CURRENT DEVELOPMENTS
Automatic Crystallisation Clauses

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Thank you Mr Chairman, ladies and gentlemen. The first thing one might say in relation to Mr Gough's paper, is to acknowledge the force of his criticisms of the critics of automatic crystallisation. The basis of the antipathy to automatic crystallisation appears to be a reluctance to permit the secret creation of fixed security over a company's assets. Our system of commercial law recognises and tolerates the infamous Romalpa clause, under which title can be reserved to a manufacturer until payment is made for goods supplied. Why we should regard automatic crystallisation of a floating charge as anathema, is far from clear, especially since, as Mr Gough points out in his paper, particulars of a charge and the possibility of its automatic crystallisation are required to be made a matter of public record.

It may be that as a matter of history the Romalpa clause was developed as an answer of the supplier of goods to the floating charge used by the provider of money. But if it is the possibility that an innocent third party may deal with the ostensible owner of goods or assets to his detriment, without any opportunity to discover infirmities of title, that is thought objectionable, then it is the Romalpa clause, rather than the automatic crystallisation clause, which should engage the attention of the law reformers.

The second comment which I would like to make is that while I would heartily agree with Mr Gough that it is silly that after 100 years of floating charges we should still be agonising about whether automatic crystallisation works, I am somewhat less sanguine than he as to the level of judicial acceptance of the possibility of automatic crystallisation. Recent decisions at first instance both in Australia and in England have left the question open as to whether automatic crystallisation can occur upon the occurrence of any event less drastic than the cessation of the business of the company. An example of that is the decision of the Supreme Court of Queensland in 1983 in Re Obie where Mr Justice Thomas expressly left the point open; and, indeed, in Re Woodroffe's (Musical Instruments) case, the decision in 1986 Chancery Reports that Mr Gough referred to, it

However, building societies are still constrained to use the services of participating member banks of the clearing house in order to clear payment orders under agreements not too different from agency cheque arrangements. The clearing aspects will be dealt with later in this paper.

II. Scheme of the Act

A. Agency Cheques

Section 100 (Part VII, Division 2) is the only section in the entire Act that deals expressly with agency cheques. It provides thus:

"Section 100(1): Where -

(a) the drawer of a cheque is a non-bank financial institution; and

(b) the cheque was, at a time when it was wanting in a material particular necessary for it to be, on its face, a complete cheque, delivered by the non-bank financial institution to a customer pursuant to an agreement under which the customer is authorised to fill up the cheque,

then unless the cheque was signed by the customer -

(c) the customer is not liable on the cheque; and

(d) the customer's account with the non-bank financial institution may not be debited with the sum ordered to be paid by the cheque.

Section 100(2): If the cheque is signed by the customer, then -

(a) as regards the holder or an indorser, the following provisions apply, namely:

(i) the non-bank financial institution shall be taken -

(A) not to have drawn the cheque; and
(B) not to have signed the cheque;

(ii) the customer shall be taken -

(A) to have drawn the cheque; and
(B) to have signed the cheque as drawer; and

(b) as regards the customer, the non-bank financial institution shall be taken to have the same duties and

liabilities, and the same rights in relation to the cheque as it would have had if -

(i) the customer had drawn the cheque;
(ii) the cheque were addressed by the customer to the non-bank financial institution;
(iii) the cheque were drawn against the customer's account with the non-bank financial institution;
(iv) the non-bank financial institution were a bank;
(v) in a case where the drawee bank pays the cheque to a person - the non-bank financial institution had paid the cheque to the person; and
(vi) in a case where the drawee bank dishonours the cheque - the non-bank financial institution had dishonoured the cheque."

The particular problems posed by this section are discussed in Part III, below.

B. Payment Orders

Part VIII of the Act (ss.101 to 112) regulates payment orders. By legislative short-cut, instead of repeating the provisions for cheques in relation to payment orders with the necessary changes, the Act provides that certain provisions (most of them, but not all), apply, subject to the modifications set out in the schedule to payment orders as if references to a cheque were references to a payment order and references to a bank were references to an NBFI: see s.104(1).

Since its enactment, the Act has been amended by the Statute Law (Miscellaneous Provisions) (No. 1) Act 1987 (Cth) and the Proceeds of Crime (Miscellaneous Amendments) Act 1987 (Cth).

These amendments and modifications for payment orders to the provisions of the amended Act make the Act unreadable and frustrating to comprehend. It is extremely difficult to ascertain that one's own consolidations and amendments pursuant to these changes are accurate.

To take a simple illustration, look at s.92. This section states: "Subject to sub-section 32(1), where a bank, in good faith and without negligence, pays a crossed cheque drawn upon it to a [bank], the bank shall be deemed to have paid the cheque in due course".

The reader's attention is drawn to the second reference to "bank" in square brackets because that is a statutory modification which has to be made pursuant to the Schedule when that section is read in the context of payment orders. This Schedule provides that the word "bank" (within square brackets - the brackets are the author's) should be substituted with the words "financial institution". One must then remember that by s.104, references to a cheque have also to be read as references to a payment

order, and references to a bank are to be construed as references to an NBFI.

So in fact, in the context of a payment order, s.92 should read: "Subject to sub-section 32(1), where a non-bank financial institution, in good faith and without negligence, pays a crossed payment order drawn upon it to a financial institution, the non-bank financial institution shall be deemed to have paid the payment order in due course".

This is a short section - relatively easy to amend and upon which to superimpose the Schedule modifications - but it suffices to illustrate how unnecessarily tortuous and confusing the exercise is, merely to work out what a particular section provides in relation to payment orders, without even considering any interpretative aspects. The sections which apply to payment orders should be re-enacted anew.

III. Agency Cheques: Section 100

There are a number of problems with s.100.

The purpose of this section is to transfer the liability of an NBFI as drawer of an "agency" cheque to the customer signing the cheques so far as holders or indorsers of the cheque are concerned and to confer upon such customers the same rights on the cheque vis-a-vis the NBFI as those available to drawers. (See Explanatory Memorandum to the Amendments and New Parts and Schedules of the Cheques Bill 1985). Thus sub-s.(2) provides that, where the cheque has been signed by the customer:

(a) as regards the holder or an indorser, the NBFI shall be taken not to have signed nor drawn the cheque; and

(b) the customer shall be taken to have drawn and signed the cheque as drawer.

The sub-section also goes on to state that as regards the customer, the NBFI shall be taken to have the same duties and liabilities, and the same rights, in relation to the cheques as it would have had if:

(i) the customer had drawn the cheque;

(ii) the cheque were addressed by the customer to the NBFI;

(iii) the cheque were drawn against the customer's account with the NBFI;

(iv) the NBFI were a bank;

(v) in a case where the drawee bank pays the cheque to a person - the NBFI had paid the cheque to the person; and

(vi) in a case where the drawee bank dishonours the cheque - the NBFI had dishonoured the cheque.

The main trouble with this provision is that it attempts to put what is basically a four-party relationship under a three-party umbrella.

Sub-section (2) only discusses the position of the NBFI vis-a-vis the holder or an indorser, and vis-a-vis the customer. The first major criticism that may be levelled against it is that it does not tell you what the position is, so far as the relationship between the bank or the NBFI is concerned. What, for example, are their respective duties, rights and liabilities vis-a-vis each other? Is it all to be spelt out in the agency agreement between the bank and the NBFI, or do the existing provisions, in some mysteriously implied way, govern their relationship vis-a-vis one another? The Explanatory Memorandum to the Amendments and New Parts and Schedules of the Cheques Bill 1985 stated that nothing in Clause 96D - the precursor of s.100 - was intended to alter the relationship between banker and customer that exists between the NBFI as drawer bank in respect of "agency" cheques. That, in the author's opinion, is not enough. An explanatory memorandum is not part of an Act. At best, the courts may have regard to it in interpreting the Act. But courts are not bound to give effect to the intention expressed in an explanatory memorandum and may well decide otherwise. Other implications may be drawn if the particular circumstances require it. Furthermore, although s.100 is one of those "mandatory" provisions in the Act in that by virtue of s.6 the rights, duties and liabilities therein may not be altered by agreement, surely the NBFI and the bank concerned may, as between themselves, set out their respective rights, duties and liabilities on which the Act is silent?

Secondly, "customer" is not defined in this Division. It is meant to refer to the customer of the NBFI in question, but it does not say so. In ordinary banking relationships, the "customer" always refers to the bank's customer, i.e. in the case of "bulk account" agency cheques, the bank's customer should properly be the NBFI.

Thirdly, another major failing of this section is that it only addresses the "bulk account" type of agency arrangement, and not the "multiple account" agency situation. Section 100(1)(a) refers only to circumstances where "the drawer of a cheque is a non-bank financial institution". Banks under the "multiple account" arrangement would therefore continue to have the same duties, rights and liabilities as under an ordinary cheque. The NBFI, being a pure agent, would have no legislative responsibilities, liabilities, rights or protections under this section.

Fourthly, consider the position where there is a "bulk account" agency and the cheque has not been signed by the customer. Section 100(1) provides that:

"Where:

(a) the drawer of a cheque is a non-bank financial institution; and

(b) the cheque was at a time when it was wanting in a material particular necessary for it to be a complete cheque, delivered by the non-bank financial institution to a customer then unless the cheque is signed by the customer;

(c) the customer is not liable on the cheque; and

(d) the customer's account with the non-bank financial institution may not be debited with the sum ordered to be paid by the cheque."

On a point of drafting, a cheque is not a cheque if it is wanting in a material particular. Section 100(1)(b) is therefore technically wrong.

Again, the problem of trying to subsume a four-party relationship under a three-party one rears its ugly head. The Act is silent on whether the non-bank financial institution is to be liable in this situation where the customer has not signed the "cheque" but someone else has forged his signature. May the bank debit the non-bank financial institution's bulk account? How do the established principles governing "banker-customer" relationships fit into this structure? One could apply the principle that a forged mandate is no mandate. But do the qualifications to this principle, such as estoppel and the Liggett defence (Liggett B. Liverpool Ltd. v. Barclays Bank Ltd. [1982] 1 K.B. 48) apply?

Section 100 would appear to absolve the customer totally from any liability if he has not signed the cheque. If this is correct, it represents quite a radical departure from the old law. The customer in an agency cheque situation would be better protected than in a non-agency cheque situation. His rights and liabilities would not be the same as those of a customer of a bank - and this is clearly contrary to the stated objectives in the Explanatory Memorandum.

A host of other difficulties arise as a result of the failure to recognise that the rights and obligations of the four parties have to be expressed vis-a-vis each other. To take another example, to whom does the customer owe a duty of care in drawing up the cheque? Section 100(2)(b) suggests but does not state that it is owed to the NBFI and not to the bank. This means that the NBFI is entitled to debit its customer's account if the customer had been negligent in drawing up the cheque. But is the bank entitled to debit the NBFI's account? The section fails to address the position of the NBFI vis-a-vis the bank.

Other cogent questions are: To whom does the bank owe the duty of secrecy? The NBFI or the NBFI's customer? Or both? Does the NBFI owe its customer a banker's duty of confidentiality by virtue of s.100(2)(b)? If it does, is it owed only in circumstances where the cheque has been signed by the customer?

Further questions may be raised in relation to the dishonoured cheque. What happens if a cheque is wrongfully dishonoured? Does the customer sue the bank of the NBFI, or does the NBFI have to sue the bank on the customer's behalf? What if the cheque has been properly and not wrongfully dishonoured?

Ignoring s.100 for the moment and working from first principles, if it is assumed that the account with the bank is held by the NBFI, one would ordinarily expect that the NBFI is the person the holder would sue for summary judgment. The customer of the NBFI is but its agent because the NBFI is the true customer of the bank. But s.100(2) provides that vis-a-vis the holder, the NBFI shall be taken not to have drawn or signed the cheque and that it is the customer who is deemed to have signed and drawn the cheque as drawer i.e. the holder will have to look to the customer, not the NBFI, for compensation. However, vis-a-vis the customer, the NBFI is taken to have dishonoured the cheque. So, in the case of a wrongful dishonour, the NBFI's customer sues the NBFI rather than the bank. May the NBFI then join the bank as co-defendant? Would provision for this have to be made in the bank-NBFI contract? Or is the situation still that, vis-a-vis the bank, the NBFI is its customer? Again, do we have to fall back on the Explanatory Memorandum to interpret this section?

Who, in reality, is the bank's customer for any determinations with regard to the "banker-customer" relationship in an agency cheque situation? In truth, what the draftsmen have done in relation to s.100 is to attempt to create two "banker-customer" relationships without fully evaluating the consequences. Section 100 has distorted some of the consequences of the application of agency principles without offering comprehensive solutions to the problems flowing therefrom.

One could go on. The short sharp truth of the matter is that s.100 just has not been carefully thought through. It ought to be completely redrafted or, in the light of the availability of new payment orders, repealed.

IV. Payment Orders

(a) The Statutory Provisions

Section 104 is the section that applies the Act to payment orders, subject to the Schedule modifications. Section 103 provides that the rules of the common law (including the law merchant) that apply to cheques, apply mutatis mutandis, in relation to payment orders. "Customer" is defined for purposes of payment orders. Both ss.103 and 104 provide that a member of

a building society or credit union shall be taken to be a customer of the building society or credit union, as the case may be.

It is curious that the definition of "customer" should be so confined to members of building societies and credit unions when the definition of payment order in s.101 is with reference to an order drawn on an NBFI. "Non-bank financial institution" is defined in s.3 to include any registered corporation within the meaning of the Financial Corporations Act 1974.

So, if a merchant bank wishes to grant its customer payment order facilities, is such a customer not a customer for the purposes of the Act? This is a dangerous omission that should be rectified. "Customer", for the purposes of payment orders, should be redefined.

Not all the provisions in the Act apply to payment orders. This fact indicates a concession to the difficulties of drafting rather than any intended difference. Division 2 contains provisions governing the presentment and payment of payment orders which parallel the provisions in Part IV relating to the presentment and dishonour of cheques. A payment order may be collected by any financial institution including a bank and presented for payment to the relevant NBFI using the same methods for cheques (s.106). These allow for truncation procedures.

In all important respects, payment orders are treated just like cheques. It is possible for payment orders to become stale where these have been apparently drawn for more than 15 months; a payment order may be crossed or indorsed; NBFIs are accorded the statutory protections afforded collecting and paying bankers in relation to the collection of cheques (ss.98 and 99) and payment orders (ss.95 and 96, as modified by s.104), and the payment of payment orders (ss.91-94, as modified by s.104).

(b) Arrangements in Place

The Act commenced operation on July 1, 1987 but to date, there has been only one NBFI payment order (the REI Building Society in South Australia) in circulation. Much of the delay is attributable to the establishment of rules and arrangements for their clearing.

It appears that the credit unions and AFCUL (the Australian Federation of Credit Unions) are quite happy with their existing agency cheque arrangements and have not taken an active part in the negotiations which banks and building societies have entered into for some kind of a "charter" with respect to the clearing of payment orders through banks.

Why do they clear through banks in the first instance? Theoretically, there is nothing to prohibit NBFIs from setting up their own clearing house or houses and dispensing with the need

to have their instruments processed through a bank or banks. The day may come when it might be more economical for them to do that, but certainly, at the present time, there is not the volume to justify the enormous costs of setting up a clearing house.

Secondly, unless there is an interface between efficient clearing systems, the payments system would not be terribly efficient and payees without accounts at institutions in both systems will be at a disadvantage.

Thirdly, the banks have exhibited considerable reluctance to allow participation by non-banks in their jointly owned clearing house. The rules pertaining to the clearing of cheques are contained in two principal instruments - the Australian Clearing House Agreement (ACHA) and the Record of Agreement Between Banks (RABB), which deals with procedures. The ACHA is a deed to which member banks subscribe and it sets out the rules of the association, membership, meetings, establishment of branch clearing houses in each state, rules governing the clearing house operations, the conduct of clearing and settlement etc.

The RABB details the procedures to be followed for cheque exchanges, presentments, dishonours, special answers, etc. To have direct access to the clearing system in Australia, a finance institution has to be a member of the Australian Clearing House (ACH). To be a member of the ACH, the institution must be a licensed bank. The question may be posed as to why the ACH Agreement (ACHA) may not be amended to include NBFIs. The answer is very readily found - clearing house members only wish to deal with other banks. The cynical would say it is a cartel; the banks would argue that there are sound reasons for excluding other organisations from the agreement, namely, prudential and practical considerations.

(1) The Prudential Aspects

- Member banks of the Clearing House are required to carry a prudential load.

- The Reserve Bank has no direct control over NBFIs like building societies and credit unions which are state-regulated. Other NBFIs are simply registered financial organisations under the Financial Corporations Act (Cth), not subject to much prudential supervision.

- Clearing houses require that there be no settlement risk whatsoever and the argument, which is not necessarily irrefragable, is that these NBFIs may present risks which are unacceptable in the interests of a stable financial system in which the public has confidence. The Australian Association of Permanent Building Societies (AAPBS), however, takes the view that the regulation of permanent building societies in Queensland and Victoria are more onerous than that to which banks are subject.

In the Bankcard Agreement Application, the Trade Practices Tribunal refused authorisation of Clause 3 of the Interbank Agreement which precluded the admission of NBFIs in relation to Bankcard. As that case indicated, there is no simple answer to the question whether the exclusion of other parties from a joint venture is, or is likely to be, anti-competitive. In some situations, it may actually be pro-competitive.

The test appears to be "whether or not the joint venture controls a 'bottleneck facility', i.e. a facility which is not available outside the joint venture, and is incapable of duplication or being 'invented around', and which others must have access to if they are able to compete in the market". If it does, then there are good grounds for arguing that the exclusion of others is anti-competitive. If not, then it may be argued that the exclusion of others is not anti-competitive, and may even be pro-competitive in that it forces others to compete at arm's length through a rival scheme.

There are valid arguments for excluding NBFIs. These may be summarised thus:

(i) It is technically possible for NBFIs to set up their own clearing system.

(ii) NBFIs have indirect access to the clearing system through agency agreements.

(iii) The inability to participate in clearing has not impaired the NBFI's ability to provide cheque payment facilities.

(iv) It is important to maintain a high level of public confidence in the payments system and admission of NBFIs might erode that confidence.

(v) NBFIs are not subject to the same onerous prudential requirements and supervision as banks and may not have the same (undoubted) ability to pay as banks.

As against these arguments, the case for opening up membership to NBFIs can be put as follows:

(i) The evidence in the USA and Canada shows that a stable payments system can be guaranteed by deposits, insurance arrangements and an associated high level of prudential supervision.

(ii) Duplication of the clearing system would be a waste of resources.

(iii) The threat of potential entry will ensure that established institutions remain competitive and efficient.

(iv) More doubtful is the argument that a more widespread participation would benefit the public in terms of easier access to payment services.

On balance, the exclusion of NBFIs is probably not anti-competitive.

Is the restriction a breach of s.45D of the Trade Practices Act (Secondary Boycotts)?

This section prohibits two or more persons from engaging in conduct that may hinder or prevent a third corporation from supplying or acquiring services for the purposes of and would be likely to have the effect of causing substantial lessening of competition in any market in which the corporation operates. The test here is to ask whether the restriction on entry to the clearing system would substantially damage the NBFI's ability to participate in providing cheque or payment order services or of lessening the market competition on these services.

The answer is, probably not. NBFIs have been able to offer cheque payment services through agency arrangements, and payment orders services may operate equally well under clearing agency arrangements. There is therefore no substantial damage to NBFIs caused by a refusal of admission to the ACH.

Is there an abuse of market power under section 46(1), Trade Practices Act (monopolisation)?

Section 46(1) of the Trade Practices Act prohibits a corporation with a substantial degree of market power from taking advantage of that power to:

- substantially damage or eliminate a competitor;
- prevent entry into any market; or
- prevent or deter anyone from engaging in competitive conduct in any market.

The question is whether "taking advantage" involves an element of "conscious predatory behaviour for a proscribed purpose" which was held to be required in Queensland Wire Industries Pty Ltd v. BHP ((1987) ATPR at p. 48,819). However, it is arguable that NBFIs are, in any case, not prevented from entry into the payment instruments market nor prevented or deterred from engaging in competitive conduct. They are free to set up their own clearing arrangements and have certainly not been substantially damaged or eliminated as competitors. Therefore, it is unlikely that an attack based on s.46(1) will succeed.

For the moment, the AAPBS has, jointly with the Australian Clearing House, developed a set of procedural rules for the clearing of payment orders. It is understood that they are ready

to be signed off, if that has not already occurred. The RABB will no longer be known as such, but as the RABBNBFI. For the most part, it will address issues similar to cheque clearing including, inter alia:

- identification for the clearing bank on the payment order;
- design specifications of payment orders;
- basic clearance procedures - what an NBFI does with a cheque and what a bank should do with a payment order;
- direct remittance procedures;
- non-arrival of remittances;
- special answers;
- collection of payment orders and agency cheques;
- how to deal with non-conforming instruments;
- presentment, dishonours, time limits and reasons;
- missing and lost items;
- dispute settlement procedures;
- adjustment of interest.

There are some differences though. In the case of a cheque, a bank settles with another bank by a warrant drawn on the bank's Reserve Bank settlement account. In the case of payment orders, the clearing bank settles with another clearing bank using their respective Reserve Bank settlement accounts. It then debits that amount from the settlement account which the NBFI in turn has with it as agent clearer. In a sense, the bank underwrites the NBFI for which it clears.

The REI Building Society Payment Order

This is reproduced with the kind permission of the REI Building Society (see Appendix). The payment order looks like a cheque. The points of difference are as follows:

(i) It bears the name of the REI Building Society.

(ii) This instrument is cleared through the Chase AMP Bank, Adelaide Branch. The number "CP-21" is called the "mnemonic" - it is there for the purpose of visual identification in branches of banks which do not have the electronic capacity to read the MICR line.

(iii) MICR line: The number "21" represents the Chase AMP Bank. "5" signifies South Australia. "528" will be the number the Chase AMP Bank has allocated to the REI Building Society.

The REI payment order preceded the rules which have been developed for payment orders. As a consequence, there will be some minor changes to the layout of this instrument. Note that under the rules, only the "mnemonic" number need be printed. There is no requirement to specify the clearing bank.

V. F.I.D., Debits Tax and Stamp Duty

Debits Tax

Following the enactment of the Cheques and Payment Orders Act, a new Taxation Laws Amendment Act was enacted with the consequence that the Bank Accounts Debits Tax (the BAD tax) has ceased to be BAD and is now known simply as the Debits Tax. It applies to payment order accounts with NBFIs in the same way as debits tax applies to cheque accounts.

Financial Institutions Duty (F.I.D.)

F.I.D. is payable on the receipt of money by registered financial institutions.

A deposit account at an NBFI will therefore be caught. However, a NBFI's account with a bank for the purposes of a clearing arrangement is exempted from F.I.D. in some states (e.g. New South Wales and Western Australia, but not Victoria).

Stamp Duty

In New South Wales, the definition of a "cheque" has been expanded by new s.46A expressly to include a payment order. While bills of exchange issued after January 1, 1983 are not chargeable with duty, such exemption does not extend to cheques under s.51(3) of the Stamp Duties Act 1920, as amended. The duty payable on a cheque or payment order is ten cents.

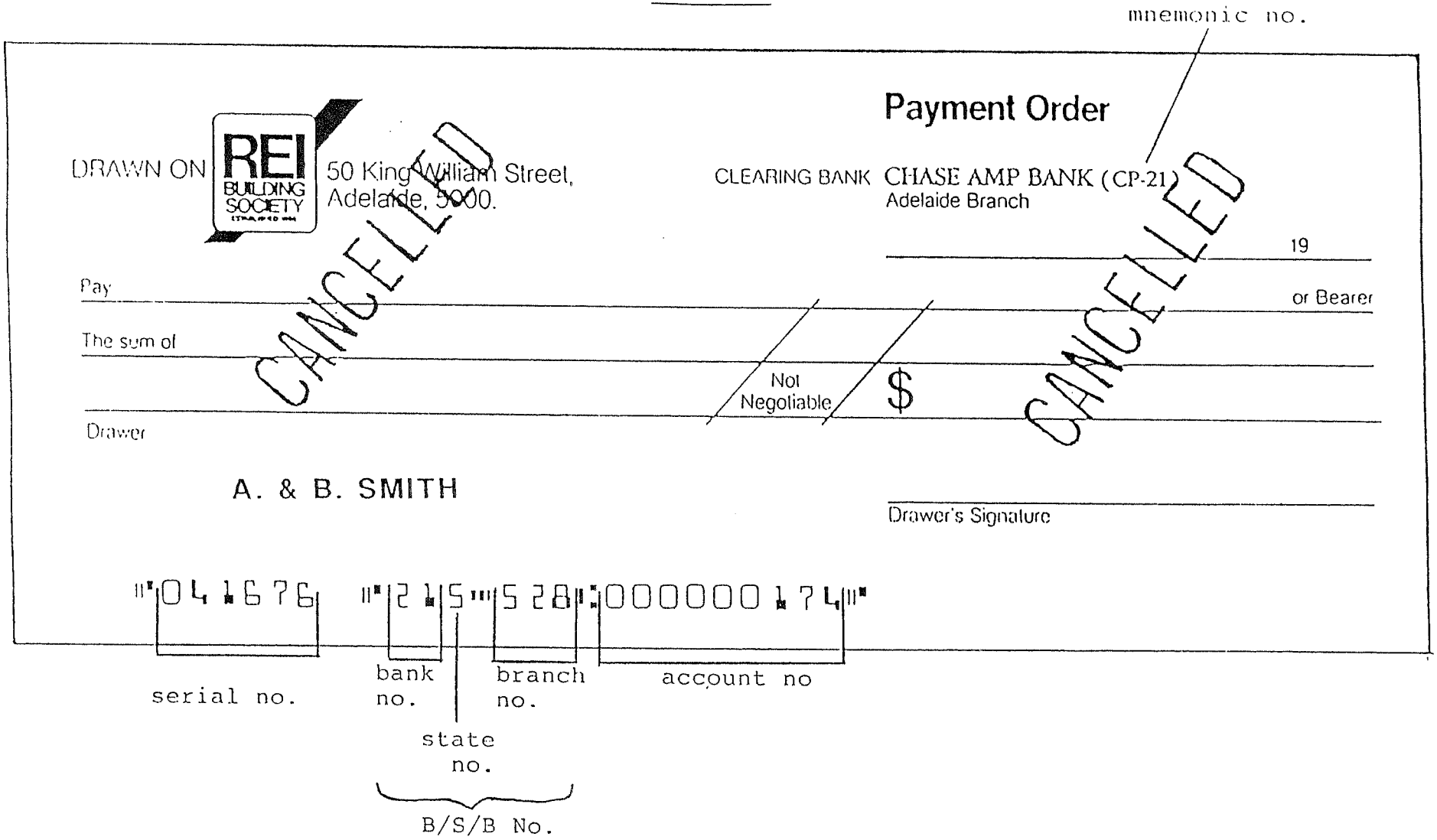
No stamp duty is payable on payment orders in Victoria.

In Queensland, "bill of exchange" is sufficiently widely defined in the Stamp Duties Act 1894 as amended to encompass payment orders. The only duty charged is on a bill of exchange payable on demand or at sight, or on presentation. This catches the payment order which is therefore subject to a duty of 10 cents. A similarly wide definition of "bill of exchange" is to be found in the South Australian provisions. However, bills of exchange (other than a cheque) issued on or after January 1, 1984 are not chargeable with duty and "cheque" would not appear to include a payment order. Thus no stamp duty is chargeable upon payment orders in South Australia.

Payment orders fall within the definition of "bills of exchange" in Western Australia and are chargeable with duty of 10 cents.

Payment orders are exempt from stamp duty in Tasmania but dutiable in the Northern Territory (10 cents) as a bill of exchange. Stamp duty of 10 cents is payable on payment orders (as bills of exchange) in the Australian Capital Territory.

APPENDIX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DRAWN ON REI BUILDING SOCIETY 50 King William Street, Adelaide, 5000.
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