are a thousand times that many that go wrong, but that don't make it to the law reports, and get settled in some other manner, it is still an impressive record of success.

This has sometimes been used as an argument that in the introduction of E.F.T., which I agree with Mr. Douglas, incidentally, is evolutionary, we should let it develop and see how it goes and hold off on the legislation.

I think it is instructive to look again at the cheque system to see why it has worked so well. After all, the cheque system itself evolved from the previous systems of payment, but in quite a different way from E.F.T. because the cheque began and remains as a particular form of a Bill of Exchange. The rights and obligations of the parties on Bills of Exchange were built up over many, many years and were well understood, so that when the cheque began to be used in London as a payment instrument rather than the credit instrument that most bills represented, it was easy to adopt these rules to settle most problems that would arise between the parties.

Now, gradually of course, the cheque system did become so large that the protections given to banks were inserted in the *Bills of Exchange Act* and gradually it became treated as a somewhat different instrument.

With the introduction of Electronic Funds Transfer, we may have some of the rules and obligations in place, and certainly it seems to be the opinion of the financial institutions

that the ones that are not in place can be regulated by contract amongst the parties. The UNCITRAL group that studied this matter seemed to find that this was a pervasive attitude amongst financial institutions in all parts of the world, that contract would be sufficient. What I would like to do is just to put a couple of examples to you to show that no matter how you draft your contract there are still going to be problems. Let me also note that these problems existed prior to the introduction of E.F.T. but perhaps not in quite as acute a form and perhaps nobody paid much attention to them.

The speed and invisibility of E.F.T. has changed these problems in their quality, I think. The first problem is the question of when payment is actually made and this is an interesting one because to some extent you can control it by the E.F.T. contracts that the organisations enter into, in much the same way that the clearing house rules now have a real legal effect on parties other than simply the parties to the clearing house agreement.

When you are trying to construct a rule for when time of payment might be, in other words when as between the institutions the transfer is irrevocable, the participants in the institution and the method of settlement become absolutely crucial. This can be seen in several existing E.F.T. systems. For example, in the FEDWIRE system in the United States, the order for transfer is irrevocable virtually from the moment it is sent. The reason is that settlement is through the Federal Reserve and is guaranteed by the Federal Reserve, so that participants in the system have a secure method of settlement. If you compare that with CHIPS, the very large payment system in New York City, you find an interesting rule of when payment is complete there. It seems to be conditional on all of the institutions surviving until the end of the day because CHIPS' rules call for the unravelling of all payments made by an institution which fails before the time of settlement at the close of business. I think most of us hope that that particular rule never has to be tested to see how well it works. As a final example, in the SWIFT network, which is essentially just a message switch, you find the method of settlement essentially determined by each transaction and the final time of payment is delayed until quite a late time in the transaction.

So those are considerations which have to be taken into account and that can, as I say, to some extent be controlled by agreement. But there is no guarantee that the time of payment which you agree among the institutions will necessarily be the time of final payment as between the end users, the transferor and the transferee. And this can lead to some quite unpleasant consequences. Probably the best example is the American case of the *Evra Corporation v. Swiss Banking Corporation* 522 F. Supp 820, rev 673 F 2d 951. The payment was late due to negligence on the part of the bank who was to make the value transfer at the payee's end, the Swiss Bank.

The plaintiff in the case was the person who was obliged to make a payment. He ordered his bank in Chicago to see that the payment was made. The contractual relationships between the plaintiff and his bank excused his bank from any negligence or any responsibility whatsoever, as is somewhat usual in banker and customer contracts in the United States. But of course the contract, no matter what it said, couldn't help the Swiss Bank who was a correspondent of a correspondent of the plaintiff's own bank. And so the action was brought in tort and indeed it seems to me that it is absolutely impossible for you to insulate yourself from tort actions in an E.F.T. payment system. The reason the *Evra* case is particularly interesting is that the failure to make payment on time, it was only $26,000.00, led to the result that the plaintiff lost the benefit of a charterparty and damages were assessed at something close to $3,000,000.00 which is an unpleasant sort of thing for bank managers to contemplate.

Let me first put your mind at rest and then upset you. The first thing is that the bank won, because they had the good fortune, I think, to go to the court of appeals where Mr. Justice Posner of the Chicago School of Law and the originator of the economic theory of law was sitting as judge. Counsel for the bank must have thought that all their

Christmases had come at once. I don't think we have time to go into it in any detail, but let me indicate that in my own view, Posner's arguments in favour of the bank would not be sustained by any court in Australia. Indeed, I believe that the opposite result would be reached.

His argument rested essentially on two propositions. The first was a very strict interpretation of what it means for losses to be foreseeable in a contractual situation. I think it is beyond question that his strict interpretation is precluded in Australia because we follow the English House of Lords decision in the *Heron II* [1969] 1 AC 350 on foreseeability and without going into any details I cannot imagine that Posner's interpretation would be accepted now in Australia. The second part of Posner's argument is that foreseeability criteria in tort and in contract are the same. That also is precluded in Australia where the foreseeability requirements in contract are rather narrower and more circumscribed than in tort. Phrased another way, the class of events 'foreseeable' by the 'reasonable man' in tort is very much larger than the events which are 'foreseeable' by the parties to a contract. So that on both counts it seems to me that the bank would have been on a losing ride had the action occurred in Australia instead of in the Circuit court of appeals in New York.

There is just one other point that I would like to mention and that is the question of the suspension of payment obligations between the transferor and the transferee in the event of a general meltdown of the E.F.T. system. You all know that things will at some time or another go wrong and the extension of Murphy's law to computers says that it will go terribly wrong and so we have got the problem of perhaps very, very many payments having been ordered but not met on time. It would seem to me that that's a very clear case for legislation. The American E.F.T. Act says that under certain circumstances those payment obligations should be suspended until such time as the system is operating again.

So to summarise very shortly what has been a very short introduction to a complicated area, I don't think that you will be entirely happy with contractual arrangements. I think that we will see financial institutions among the forefront in calling for legislation at least of certain types. Whether it will happen as fast as the new Cheques Bill has happened we will have to wait and see. Thank you.