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The Dematerialisation of Banking Instruments in Lesotho: Legal Implications

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Introduction

The advent of electronic banking in its varied forms and its rapid worldwide development and adaptation in the last two decades perhaps poses the most serious challenge to banking operations since the passage of the *Bills of Exchange Act*, (1882) in England; the contents of which were received in the then Kingdom of Basotholand under the *Bills of Exchange Proclamation*, 1912. The increased use of and adaptation to electronic devices and other forms of information technology has not always been accompanied by an appropriate legal regime to regulate it. This raises concerns since current trends show that the use of electronic technology is bound to increase if the financial services sub-sector is to continue providing both the quantity and quality of services demanded of it. In England, for example, it has been observed that:

the number of adults with bank accounts has grown from 25 per cent to 60 per cent in the past fifteen years. It is estimated that 2,500 million cheques and 500 million credit transfers were made in 1984. Paper-based systems are slow, labour-intensive, correspondingly expensive to provide and maintain. The customer is being encouraged to use automated teller machines and cash dispensers where possible, and the demise of the bricks and mortar of national branch banking networks for the provision of many routine banking functions is actively being forecast by planners and

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strategists looking out over the next decade¹.

Elsewhere, the demand for financial services has, equally, grown. In Lesotho, electronic banking comprising mainly of Bankers' Automated Clearing Services (BACS), Clearing House Automated Systems (CHAPS), Society of Worldwide Inter-bank Finance Telecommunications (SWIFT), Automated Teller Machines (ATM) (and to some limited extent the Electronic Funds Transfer at Point of Sale (EFTPOS) and the INTERNET² are estimated to account for up to 50 per cent of the total volume of banking transactions.³

All these generally indicate that paper-based banking operations and information storage systems are being replaced by electronic and digital messages which are in large measure intangible and can only be accessed either by a computer screen or appear in print form only at the end of the transaction. This has far reaching legal implications for the nature, attributes and the processes which banking instruments have acquired in the period of more than one hundred years since the promulgation of the *Bills of Exchange Act, 1882*.⁴

¹ Jonathan Less "Fraud, Error and System Malfunction: A Banker's View" in R. M. Goode (Ed), *Electronic Banking: The Legal Implications* (Institute of Bankers) (1985), pp. 57-58.

² For a detailed study of the nature and operations of Electronic Funds Transfers (EFT's) see R.M. Goode (Ed), *Electronic Banking: The Legal Implications*, op. cit. pp. 1-29; Anu Araro, *Electronic Banking and the Law (Banking Technology)* (London) (1993), pp. 1-21, 45-59, 61-84, 85-106. See also W. Kulundu "Bkomye", *Electronic Banking: An Overview of Systems and Operations*, *Lesotho Law Journal* (1999) (forthcoming).

³ See generally, *World Trade Organisation (the WTO) (Special Studies 2)*, "Electronic Commerce and the Role of the WTO" (1998), p. 6. These estimates exclude the use of other forms of electronic devices, such as the telephone and the facsimile. Electronic banking services in South Africa are "more advanced than those of Lesotho and their use is likely to be greater in percentage terms than the figures given for Lesotho. Worldwide, recent studies indicate that the share of Internet in world trade has catapulted from virtually zero to a predicted US\$ 300 billion in the ten years up to the turn of this century."

⁴ Commenting on this phenomenon Eyron-Smari "Electronic Banking: An Overview of the Legal Implications" in R. M. Goode (Ed) op. cit. p. 1, has observed that: "the optimist may suggest that there is nothing fundamentally new in electronic funds transfers; it is merely a variety of novel methods of transferring funds from D to C, and in banking any legal problems will be solved by analogy with existing law. The relationship of banker and customer is fairly well settled, and all that will be needed is the fitting of changed methods into an established framework. But optimism, based on a partial truth, oversimplifies the matter. Certainly the cheque, which commits the paying bank and when he decides to pay it (and which gives the unpaid payee a right of action against the drawer) is an uncertain basis for analogy." Further on, the same author states that: "banking practices in the new technology is hardly yet sufficiently mature to provide the guidance that the courts would look for; and the potential complications of effectively coping with its

the BACS batching process, are alarming. Clear and published rules might avoid some of the litigation that almost certainly lies ahead."

This paper discusses the problems relating to the dematerialisation of banking and the legal implications resulting therefrom. In particular, the paper discusses problems relating to first and third party electronic banking transactions. It will, however, be noted that due to the dearth of local materials and cases, because these technologies are still novel and on an experimental basis in Lesotho, reliance is made on materials and cases from other jurisdictions, where these transactions have had a long history of operation. At the local level, reliance is made exclusively of the *Bills of Exchange Proclamation*. The case law referred to comes from elsewhere. The legal implications drawn from these cases and experiences are, however, persuasive authority in Lesotho and in the absence of local materials will be applied by the courts.

The problem of dearth of local information and materials is compounded by the fact that contracts establishing and governing the provision of these services hardly provide for a way forward in the resolution of the many issues that are likely to confront both the banker and his customer. Again, banking practice is not sufficiently developed to step in and provide the required answers. It is to be noted, however, that international initiatives are beginning to emerge, for example, the European Union (1996) and UNCITRAL (1997) to bolster the lack of industry-based initiatives in this regard. It can only be hoped that the banking industry in this country will soon be able to emulate these developments from elsewhere!

The nature and some attributes of bills and notes

The *Bills of Exchange Proclamation, 1912* (a replica of the English Act of 1882, hereinafter, referred to as the *Proclamation*,) anticipated that payment instructions, whether inter-bank or customer-bank based, would be paper-based,⁵ in the sense that the instructions would entail some permanent form on paper or some other writing material and expressed in words.

⁵ Making this point, UNCITRAL (1987) states: "Technology requires an adjustment of the law in regard to such matters as the periods of time within which various actions are to be taken, the presence or absence of liability arising out of computer failure at one of the banks, clearing houses or communication networks, the time when a funds transfer becomes final and the consequences of finality. Modifications of this nature to the existing legal rules do not affect their structure, but they may modify their content to an important degree." The WTO (Special Study 2) 1998, at p. 37. Also states that: "a key issue regarding electronic commerce and the Internet is the need for legal clarity and for adequate redress mechanisms. Legal uncertainty can arise within the country if electronic contracts are unclear in terms of their enforcement or redress potential. The extrapolation of existing contract law to the electronic sphere may minimise such uncertainties. However, this situation can become complicated in the case of international transactions, where uncertainty about the jurisdiction of Internet commerce is seen as one of the main obstacles to international trade."

⁶ See BEP, sections 3, 4 and 5.

and figures which would then be authenticated by a signature of the person giving the instruction.⁷ The essential characteristic of these instructions was that they would not be readily altered without defacing the instrument itself; and that because the instrument assumed a physical and tangible form, it would be delivered⁸ and presented⁹ to the paying bank by the payee or other person on his behalf.

The process of delivery and presentation of the instrument was also anticipated to take some significant period of time, sometimes several days or even weeks;¹⁰ and the payee was entitled to endorse it, transferring his rights to the bearer.¹¹ A holder in due-course who acquired the instrument in good faith and for value effectively became the payee.¹² In this way, an instrument could be discounted from one person to another, giving the instrument the essential characteristics of transferability and negotiability.¹³

But this is not all. Because the instrument assumed a physical and tangible form, it acquired the attributes of property in its own right.¹⁴ A person could not be a holder in due-course unless he was in possession of the instrument. This meant that the instrument was not just a series of commands to pay at a particular time and place, but rather its possession constituted property. These essential attributes of paper-based instruments have been neatly summarised by Smart as follows:

(They) represent a succession of contracts; with every party acquiring rights and liabilities; it is a document requiring presentation, and it is itself an item of property. The difficulties of translating all this in electronic terms make any such translation unlikely in the foreseeable future.¹⁵

Electronic banking has changed all this. Starting with the telex and then the telephone and facsimile and more recently, electronically generated signals through computers or magnetic tape, payment instructions are today conveyed to banks without any tangible record being left behind by the drawer, Karmel has pointed out that:

⁷ See BEP, sections 22, 23 and 29.

⁸ See BEP, section 20.

⁹ See BEP, sections 30, 40 and 41.

¹⁰ See BEP, section 39.

¹¹ See BEP, section 30.

¹² See BEP, section 37.

¹³ See BEP, section 30.

¹⁴ See BEP, section 37.

¹⁵ Eymon Smart, "Electronic Banking: An overview of the Legal Implications" in R. M. Goode (Ed) *op. cit.* p. 2.

The information and technological revolutions, in particular the use of electronic technology as applied through the medium of computers, has in the last decade and half had a very significant impact on banking and other financial services, both at the domestic and international levels. Volume, speed, time and storage expenses are cut dramatically. The trend is to move away from paper-based transactions to paperless ones, appearing only as electronic messages on computer screens, which may only become tangible if printed.¹⁶

This is the system, which has now been dubbed "the third great age of payment systems" after cash (notes and coins) and cheque and credit cards.¹⁷ Instructions for payment are expressed in computer codes, with the handwritten signature replaced by a Personal Identification Number (PIN) or 'password'. Often there are no records of the actual instructions given, although the message may sometimes be logged during transmission. In a majority of cases, the instructions are instantaneous or take significantly short periods of time to convey and to be acted upon. This usually leaves no time for either a countermand or a revocation, nor is the instrument amenable to negotiation by endorsement. In some cases, the instructions are subject to alteration and erasure, leaving no record of the original. This has been partly possible because of the recognition that even under the paper-based payment systems, what was essential for the transaction to bind the parties was the information contained therein rather than the document itself. Explaining this process, Reed has stated:

In many ways, banking has been concerned with the possession and dissemination of information ever since the development of bills of exchange in the Medieval times. Until recently, however, that information was embodied in a physical object: a cheque, documentary credits or banker's own records, and as a result, most of the existing law of banking is concerned with the transfer of those pieces of paper and actions taken in respect of the information contained on them. Computers have freed information from these physical constraints. It is now possible to talk about 'pure' information divorced from the medium that carries it, which can be reproduced an infinite number of times and transferred across enormous distances all at speeds very close to the speed of light.¹⁸

¹⁶ Martin Karmel, "Procedure and Evidence: The Maintenance of Transaction Records, Proving the State of Account in EFT Transactions," in R. M. Goode (Ed) *op. cit.* p. 57.

¹⁷ Anu Araro, *op. cit.* p. 3.

¹⁸ Chris Reed, *Electronic Finance Law*, (Woodhead-Faulkner) (London) (1991), p. 1. See also Alan Urbach, "The Electronic Presentation and Transfer of Shipping Documents" in R. M. Goode (Ed) *op. cit.* p. 120, where he says: "In a normal transaction, it is the information in the paper that is the critical part. It is only in disputes that an authentic document is required."

By this process, payment systems have become dematerialised. The result of this development has been that two systems of banking, each based on its own technological assumptions, exist side by side. On the one hand, there is the paper-based system that was founded under the *Proclamation*; and on the other, there is electronic banking, operating under the aegis of the new information and technological order. Of the first, cheques, documentary credits and bills of lading are the most common forms; of the latter, BACS, SWIFT, CHAPS (Clearing House Inter-bank Payments CHIPS (in the USA), ATM'S, EFTPOS and Internet banking are the main operational forms. The ethos of operating each of these systems are different and sometimes conflict with each other.¹⁹

The driving force behind the development of electronic banking has been supplied largely by two factors. Firstly, there has been an astronomical demand for banking and other financial services. The increase in the volume of banking business has, in turn, created a competitive atmosphere in which financial institutions are required to optimally use their resources and, in particular, to eliminate the traditional constraints which lead to wastage of time, space and administrative and other handling overheads. A major concern for financial institutions has been the reduction of the volume of the paper generated in the course of their operations. Because of the large volume of paper handled, banking operations have traditionally been said to be labour intensive and comparatively more expensive. It has been observed in this regard that:

Because on the whole the present clearing systems are based on the physical presentation to the bank of the instrument evidencing the right of payment, it takes up to four days for the payment process to be completed. This undoubtedly results in waste of time and resources; there are limits to the economies that can be achieved when inter-bank cheque clearing is based on the physical movement of paper.²⁰

Secondly, electronic banking has been adapted rapidly by financial institutions partly as a logical response to the problems posed by and the shortcomings inherent in paper-based transactions. The technology built into these instruments is said to aim at four principal goals: the increase in and

¹⁹ This is notwithstanding the observation in *Barker v. Wilson* [1980] 1 WLR 884, that, 'The ... of Exchange Act must be construed in 1980 in relation to the practice of bankers as we now understand it. So construing the definition of "Bankers' books and the phrase "an entry in a banker's books", it seems to me that clearly both phrases are apt to include any form of record kept by the bank of transactions relating to the bank's business, made by any of the methods which modern technology makes available, including, in particular, microfilm'.

²⁰ Anu Araro, *op. cit.* P. 105. See also Jonathan Lass, 'Fraud, Error and Systems Malfunction: A Banker's View' in R.M. Goode (Ed) *op. cit.* p. 57.

expansion of the customer base; the reduction of the net costs of handling payments; the liberation of banking from the age-old constraints of time and space, and, the introduction of new products and services.²¹ These goals present immense advantages and benefits to the banking industry and as a result of them, electronic technologies of various types have been adapted.²² Financial institutions that are not willing or able to adapt to the new technological age may be doomed to failure!

Legal implications

There are several and serious consequences that may result from the adaptation of these technologies. To decipher properly the consequences resulting from these technologies, our analysis in this part of the paper is divided into first and third party applications. First party applications are those that involve directly the customer, where he holds either an ATM or EFTPOS card, or in more recent times, is linked to the bank by Internet. Third party applications on the other hand, are those which involve persons other than the customer, dealing with the customer's bank on the authority of instruments that they hold, such BACS, CHAPS (CHIPS), SWIFT, and a truncated cheque, purportedly originating from the customer. Each of these scenarios beholds different legal consequences. First party applications represent electronic banking technologies as immediate payment systems; and the second are a deferred payment system.

First party transactions

Where a customer is dealing directly with his bank, either with an ATM, EFTPOS card or is linked to his bank by Internet, two important questions arise: When is payment deemed to have been made to the customer; and who bears responsibility where a fraud, error, mistake or a systems' malfunction occurs?

When is payment deemed to be complete?

The essential nature of first party electronic banking transactions is that they are instantaneous, being completed within minutes of starting the process. For example, where a customer is desirous of withdrawing money from his

²¹ See generally Anu Araro, *op. cit.* pp. 2-3; David Robinson, 'The structure and Characteristics of the Principal Electronic Banking Systems' in R.M. Goode (Ed), *op. cit.* p. 5.

²² Anu Araro *op. cit.* p. 9, has commented on this that: 'It is estimated that approximately 50% of the total non-cash payment transactions in the World today are made via electronic systems of one form or the other, with EFTPOS, debit cards leading the way. The number of cash withdrawals from ATM's grew by 9 % topping the one billion mark in 1991; whereas, purchases made by debit cards rose by 88 % from 192 million in 1990 to 360 million in 1991'.

account with an ATM card or paying for groceries purchased from a store with an EFTPOS or Internet, the electronic machine immediately initiates the process of debiting his account by the amount of either the withdrawal or the purchase price the moment he keys into the ATM his card and PIN number; or in the case of an EFTPOS, swipes his card into the machine at the point of sale and inserts his PIN number. Once the 'enter' button is pressed, the transaction becomes complete and the service requisitioned for is finalised. In the case of an ATM withdrawal, the money is dispensed from the machine. This is so even where the customer may be using a machine other than that of his own bank, if the bank operates within a network, such as SASWITCH,²³ for example. In the case of EFTPOS purchases, when the groceries are delivered. The same will apply to an Internet transaction. Once a customer keys in his PIN and presses the 'enter' button, his account will be automatically debited by the amount of the transaction; simultaneously crediting the seller's account.

Barring evidence of fraud, the customer will be hard put to show that the transaction that he has just completed is not binding on him. Whether the ATM or EFTPOS machine is on-line or off-line,²⁴ the amount of the transaction, if funds are available or overdraft facilities have been arranged, will be debited from the customer's account and payment deemed to have been made. The customer can not at this stage, either countermand or revoke the instructions he has fed into the machine; any corrections he may wish to effect being limited to cancellation of all the instructions or repeating the transaction, if, for example, less money than desired was withdrawn, or by re-depositing back into the bank the balance of the amount drawn. It is in this regard that it has been commented about first party transactions, in particular, the ATM, that:

The use of ATM terminals has produced certain disadvantages, for example, a customer drawing cash from an ATM will usually have his or her account debited the same day. This eliminates the small cash flow advantages to the customer when making payment by cheque (which can take three or four days to clear).²⁵

But as against this apparent disadvantage, there are numerous advantages that the customer may draw from by using these devices.²⁶

²³ The SASWITCH group includes the following banks: ABSA, Nedbank, First National Bank, Standard Bank South Africa and Volkskas Bank. Lesotho Bank is a sponsored bank in the network by Nedbank.

²⁴ For the concept of 'on-line and off-line', see W. Kulundu-Bhonye, 'Electronic Banking: An Overview of Systems and Operations,' in: *Lesotho Law Journal*, (1999) forthcoming.

²⁵ Anu Araro, *op. cit.* p. 102.

²⁶ See generally, Anu Araro, *op. cit.* pp. 101-102.

Fraud and systems malfunction.

The liability of the parties to a first party electronic transaction will, however, be affected where there has been a fraud or systems malfunction. In both these two situations, the customer would be averring that by either the fraud of another or the malfunctioning of the device at hand, he either gave no instructions or that the instructions given were not followed to the letter giving rise to a loss; and that because in both situations the instructions were not his, the purported debit or other transaction is not binding on him and any moneys withdrawn from his account should be reimbursed. This assertion is equivalent to the defense of *non est factum* in contract law.

In respect of first party transactions, fraud arises where both the card and the PIN or 'password' in the case of the Internet are either stolen (the most common scenario being, where the card and PIN are intercepted in the post) without the fault of the holder by a third party, or where a computer expert accesses information on the card by the technique called 'skimming', whereby the correct PIN number of the holder is scrambled on a counterfeit card and used as the genuine card; or where bank employees and computer information technicians while servicing machines, may gain access to codes which they then use to withdraw funds from customers' accounts.²⁷ A typical example of these frauds is represented by the facts in the *Ognibene v. Citibank*²⁸ case. Here a conman pretending to be a bank employee asked to borrow from the plaintiff his card on the pretext that he was testing the computer system. He memorised the PIN and subsequently withdrew \$400 from the customer's account. It was held that the bank was negligent in not warning customers that they should not give their cards to third party strangers who, by watching them enter the PIN, would later re-activate the system and defraud them. This situation may be compounded by banks operating in networks, where customers of different banks have access to the same facilities. In this way, details of customers of bank A will be available to employees and technicians of bank B, to whom they owe no duty of care.

Where a fraud is proved to have occurred, the customer will not be deemed to have undertaken the alleged transaction; the act having taken place without his authority, sanction or contributory negligence. The bank will be called upon to reimburse the customer of any loss or losses incurred up to a

²⁷ See generally Anu Araro, *op. cit.* p. 104. There have been many allegations from customers of what has come to be known as 'robotic thefts'. In the UK for example, it was reported in the *Building Societies Ombudsman* 1990-91, that an engineer who was servicing the computers of Clydesdale Bank was assisting the police over allegation of withdrawals from ATMs using information obtained while he was servicing machines. See also, Martin Karmel, *op. cit.* p. 51.

²⁸ NA 448 NYS 2d 845. This ruling was influenced by the fact that, there had been several incidences of the same type, giving rise to a notional duty of care on the part of the bank to warn customers.

limit. But the situation is quite different where the customer is partly or wholly responsible for the circumstances leading to the loss of his card and PIN. This may happen as for example, where the customer keeps the card and PIN in the same place so that in the event of a theft, the thief easily accesses his account;²⁹ or where the card and or PIN are stolen and the customer takes unduly long to report the theft both to the police and the bank and as a consequence his account is debited with ease. Where such is the case, the customer will be responsible for a proportion or the whole loss suffered.³⁰ This principle is founded by analogy to paper-based transaction. In the leading case of *London Joint Stock Bank Ltd v. Macmillan & Arthur*,³¹ Lord Finlay said:

If a customer draws a cheque in such a manner which facilitates fraud he is guilty of a breach of duty as between himself and the banker and will be responsible to the banker for any loss sustained by the banker as a natural and direct consequence of his breach of duty³².

A malfunction, on the other hand, occurs when the machine or card alone (or in combination with the PIN) are unable to perform an appropriate task on

²⁹ Studies in the UK and US show that the number of people who carry their cards and PINs together and hence fall prey of easy thefts is inordinately high, in some cases being as high as 70% of the total number of card holders. Where a theft takes place in these circumstances, the customer should be held fully liable for the loss as his negligence in this regard is analogous to the person who signs all his cheques in blank and then carelessly leaves them to fall in the hands of a thief.

³⁰ Under the UK's Consumer Credit Act, 1974, the limit of liability of a customer holding an ATM is British pounds 50, although the Act gives the bank the right to cancel the card after notice of execution of the agreement has been given. See also the recent ruling in the case of R.V. Spiby [1990] Times Report 211, where the Court of Appeal held that, where a computer recorded, by mechanical means and without the intervention of a human mind, information evidence of printouts from that computer was admissible evidence. In the absence of evidence to the contrary, courts would presume that such a computer was in working order at the material time. The customer will not be liable for losses after notice of loss of the card has been given.

³¹ [1918] AC 777. See also *Greenwood v. Martins Bank Ltd*, [1932] All E. R. (Rep) 318 and *Kepthalla Rubber Estate Ltd v. National Bank of India* [1909] 2 K. B. 1010.

³² *op. cit.* at p. 789. In *Tai Hing Cotton Mill Ltd v. Liu Chong Hing Bank Ltd & Others* [1985] 2 All E. R. 947 Lord Scarman held in similar vein at page 953 that: "In the absence of an express agreement to the contrary, the duty of care owed by a customer to his bank in the operation of his current account was limited to a duty to refrain from drawing a cheque in such a manner as to facilitate fraud or forgery and a duty to inform the bank of any unauthorised cheques purportedly drawn on the account as soon as he, the customer becomes aware of it. The customer was not under a duty to take reasonable precautions in the management of his business with the bank to prevent forged cheques being presented for payment, nor was he under a duty to check his periodic bank statements so as to enable him to notify the bank of any unauthorised debit items, because such wide duties were not necessary incidents of the banker/customer relationship."

the instructions of the customer; or where there is a break down in the electrical supply or other device, resulting in a loss to the customer. The underlying principle here being that the bank at least impliedly warrants the proper and efficient functioning of both the card and the machine as a condition *sine quo none* issuing the card. In this situation, the bank will be liable to the customer to the extent of the loss, whether such, is in amounts wrongly charged to the customer, or the short fall on his instructions. In other words, the bank will be liable for the non-execution or defective execution of the cardholder's mandate³³ to the full extent of the loss suffered. Again, the bank is liable notwithstanding the fact that a machine other than the banker's machine was used, if the banker operates within a network.

Third party transactions

Third party applications involve technologies utilising BACS, CHAPS (CHIPS), SWIFT, cheque truncation and to some extent EFTPOS. Here the customer draws an instrument or initiates processes that are electronically operated to transfer funds to a third party, usually through a settlement bank and clearing house. In this category of applications, the third party is the recipient and beneficiary of the funds transfer, unlike in first party ones, where the customer himself is the beneficiary. Here, some of the legal issues that arise relate to the following: when payment is deemed to be completed; who bears liability for error, mistake or malfunction; whether the customer can revoke and countermand his instructions; and what are the effects of cheque truncation on the position of the holder in due course.

When is payment deemed to be complete?

As with first party applications, it is important to determine when payment is deemed to be complete in EFT transactions, because this question will impact on who ultimately bears liability for the transaction as between the parties to the contract. The time when a particular EFT transaction will be deemed to be paid has been said to depend largely on the electronic funds transfer system in use. This is in turn dependent on the peculiar nature and terms of issue of each of the payment systems. Because third party EFT's are either provided by independent agencies established by the settlement banks themselves or by international and regional ones, the terms of issue and operation, provide in some detail, the respective duties and liabilities for each of the parties to the contract. They sometimes include even time frames within which the message is deemed to be delivered and payment made.³⁴

³³ The Jack Report: *Commission on Banking Services: Law and Practice* (Comm. 622 (London) HMSO, 1989, in the UK, recommended further that the bank should be liable for the interest and consequential loss suffered by the customer.

³⁴ A BACS application, which was established as a cost effective automated clearing house service for inter-bank clearing of payments and collection transactions originating either from

Highlighting this important attribute of third party EFT transactions, Woods has said:

The relationship between banker and customer is contractual and founded on one contract which normally includes the relationship of creditor and debtor with regard to the balance in the customer's account and the relationship of principal and agent in respect of the payment if the customer's cheques are drawn on the customer's account. Above all, it is a continuing relationship. The obligation to sign and write is giving way with advanced technology to the push-button-plastic card system³⁵.

This, however, is not the end of the matter. In respect of each EFT payment made, the question of when payment is deemed to have been made may still arise.

Under the *Proclamation*, the issuance and presentation of a cheque to a bank has been said to merely constitute a mandate by the drawer to pay a certain sum of money at a future date. It does not operate as an assignment of any part of the drawer's credit balance.³⁶ Payment on the cheque will

a sponsoring banks or from customers sponsored by member banks may be sent in advance of thirty days, but must be available three days prior to the payment date since it is a three day payment cycle system. Three days to the day of payment, BACS processes the data into credit and debit instructions for each of the member settlement banks, completing this process by the second day. At the end of that day, the data is taken to the individual banks for inputting and corrections, if any. On the third day, the data is accepted by the banks, simultaneously setting into motion credit and debit transactions of the parties involved. Once the inter-bank transactions are over, BACS informs both the Central Banks and all the settlement banks involved of the final settlement for clearing. The system replicates itself on the initiation of a new BACS instruction. For a detailed operational study of the other systems, see: W. Kulundu-Bitonye, op. cit. pp. 8-15.

³⁵ Eric Wood, 'The Quantum and Limits of Liability', in R. M. Goode, *Op. cit.* p. 83. Making the same point, Professor Reed, op. cit. p. 80-87 has said that, "although electronic banking rests on a shaky legal foundation the use of technology is certain to increase rapidly in the future. A combination of technology 'push' and commercial pressures makes this inevitable. What, in my view, is the likely future for the law? The law regulating electronic consumer banking will need to be developed primarily through legislation. If this is neglected, the banks will regulate the area through contracts, which, while they ensure a good commercial return on investment in the technology, leave consumers without proper protection in this important area of their lives."

³⁶ See BEP section 53 (1). This means that the issuance and presentation of a cheque neither establishes a legal or equitable assignment on the funds in the drawer's account. In *Curran v. New Park Cinemas & Others*, [1951] 1 All ER 295, it was held that a mandate given by a customer to his banker to pay a debt to a third party who knows nothing of the matter could not establish a legal assignment and the creditor could not be treated as an agent of the third party to notify him on the intended assignment. In *Lister and Co. v. Stubbs* (1890) 45 Ch D 1, it was also held that the placing of money in a separate account by a bank did not constitute a trust in favour of the intended payee. See also *Mossley v. Cressley's Co.* (1865) LR Eq 405, and *William v. Everet* (1811) 14 East 582. (It is to be noted as a distinguishing

depend *inter alia* on the availability of funds, the ascertainment of the drawer's signature and the cheque being cleared through the settlement process, as in the majority of cases, several banks will be involved in the transaction. This rule has been explained thus:

There is no transfer of funds by the initiation or notification of the transfer mandate and payment is finally and irrevocably made to the payee. ... When the paying bank irrevocably commits itself to make the payment. [This is] because the very existence of these methods of transferring money anticipate the existence of suitable clearing systems and the settlement takes place between the paying and the collecting banks by the striking of net balances between the banks on each business day³⁷.

This means that third party payment applications operate essentially as deferred payments, providing for a waiting period within which the clearing process is allowed to take place. Only when this process is over will payment be deemed to have been made. This rule replicates the holding in *Pollard v. Bank of England*,³⁸ when it was said in respect of payment by cheque that:

Payment is complete when the paying bank commits itself irrevocably to that payment; in other words, when the amount of the payment has been included in the daily inter-bank settlement at the clearing house and the net balances settled by a transfer from one clearing bank to another at the Bank of England. Payment is not completed merely by the receiving bank taking delivery of the cheque or credit transfer form; the time when the bank merely accepts the intention to pay³⁹.

An example of this phenomenon may be given by the case of *Parr's Bank Ltd*

feature, that in EFTs, the drawer is a customer of the paying bank, and there is no question of the bank holding the funds in a separate account).

³⁷ *Anu Araro*, op. cit. p. 160. See also, *London Joint Stock Bank v. Macmillan and Arthur* [1918] AC 777. This point has been made differently by Peter Ellinger 'Electronic Funds Transfer as a Deferred Settlement System', in R. M. Goode, *Op. cit.*, when he said: "as between the bank on whom the cheque is drawn and the holder, the cheque does not constitute an undertaking. The bank, which is merely the customer's agent, has the authority to honour the cheque, but, in the terms of the instrument, the bank is under no obligation to make the payment. Indeed, if the bank receives notice of countermand before it pays the instrument, it is bound to dishonour it."

³⁸ [1871] LR 8 QB 623.

³⁹ *Op. cit.* p. 837. In *Mardorf Peach & Co Ltd v. Attica Sea Carriers Corporation* [1976] 2 All ER 249, the Court of Appeal said that: "payment which banks consider equivalent to cash payment is complete when the payment instruction is given to the collecting bank and accepted by that bank without objection; the subsequent processing of the instruction, being merely an internal banking matter which does not affect the legal position between the drawer and the payee." See also: *Redskin v. Severo Sibirsko AC* [1933] 1 KB 47.

v. Thomas Ashby and Co,¹⁰ where a cheque was presented by the plaintiff bank through the clearing system to the defendant bank; and under the then clearing house rules, a drawee bank was required to return an unpaid cheque on the same day of presentation. The cheque was not returned until the following day. In the meantime, the plaintiff bank, acting on the assumption that the cheque had been paid, honoured a bill from its customer. The Court held that the plaintiffs were entitled to recover the sum of the bill from the defendants, since the delay in returning the dishonoured cheque amounted to a misrepresentation that the cheque was in the process of being cleared.

The time when payment is deemed to be complete will usually coincide with the time when the drawer loses his right to countermand or revoke the cheque. In respect of electronic payment systems, this will vary from system to system, as per the rules of issue and operation.¹¹ For CHAPS, for example, an instruction cannot be countermanded or revoked after the message has gone through the gateways of the receiving bank; and for SWIFT, an instruction becomes irrevocable once it has been acknowledged and verified by the receiving party.¹² The rationale of this approach was supplied by the second Circuit Court of Appeals in the case of *Debrueck & Co v. Manufacturing Hanover Trust Co*,¹³ when Moore, J., held:

Once an instruction given for CHIPS (equivalent for CHAPS in Europe) transfer was released by the paying bank, it was irrevocable. The transfer was executed through an autonomous network and invariably reached the recipient bank almost instantaneously once it was released by the computer terminal of the transfer bank, and the transfer of the funds to the credit of Herstatt's account was therefore considered complete as soon as it was effected by the defendant bank.¹⁴

How does a commitment of the paying and receiving bank bear on the fact that the payee is finally paid? In other words, what happens where the paying or receiving bank becomes insolvent before discharging its actual payment obligation, with the consequence that there are no funds for the payee? This scenario distinguishes between a mere commitment to pay,

¹⁰ [1898] 2 QB 460. See also the facts of *Polson and Another v. The Bank of England* (1871) LR QB 623. See further *Momm v. Barclay's Bank International Ltd* [1976] 3 All ER 588, where it was held that "payment was complete when the defendant bank decided to accept Herstatt's instruction to the credit of the plaintiff's account and set its computer processes into motion to debit the payer's account and correspondingly credit the payee's account."

¹¹ Martin Karmel, *op. cit.* p. 64.

¹² Anu Araro, *op. cit.* p. 165; W. Kulundu-Bitonye, *op. cit.* pp. 10-15.

¹³ 609 F 2d 1047 [1979] (US Court of Appeal).

¹⁴ *op. cit.* p. 1061.

however irrevocable, and an actual payment.

Where the paying bank becomes insolvent before making the actual payment through the clearing system, the payee has no claim to any specific funds as against the bank. His rights are limited only to a claim in insolvency in competition with all other creditors. In addition to this right, the payee-creditor may have direct recourse against the drawer-debtor for the discharge of the original obligation. If the drawer-debtor has already paid, he will be required to pay again! This is because, as between the drawer and the payee, the electronic funds transfer represents an irrevocable payment instruction giving rise to rights as against the transferor. In *W. J. Alan & Co. Ltd. v. El Nasr Export & Import Co.*,¹⁵ where the paying bank confirmed an irrevocable credit in favour of a seller after being put in funds by the buyer, and it became insolvent before honouring its credit, it was held that the seller could, among other courses of action, have direct recourse to the buyer to pay for a second time. Where however the receiving bank becomes insolvent after being put in funds by the paying bank, the payee-creditor would bear the loss.¹⁶

Error and systems malfunction

The UNCITRAL (1991) has identified four factors which influence error in respect of EFTs. These are: the non-standardisation of message formats between various EFT systems; the re-creation of messages; the non-standardisation of procedures, and equipment failure or software error.¹⁷

However, as with first party applications, there is a presumption that EFT deferred payment funds transfers will function properly, efficiently and timeously;¹⁸ that the message will originate from the right customer and not somebody else; that breakdowns will not unnecessarily interfere with and stifle the operations of the system; or that there will be no external tampering with operations leading to losses by the customer. Where the bank has

¹⁵ [1972] 2 All ER 127. See also: *Re Farrow's Bank* [1923] 1 Ch. 41, and *E. D. & F. Man v. Nigerian Sweets and Confectionery* [1927] 2 Lloyd's Rep. 50.

¹⁶ *Royal Products Ltd v. Midland Bank Ltd* [1982] 2 Lloyd's Rep. 194. In this case, the plaintiffs instructed that funds should be transferred from an account with the defendant bank to an account in their name with another bank. The second bank became insolvent soon thereafter. The plaintiffs unsuccessfully sought to claim that the transfer was invalid.

¹⁷ Greater international harmonisation of formats, procedures, equipment and software is being advocated as the way forward in remedying some of these shortcomings both at the domestic and international levels. Efforts in this regard are being undertaken by the Banking Committee of the International Standards Organisation (ISO), a committee of UNCITRAL.

¹⁸ SWIFT, for example, undertakes responsibility for the completeness, accuracy and timeous delivery of each message put through its gateways on the same day.

seen to these matters, or acts within a reasonable limit,⁴⁹ the instructions from the customer form the basis of the mandate between himself and the paying bank; and if such instructions are implemented before a revocation is received, the mandate has been effectively discharged. Such bank would be entitled to debit the customer's account with the principal sum, plus any notified charges for services rendered. In addition to the legal analogy to be drawn from the cheques' experience, these matters will also be covered by especially agreed terms between the customer and his bank arising out of the contract entered into when the account was opened.

The degree of carelessness on the part of the customer which may shift the burden of liability from the bank in these situations is still somewhat uncertain. From the current state of case law, it would seem that the bank can only succeed to shift this burden by alleging that the customer either knowingly tolerated or conspired in the forgery of the signature on the payment instructions. Mere carelessness on the part of the customer is not binding on him. In *Kepitagalla Rubber Estates Ltd v. National Bank of India*,⁵⁰ where the directors of a company carelessly left cheques of the company in the custody of the Company Secretary, thereby enabling him to forge them, it was held that, by this act, the bank was not relieved of the duty of care and skill to its customer and should have satisfied itself before making the payment on the forged instruments. The bank is duty-bound to exercise reasonable care and skill to protect its customers. The standard of care expected in this case is that of a reasonable banker acting in accordance with accepted current banking practice. This duty of the banker has to be read together with the obligation of the bank to conform to the mandate of the customer. Where the instructions passed through the gateways of the bank are at variance with those given by the customer, the bank cannot debit the account of such customer.

If the error or mistake entails an ambiguity as to the payment instruction, for example, where the identity of the payee is in doubt, or where, on account of several accounts being held by the customer with the same bank, it is not clear from which account the transfer should be made, the bank will be protected if it carries out its mandate within a reasonable interpretation of

⁴⁹ Writing about CHAPS, it has been persuasively argued that: "the obligation of the paying bank is simply to act expeditiously as possible in the circumstances; and if payment on the same day is prevented by a mechanical breakdown, pressure of work arising from instructions previously received, or a defect or default on the receiving bank's side of the gateway, the paying bank would not be liable to its customer for the delay." [1909] 2 KB 1010.

⁵⁰ See, also, *London Joint Stock Bank Ltd v. Macmillan* [1916] AC 777 and *Tal Hing Cotton Mill Ltd v. Liu Chong Hing Bank Ltd* [1985] 2 All ER 947.

⁵¹ *Selangor United Rubber Estates Ltd v. Craddock (No. 3)* [1968] 2 All ER 1073.

the customer's intentions and in good faith.⁵¹ The bank will, in these circumstances, be entitled to debit the customer's account. The bank will equally be entitled, if the transaction giving rise to the instructions to pay between the customer and the payee are vitiated by fraud or misrepresentation or where there is mistake as to the existence of the subject matter.⁵² The same will apply where the bank discharges an enforceable liability of the customer, even if the instructions relied upon are outside the actual or apparent authority of the signatory or agent.⁵³

Where, however, the customer has not instructed the bank to pay and the purported debit is a result of an error, mistake or forgery, such debit will be invalid, and the customer may sue for reimbursement of funds debited. The customer has not authorised the transaction and he is, therefore, not bound by it. This may arise where, either, the customer's signature is forged, or the person purporting to act on his behalf has exceeded his authority; or indeed, had no authority at all. A bank paying in these circumstances would be in the same position "as if it pays a cheque bearing a forged signature; it acts outside its mandate in acting on the forged or unauthorised instruction."⁵⁴ If, however, the customer has represented the agent to be invested with wide discretionary authority, he will be estopped from disclaiming the particular exercise if it is of the nature and type represented; or the signatory was acting within his apparent authority.⁵⁵ Similarly, the customer will be estopped from denying the genuineness of instructions for payment out of his account, where he has failed to respond to several inquiries from the bank. His silence is tantamount to an acknowledgment that the said instructions were his own or authorised by him.⁵⁶

Once the payment instructions have been deposited with the bank, such bank henceforth assumes the risk of not complying with them, whether such

⁵² See *Westminster Bank Ltd v. Hilton* (1926) 43 TLR 124.

⁵³ See *Babcock v. Lawson* (1878) 4 QBD 394; *Polard v. Bank of England* (1871) LR 6 QB 623 and *Deutsche Bank v. Berfro & Co* (1895) 73 LT 669.

⁵⁴ See *London Intercontinental Trust Ltd v. Barclays Bank Ltd* [1980] 1 Lloyd's Rep. 241 and *Liggitt (Liverpool) Ltd v. Barclays Bank Ltd* [1928] 1 KB 46.

⁵⁵ Robert Pennington, "Fraud Error and Systems Malfunction: A Lawyer's Viewpoint" in R. M. Goode, Op. cit. p. 70. See also *Cadlin v. Cyprus Finance Corporation (London) Ltd* (1983) QB 759. In *Brook v. Hook* (1871) LR 6 Ex 89, it was held that an assertion by the agent that the customer has ratified the forged signature only amounts to a gratuitous promise which is not binding to the customer. Only a positive assertion that the forged signature is his own will estop him from repudiating liability on the instrument.

⁵⁶ *Mahony v. East Mining Co* (1875) LR 7 HL 889. Where the customer is a company, either whose directors have been irregularly appointed or have stayed in office beyond their mandated period, the bank will be protected, if it effects instructions which such directors give on behalf of the company.

⁵⁷ *Brown v. Westminster Bank Ltd* [1964] 2 Lloyd's Rep. 187.

...effect, or not effected at all. The bank will be liable for any consequences resulting from the termination or repudiation of the transaction upon which the instructions were given. As a bailee and agent of the customer, the bank is duty bound to exercise due diligence on the customer's behalf. This duty is not diminished by the bank opting to employ another bank or agent to carry out the instructions.⁵⁹ Where the fault is with the receiving bank or other institution, for example, where the receiving bank fails to acknowledge the payment transmission, the paying bank has discharged its obligation to the customer and will not be held liable for any losses that may arise in this regard.⁶⁰

Aspects of error and fraud may arise out of deficient or improper security systems, which enable the entry of unauthorised persons into banking operations, allowing them to fiddle with terminals or to alter payment messages. Codes and other "passwords", combining with the processes of entry, authorisation and the encryption of payment messages have, however, up to date worked well to reduce incidences of error or fraud in this regard. It is, however, not unknown for "robotic" thefts or what has come to be known as "tapping" into landlines to take place even in the most sophisticated systems. This is partly achieved by unscrambling payment messages with the help of miniature scrambling devices.

Systems failure and breakdowns may, on the other hand, arise out of a variety of causes, ranging from wrong inputs into the system to poor maintenance. Liability arising from these defects, including consequential loss where negligence is established,⁶¹ will usually be the subject of express contractual terms under the rules of issue (or in the USA and the UK subject to statutory provisions).⁶² Clearly, customers should not suffer liability or loss for system's error or malfunction. The system's provider should bear liability for these shortcomings, unless it can be shown that the customer contributed to the malfunctioning or defect.⁶³

⁵⁹ *Calico Printers' Association v. Barclays Bank Ltd* (1933) 36 Com Cas 71. See also *Chambers v. Miller* (1862) 1 CBNS 125.

⁶⁰ However, see the ruling in *Barclays Bank Ltd v. W. J. Simms Son & Cooke (Southern) Ltd* [1980] QB 677, where it was held that a paying bank could recover the amount of a cheque which it had paid by oversight after the drawer had countermanded. The authority of this case is doubtful and is unlikely to be followed in the light of the *Delecta* case above, and the internal rules of EFT systems.

⁶¹ *Chatterton v. London & County Banking Co Ltd* (1891), *The Mirror* (3rd Nov.) p.394.

⁶² The Electronic Funds Transfer Act, 1978 (USA) and the Contract Terms Act, 1977 and the Supply of Goods and Services Act, 1982.

⁶³ The Australian Code on Electronic Payments, 1990, provides that the service provider should bear total responsibility for any system failure and malfunctioning.

Cheque truncation and the position of the holder in due course
Although currently operated on a very limited scale, even in the developed countries,⁶⁴ cheque truncation holds great potential for reducing the volume of paper-based funds transfer payments through banks. Cheque truncation is the process by which the data on the cheque or other payment instrument for that matter, is captured either on magnetic tape or digital computer encryption system by the collecting bank, which bank retains the original cheque, transmitting only the captured data to the paying bank for its action. The account of the drawer is debited by the amount on the instrument on the strength of the data transmitted by the collecting bank. In this way, the physical movement of large volumes of paper is avoided, saving both time, resources and tapping into the economies of scale, at the inter-bank cheque clearing level.⁶⁵ When fully developed, this mode of funds transfer should prove quite useful for other payment modes, such as credit transfers,⁶⁶ the payment of salaries and rentals. This should be possible with the UNCITRAL initiative to standardise message formats, payment procedures, equipment and software across EFT systems.

Cheque truncation is the most novel EFT payment system, with German banks leading the way. When trading in the Euro-cheque, collecting banks in Germany capture in their databases, only the essential data on the cheque on a magnetic tape. This information is then transmitted to the paying bank. On the basis of this information, the paying bank meets its obligations to the payee. This process operates at the general clearing level, and the daily balances are forwarded to the Bundesbank by the clearing banks for final settlement. Because of the immense success of this programme, the scheme has recently found its use in banks in other European countries through international bilateral agreements. The scheme now operates in Austria, the Netherlands, Norway, Spain, Sweden and Switzerland and to some limited extent in the UK.⁶⁷ French banks also operate an internal cheque truncation in the Euro-cheque.

⁶⁴ To the knowledge of the author, cheque truncation hardly exists in many developing countries, including South Africa. In these countries, the traditional Country and Tow Clearing systems, which take an average of four days to clear, are still in place. Cheques or other instruments are cleared through the banking system, by the physical presentment by the collecting bank to the paying bank, and payment is conditional on funds being available on the drawer's account, in addition to the verification of the drawer's signature.

⁶⁵ Anu Arora, "The Electronic Presentation of Instruments: the Truncation of Cheques and other Non-Negotiable Instruments Through EFT", R. M. Goode (Ed) *op. cit.* p.105.

⁶⁶ See generally: Allan Urbach, "The Electronic Presentation and Transfer of Shipping Documents" in R. M. Goode (Ed), *op. cit.* p.111; Peter Eiling, "Electronic Funds Transfer as a Deferred Settlement System", in R. M. Goode (Ed), *op. cit.* p.40.

⁶⁷ The Initiative to Introduce inter-bank cheque truncation in Eurocheque was undertaken by Midland Bank, which also acts as the clearing-house for these cheques in the UK.

Prior to this European experiment in the Euro-cheque, Cheque truncation in the UK was limited to trading between branches of the same bank, which in most cases have a common network. Cheques collected for inter-bank trading are still physically presented to the paying bank for clearance.⁶⁶ It is expected however that cheque truncation will extend to ordinary cheques as technology is being developed to transmit data either by direct telephone transmission as through existing EFT systems such as SWIFT, CHAPS and CHIPS, by computer or document Image Processing (DIP).⁶⁷ But before this is achieved, banks will have to establish guidelines governing the sharing and exchange of information between themselves and to facilitate mutual access to each other's cheque storage files. Cheque truncation as a banking practice, however, is a plan for the future in most developing countries, including Lesotho.

Several legal impediments stand in the way of implementing cheque truncation in full in its present form. Perhaps, foremost among these problems, is how to resolve the issue that a cheque is a negotiable instrument that may be endorsed to third parties without limit, making it a very convenient tool for trade. This is partly due to the old age recognition that cheques, like other negotiable instruments, constitute not only a series of payment commands or instructions, but are items of property in their own right. Thus, possession of the instrument entitles the holder-in-due-course to rights in the instrument as its 'true owner',⁶⁸ and may sue in an action for conversion if wrongfully deprived.⁶⁹ Cheque truncation washes away this important attribute, rendering them mere payments commands to specific persons, without the capacity of being indorsed,⁷⁰ or discounted.⁷¹ Without being in possession of the instrument on physical endorsement, the holder-in-due-course cannot enforce the drawer's or other endorsers' warranty that the instrument shall be paid on presentment.⁷² Professor Ellinger captures the essence of this when he observes:

The drawer warrants that it will be both accepted and paid. Any

⁶⁶ Anu Arora, 'The Electronic Presentation of Instruments: the Truncation of Cheques and other Negotiable and Non-Negotiable Instruments Through EFT', in R. M. Goode (Ed) *op. cit.* p. 105.

⁶⁷ Anu Arora, *op. cit.* p. 41.

⁶⁸ See BEP SS, 29 and 38.

⁶⁹ See BEP SS, 69-70 and 79 (2). See also *R v. Kohn* (1979) *Crim L.R.* 675, where it was stated: 'negotiable instruments are to be regarded as a special type of property, differing from ordinary chattels in that their possession confers certain contractual rights on the holder, but that they differ from ordinary contracts by the existence of proprietary elements.'

⁷⁰ See BEP S, 55.

⁷¹ See BEP S, 31.

⁷² See BEP S, 55. Where the drawer has, for some reason, countermanded the payment instructions, the holder-in-due-course may sue on the cheque since the drawer undertook a payment obligation by issuing the cheque.

other person who transfers the instrument under his own signature - an endorser, assumes a similar undertaking... If the bill is dishonoured by non-acceptance, an immediate right of recourse accrues to the 'holder' against the drawer and the endorsers. If the accepted bill is dishonoured by non-payment, the 'holder' has in addition, the right to enforce the bill against the acceptor".

It is difficult, if not impossible, to see how a bill that has been presented electronically could be endorsed or discounted to another party even if it were possible for the endorser to add his signature by means of a 'password.' Even then, another problem would still persist, and this is that, the instrument has to be delivered on endorsement in order to bestow rights to the holder.⁷⁶ How is delivery to be achieved electronically on the computer screen? And how may an instrument be presented by the 'holder' to comply with Section 44 of the BEP?⁷⁷ In several cases, courts have held that presentment is a necessary process to validate the bill or instrument for payment. In *Griffin v. Weatherby*,⁷⁸ Blackburn J., as he was then, said: 'presentment for payment must mean presentment according to mercantile usage; the document itself must be presented, though not the holder.' Similarly in *Barclays Bank Plc v. Bank of England*,⁷⁹ it was held that: 'the collecting bank's duty of presentment of the instrument is not discharged until the cheque is physically handed to the drawee bank for payment through the clearing system. It has long been the established banking practice that presentment through the clearing system within a reasonable time is the valid presentation.' It may be arguable that the presentation of the data on the cheque to the paying bank is sufficient to accord with Section 44 of the BEP. Banking practice in this regard may prove instrumental in convincing courts that cheque truncation is an accepted practice.⁸⁰

This problem is compounded by the great diversity and consequent incompatibility of the hardware in use between existing EFT systems and banks themselves. In many developing countries, including Lesotho, where computerisation generally, and computerisation of banking services, in

⁷⁶ Peter Ellinger, 'Electronic Funds Transfer as a Deferred Settlement System' in R. M. Goode (Ed.), *op. cit.* p. 41.

⁷⁷ See BEP SS, 20 and 30.

⁷⁸ Which provides *inter alia* that: 'Subject to the provisions of the Proclamation, bill must be duly presented for payment. If it be not so presented the drawer and endorsers shall be discharged.' Cheque truncation as currently practiced, may also run counter to Sections 23, 52, 54 and 60 of the BEP.

⁷⁹ (1988) LR 3 QB 753.

⁸⁰ (1985) 1 All ER 385. See also *Re Farrow's Bank Ltd* [1923] 1 Ch. 41.

⁸¹ See *Barker v. Wilson* [1980] 1 WLR 884. Also the exceptions provided under Section 45 of the BEP may form a foundation for accepting cheque truncation as an accepted banking practice.

particular, is still at very rudimentary levels, this presents insurmountable problems, at least in the short run⁶¹.

The other problem associated with cheque truncation is the one of verification and authentication of the drawer's signature. Since the cheque does not leave the premises of the collecting bank, the paying bank never gets to authenticate that the cheque was in reality issued by its customer. The paying bank acts on the basis of the code encryption and other information captured by the collecting bank. Is the assurance that the cheque has been signed sufficient to meet the requirements of Section 22 of the BEP? How about if the cheque should turn out to have been forged or unauthorised? Clearly, under these circumstances, the paying bank has no protection under Section 23⁶² and will open itself to liability for negligence⁶³. It is unlikely that most banks will be willing to pay large sums of money on the basis of cheques truncated through other banks. This reluctance will not go away, even where the paying bank is able to partially overcome this problem by requiring the drawer to show some kind of PIN or 'password' on the face of the instrument. The possibility that the cheque and PIN have been forged or stolen will require that the paying bank exercises caution.

Notwithstanding these legal and logistical problems, interest in cheque truncation has continued to grow, mainly because of technology push factors and the economies of scale to be drawn therefrom. In 1986, Australia, in a bold step, amended the *Bills of Exchange Act*, 1909, to accommodate cheque truncation as a mode of presentation of the cheque. Section 62(2) permits presentment of the cheque to be undertaken by 'other means' than presenting the cheque. Where the cheque is presented by 'other means', the method of presentment should be identified with reasonable certainty and the order to pay must be in a form that is 'intelligible' or is readily 'decipherable' by the drawee bank. The legal huddles imposed by the equivalence of Section 44 of

⁶¹ Peter Ellinger, 'Electronic Funds Transfer as a Deferred Settlement System' in R. M. Goode (Ed) *op. cit.* p. 29; where he observes that: 'the replacement of Bills of Exchange and Promissory Notes by records stored by an EFT network appears at this stage a plan for the future. Their unique characteristics pose a challenge to any EFT network that wishes to make provision for them by the use of its technology.'

⁶² See also the ruling in the *Koptagalla* case [1909] 2 KB 1010. This position does not apply in relation to endorsements. See sections 19, 24 and 25 of the BEP. See also Anu Araro, 'The Electronic Presentation of Instruments', in R. M. Goode (Ed) *op. cit.* p. 110.

⁶³ This is because the bank can only debit the customer's account against a valid mandate and therefore must ascertain that the instrument, the basis on which payment is made is properly drawn with a valid signature. Commenting on this phenomenon, Anu Araro, *op. cit.* p. 37 has said: 'the banks would consequently be guilty of negligence if a defect in the cheque in question or in the title of the collecting bank's customer could have been discovered if the instrument had been physically presented for payment.' See also: *Lipsett v. Lipsett* (1900) 17 Q.B. 100; *Barclays Bank Ltd* [1926] KB 48 and *M'Kenzie v. British Linen Co.* (1881) 6 Q.B. 32.

the BEP have been removed by allowing the drawee bank to designate its data processing centre as a place for 'presentment'.⁶⁴ It is, however, important to note that Section 62(2) does not relieve the paying bank of its liability on an unauthorised or forged cheque.⁶⁵ Similarly, in the UK, the Jack Committee⁶⁶ recommended, *inter alia*, that the equivalence of section 44 of the BEP, alongside section 3 of the *Cheques Act*, 1957, should be amended to allow for the electronic presentation of data.

Conclusions

Two trends are shown by both the domestic and international scenes of electronic banking. Firstly, electronic banking is fast expanding and taking over from the traditional, paper-based systems, which has worked for the last century or so. The identity of the bank as constituting 'brick and mortar' is fast changing to the digital age. Although partly this has been due to technological push factors, this change can also be rationalised from the point of view of an industry seeking internal cohesion and the optimal use of resources at its disposal in a competitive age. Traditional banking, utilising both town and country clearing systems rely on the physical presentation of instruments evidencing the right of payment. This inevitably results in waste of time and misuse of resources and does not take advantage of the economies of scale possible. In the words of Professor Reed: 'although electronic banking rests on a shaky legal foundation, the use of technology is certain to increase rapidly in the future. A combination of technology push and commercial pressures makes this inevitable'.⁶⁷ However, the direction of this development in terms of the legal and regulatory regime evolving is not certain, and more has to be done to protect the consumer.

What could then be the likely future for the law with regard to electronic banking? This question underlies the second trend emerging in electronic banking. The initiative to evolve a legal regime to regulate electronic banking has largely remained with the banking industry itself through contracts with their customers. Where contract is inadequate or fails to answer the problem at hand, extrapolation of the existing bills of exchange law is applied to the problem by analogy. However, as Eynon Smart has warned:

The optimist may suggest that there is nothing fundamentally new

⁶⁴ Section 62(2).

⁶⁵ This section states: 'Where a cheque is presented for payment otherwise than by exhibiting it to the drawee bank, nothing in this section shall be taken to relieve the drawee bank from any liability to which the drawee bank would have been subject in relation to the cheque if it had been presented by being exhibited to the drawee bank.'

⁶⁶ Commission on Banking Services.

⁶⁷ Chris Reed, *op. cit.* pp. 88-87.

Law and Practice Comm: 622 (1989).

In electronic funds transfers, it is merely a variety of novel methods of transferring funds from D to C, and in banking, any legal problems will be solved by analogy with existing law...But optimism, based on a partial truth, oversimplifies the matter. Certainly the cheque, which commits the paying bank only when he decides to pay is an uncertain basis for analogy⁸⁸.

The result of this development has been that the law on electronic banking is scattered and very thin indeed⁸⁹ and in many developing countries is, virtually, non-existent. As Professor Reed again notes: "While this may ensure a good commercial return on investment on the technology, it leaves consumers without proper protection in this important area of their lives"⁹⁰. Governments, particularly in developing countries where there is little by way of a legal regime regulating electronic banking, have to take more initiatives to protect the rights of consumers and make electronic banking relevant to their legal systems.

⁸⁸ Eynon Smart, "Electronic Banking: An Overview of the Legal Implications", in R. M. Grode (Ed.), *op. cit.* p. 1. Making the same point, WTO (Special Study 2) 1998, at p. 37, also states: "a key issue regarding electronic commerce and the Internet is the need for legal clarity and for adequate redress mechanisms. Legal uncertainty can arise within the country if electronic contracts are unclear in terms of their enforcement or redress potential. The extrapolation of existing contract law to the electronic sphere may minimise such uncertainties. However, this situation can become complicated in the case of international transactions, where uncertainty about the jurisdiction of Internet commerce is seen as one of the main obstacles to inter-trade."

⁸⁹ A part from the USA and Australia, which have comprehensive legislation governing electronic banking, most other countries of the world rely on contract as the basis for regulating modern banking.

⁹⁰ *Chris Reed* 1996, p. 57.

Lesotho's Administration of Justice Draft Bill: A Remedy for the Problems of Delays in the Courts or a Trojan Horse?

Nqosa Leuta Mahao

Introduction

Save for a few hiccups that have occurred, Lesotho has, since 1993, rejoined the community of nations that embrace constitutionalism as a compass guiding processes of governance, inter-institutional and state-citizen relations. Lesotho's political system is based, first and foremost, on the precepts of the rule of law as enshrined in the letter and spirit of the Constitution. However, the attainment of constitutional rule has been followed by a rather slow pace of reforming institutions of government as well as putting in place legal frameworks addressing some of the maladies of the past. The Law Reform Commission, established in 1998, is destined to play an increasingly critical role in this regard. As should be expected, some of the proposals which will issue from this body will naturally be controversial, either because they are novel or because they threaten entrenched aspects of the Constitution.

It is a critical assumption of the rule of law that the general public has full confidence in the justice delivery system. Delays in litigation can negatively affect this confidence and induce the search for solutions outside

The Law Reform Commission was established in terms of the Law Reform Commission Act NO. 1993 with the mandate to review all laws to align them with the Constitution.