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***The regulation of electronic funds transfers:  
Problematic aspects relating to the liability  
of banks***

by

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## Summary

The evolution of various payment instruments shows a marked inclination away from the reliance on physical currency. This has, in turn, led to the construction of new manifestations of wealth.<sup>1</sup> Due to revolution and developments of technology, payment can be made by various means such as physical delivery of conventional money (coins and bank notes) from the payer to the payee,<sup>2</sup> but may also be made through tangible paying methods other than negotiable instruments such as debit or credit card or by way of electronic funds transfer.<sup>3</sup>

The development of payment systems makes it a reality for consumers to choose their preferred method of payment suitable for their banking needs and circumstances. Electronic funds transfer is a generic term that embraces any transfer of funds in which electronic techniques replace one or more of the steps in the process that were previously done by paper-based techniques.<sup>4</sup> This includes automated teller machines, the transfer of funds at the point of sale, direct deposit or withdrawal of funds and funds initiated by telephone.<sup>5</sup>

The use of electronic funds transfer systems is described as the ultimate act of payment for not only is the value which is transferred reduced to a symbolic form, but the symbolic form itself is removed from the immediate possession of the parties to the transfer, payment also essentially becomes the transfer of information.<sup>6</sup> Electronic funds transfer are easy and convenient to use. However, new technology has not only provided an ever-increasing range of electronic payment products, it has also had far-reaching effects on the way in which banks operate.<sup>7</sup>

Owing to the lack of legislation in South Africa to regulate the use of electronic funds transfer, banks rely on the law of contract and mandate to exempt themselves from liability. Therefore, the research problem that this dissertation aims to address revolves around the legal implications of electronic funds transfer, This includes the

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<sup>1</sup> C Visser "The evolution of electronic payment systems" (1989) 1 *SA Merc LJ* 198-207 198.

<sup>2</sup> WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 667.

<sup>3</sup> WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 667.

<sup>4</sup> C Visser "The evolution of electronic payment Systems" (1989) 1 *SA Merc LJ* 198-207 200.

<sup>5</sup> C Visser "The evolution of electronic payment Systems" (1989) 1 *SA Merc LJ* 198-207 200.

<sup>6</sup> C Visser "The evolution of electronic payment Systems" (1989) 1 *SA Merc LJ* 198-207 200.

<sup>7</sup> I Meiring "The South African Payment System" (1996) 8 *SA Merc L.J* 164 – 174 164.

questions surrounding reversal and recovery of electronic funds transfer when payment is considered to be final and complete. Ultimately, I will attempt to address apportionment of liability between banks and consumers.

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**This dissertation is dedicated to my late Mother Fikile Trinity Masuku**

**1980/02/16 – 2009/03/03**

**Lala kahle Mama**



# Table of contents

<b>Declaration</b> .....	<b>i</b>
<b>Summary</b> .....	<b>ii</b>
<b>Acknowledgements</b> .....	<b>iv</b>
<b>Table of contents</b> .....	<b>vi</b>
<b>Chapter 1 Introduction</b> .....	<b>1</b>
1.1 Background and purpose of study.....	1
1.2 Overview of chapters .....	2
<b>Chapter 2 The legal nature of electronic funds transfers</b> .....	<b>4</b>
2.1 Introduction .....	4
2.2 Electronic funds transfers in general .....	4
2.3 The nature of electronic funds transfers .....	7
2.4 Completion of payment .....	9
2.5 Conclusion .....	10
<b>Chapter 3 The regulation of recovery and reversal of                 electronic funds transfers</b> .....	<b>11</b>
3.1 Introduction .....	11
3.2 Reversal of electronic funds transfers .....	11
3.3 Recovery of electronic funds transfers .....	15
3.4 Conclusion .....	17
<b>Chapter 4 Unauthorised transactions</b> .....	<b>19</b>
4.1 Introduction .....	19
4.2 The nature of bank-customer relationship.....	19
4.3 Rights and duties of the parties.....	21
4.4 The risk of loss .....	24
4.5 Conclusion .....	28
<b>Chapter 5 Summary and recommendations</b> .....	<b>30</b>
<b>Bibliography</b> .....	<b>33</b>
Literature .....	33
Case law.....	34
Legislation .....	34

# Chapter 1

## Introduction

### 1.1 Background and purpose of study

Over the last few years, South Africa has experienced a steady increase in the use of electronic funds transfers (EFTs) and a reduction in the number of cheques processed by the Automated Clearing Bureau.<sup>1</sup> The escalation of the different forms of payment systems in South Africa is the result of a revolution in the banking sector. Schulze submits that this is because of three main forces: changes in information technology, changes in communications technology and globalization. As he explains, these forces also have a huge impact on the concept of money as humankind has come to know it over the last 3000 years.<sup>2</sup>

The legal position surrounding the use of EFTs is clouded in uncertainty due to the lack of governing legislation. Generally, there are few reported court decisions dealing with EFTs. This is due to a number of factors. For instance, because this method of payment is electronically based and requires little human intervention, there are few disputes between banks and consumers.<sup>3</sup>

Secondly, the amount that is involved in transactions may sometimes be small and therefore not worth it for the payer or consumer to litigate when they do not agree with the records of the bank.<sup>4</sup> Thirdly, banks are the sole scribes of the rules and standards of the use of EFTs. Therefore, consumers bind themselves to contractual provisions that may be prejudicial to them upon the issuing of the plastic bank card.<sup>5</sup> Currently, South Africa does not have a proper legislative framework to regulate EFTs. Consequently, banks rely on the South African Code of Banking Practice,<sup>6</sup> (the Code) as well as unilaterally adopting their own standards to regulate the use of EFTs.

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<sup>1</sup>WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 668.

<sup>2</sup>WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 667.

<sup>3</sup>WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 669.

<sup>4</sup>WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 669.

<sup>5</sup>WG Schulze "Countermanding an electronic Funds Transfer: The Supreme Court of Appeal Takes a Second Bite at the Cherry" (2004) 16 *SA Merc LJ* 667-684 669.

<sup>6</sup> The Code of Banking Practice, 2012.



The primary sources of law regulating the use of EFTs are the laws of contract and mandate. Although the Electronic Communications and Transactions Act<sup>7</sup> (ECTA) provides protection to consumers, it has limited application for the use of EFTs as it does not exclusively deal with electronic banking services.

EFTs raise quite a number of legal issues that cannot be addressed by ECTA as it has limited application. These aspects include the nature of the relationship between the consumer and the bank, finality of payment, the exact duties of the banks involved in affecting payment, apportionment of liability and reversal and recovery of payments.

Therefore, the purpose of this dissertation is to explore the legal nature of EFTs and address some of the legal issues that have already reached our courts. I consequently investigate the potential harm of not having a proper regulatory framework for EFTs. In my view, consumers currently bear most of the losses that are related to EFTs due to the unequal bargaining power between the parties.

## **1.2 Overview of chapters**

With the aim of addressing the research problem outlined above, this dissertation consists of various chapters in which I will present my arguments. As a point of departure, in Chapter 2 it is necessary to lay the foundation of the general principles and the legal nature of EFTs. This includes the general duties and obligations of the parties.

It has been submitted by various authors that a third party who receives an electronic payment by mistake is not entitled to that money as nothing was owed to him or her. Therefore, Chapter 3 introduces the legal issues surrounding reversal and recovery of EFTs. The arguments will be based on cases that have been decided by our courts.

In Chapter 4, I will address the apportionment of liability in so far as it relates to fraudulent and erroneous EFTs. To support arguments in this chapter, I will also consider the general provisions contained in consumer contracts that allow banks to exempt themselves from liability as well as the provisions of the Code of Banking Practice. In conclusion, Chapter 5 will contain recommendations.

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<sup>7</sup> 25 of 2002.

## Chapter 2

### The legal nature of electronic funds transfers

#### 2.1 Introduction

Methods of payments have evolved from the ancient method of bartering to the most common and present method of electronic banking. Owing to the rapid developments of technology, we are now moving towards the day when payment will be made by way of modern systems. This will be considered to be the new rule and cash will be an exception.<sup>1</sup>

The court in *In Vereins -und Westbank AG v Vereins Investments*,<sup>2</sup> described payment as a juristic act that requires the cooperation and agreement of the creditor and debtor, and it further requires the meeting of the two minds and collaboration for it to be affected. There are two categories of electronic payments, namely non-consumer activated systems and consumer activated systems. This dissertation will focus on consumer activated systems.

There is currently no legislation in place to regulate EFTs and as such, the relationship is regulated by the law of contract and the law of mandate. It is imperative to comprehensively understand the nature of EFTs. My aim in this chapter is to give a brief overview of the concept and legal nature EFTs. Moreover, I will consider the legal issue related to the finality of payment.

#### 2.2 Electronic funds transfers in general

EFTs are not regarded as an instrument of payment but rather a method of payment. The use of EFTs makes it easy for payments to be affected from one person to another. However, with banks being the sole scribes of the rules and conditions, consumers are arguably placed at a disadvantage, which tends to lead to an unfair apportionment of liability between banks and consumers.

There is no universally accepted definition of EFTs. However, in order to understand the problematic aspects relating to the use EFTs, it is paramount to briefly

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<sup>1</sup> WG Schulze "The Mode of Payment of Insurance Premiums: Different Methods Compared" (2011) 23 *SA Merc LJ* 64-81 53.

<sup>2</sup> 2002 4 SA 421 (SCA) para 38.

describe EFTs in terms of existing definitions. The UNCITRAL Legal Guide on Electronic Fund Transfers defines EFTs as a funds transfer in which one or more of the steps in the payment process that were previously done by paper-based techniques are now done by electronic techniques.<sup>3</sup>

The Code describes EFTs as a direct payment to a third party from a client's account by any electronic means, including an Automated Teller Machine, cell phone, telephone and internet.<sup>4</sup> Meiring describes EFTs as a fund transfer effected through the banking system by electronic techniques, with input and output methods being largely or completely in electronic form.<sup>5</sup>

Roestoff submits that it is inaccurate to speak of a "transfer of funds", as there is in actual fact no physical transfer of notes and coins to the beneficiary. The transfer is executed by a series of mandates that eventually results in the crediting of the beneficiary's account and the debiting of the originator's account.<sup>6</sup> Payment by the transfer of funds therefore entails an adjustment of balances on the bank accounts of the payer and the payee.<sup>7</sup> Schulze explains that payment by EFTs constitutes a novation of the original debt, as the beneficiary accepts that the money in terms of the transaction underlying the electronic fund transfer should be paid to the beneficiary by the originator's bank.<sup>8</sup>

Granted, the use of EFTs has brought many legal issues and most of these issues remain open questions due to the lack of proper regulation. An apparent question that has been raised is whether an EFT is an absolute payment or a conditional payment. Schulze argues that by prescribing or rather consenting to an EFT as a method of payment, one accepts such a transfer to be an absolute payment because one of the debtor's (payer's) accounts has been debited with the amount of the transfer.<sup>9</sup> He further contends that by the mere fact that payment by EFT is regarded to be absolute and not merely a conditional payment, it

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<sup>3</sup> United Nations Commission on International Trade Law *Legal guide on electronic funds transfers* (1987) 12.

<sup>4</sup> South African Code of Banking Practice (2012) 38.

<sup>5</sup> I Meiring "The South African Payment system" (1996) 8 SA Merc LJ 164-174 165.

<sup>6</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 274.

<sup>7</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 274.

<sup>8</sup> WG Schulze "Countermanding fund transfer: The Supreme Court of Appeal takes a second bite at the cherry" (2004) 16 SA Merc LJ 667-684 271.

<sup>9</sup> WG Schulze "Countermanding fund transfer: The Supreme Court of Appeal takes a second bite at the cherry" (2004) 16 SA Merc LJ 667-684 674.

satisfies one of the characteristics of money, namely that it should not be linked to the credit of the payer.<sup>10</sup> It should be noted that the transfer of funds does not constitute a cession of rights by the originator's bank to the beneficiary's bank.<sup>11</sup> EFTs embrace different kinds of services and transactions, including transfers effected through an ATM, telephone, mobile cellular phone or by a computer where a customer is registered for internet banking.<sup>12</sup>

There are two types of fund transfers, namely credit transfers and debit transfers. A credit transfer is described as a process in which funds are "pushed" from the transferor to the transferee. Where both parties maintain bank accounts, the transferor instructs his bank to debit his account and credit another bank account, resulting in the debiting of the originator's account and the beneficiary obtaining a personal right against his bank to credit his account.<sup>13</sup>

Credit transfers can also be achieved through a series of mandates regarding the crediting of the creditor's bank account,<sup>14</sup> while it may also be initiated by a debtor who intends to pay with a credit transfer. The right of the debtor's bank to debit the account is based on the agreement entered into between the parties.<sup>15</sup> In debit transfers, the debtor needs to consent to the pulling of funds from the account and in other instances it may be necessary for a debit transfer to be accompanied by a debit order whereby the bank is instructed to credit the creditor's bank account with the relevant amount.<sup>16</sup>

As part of electronic banking, it is imperative to understand the concept of consumer-activated EFT systems, which are used in EFT transactions and incorporate different systems that a consumer can elect to use. Consumer-activated systems include ATMs, EFT at a point of sale, internet banking and electronic money.<sup>17</sup> ATM

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<sup>10</sup> WG Schulze "Countermanding und transfer: The Supreme Court of Appeal takes a second bite at the cherry" (2004) 16 *SA Merc LJ* 667-684 674.

<sup>11</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment* in South Africa (2016) Ch 7 273.

<sup>12</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment* in South Africa (2016) Ch 7 273.

<sup>13</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment* in South Africa (2016) Ch 7 274.

<sup>14</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment* in South Africa (2016) Ch 7 274.

<sup>15</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment* in South Africa (2016) Ch 7 275.

<sup>16</sup> C Visser "The evolution of electronic payment systems" (1989) 1 *SA Merc LJ* 198-207 200.

<sup>17</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment* in South Africa (2016) Ch 7 275.

systems are used for almost all banking transactions, including withdrawals, balance enquiries and deposits.<sup>18</sup> However, it functions as a method of payment in the case of EFTs. EFTs at a point of sale include payment by credit and debit card where the bank is instructed electronically to effect payment. This system does not allow consumers to countermand payments and since the bank acts as a mandatary, it is expected to act with reasonable care and skill in this regard.<sup>19</sup> Moreover, given the nature of this system, at least three contractual relationships will come into existence.<sup>20</sup> It should be noted that the contracts will vary, which arguably is one of the reasons why apportionment of liability is problematic.

### **2.3 The nature of electronic funds transfers**

Due to the absence of legislation dedicated to the regulation of EFTs, the legal relationship between banks and consumers is regulated by the general principles of contract law and the law of mandate. The Electronic Communications and Transactions Act (ECTA) provides a general framework for the facilitation and regulation of electronic communications and transactions, which include electronic transactions for financial services.<sup>21</sup>

The terms of the respective individual agreements relating to the services rendered by banks are further regulated by the Code and legislation of a more general application, such as the National Credit Act<sup>22</sup> and the Consumer Protection Act.<sup>23</sup> The underlying agreement entered into by the consumer and the bank is based on the law of contract. The contracts may vary depending on what provisions the banks choose to insert in the agreement. As part of their mandate, the originator's bank is under a duty to exercise reasonable care and skill.<sup>24</sup>

There are various aspects of the originator's bank's duty to exercise reasonable care and skill. For instance, where the customer does not specify how a transfer should

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<sup>18</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 282.

<sup>19</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 276.

<sup>20</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 277.

<sup>21</sup> WG Schulze "Countermanding fund transfer: The Supreme Court of Appeal takes a second bite at the cherry" (2004) 16 *SA Merc LJ* 667-684 670.

<sup>22</sup> 34 of 2005.

<sup>23</sup> 68 of 2008.

<sup>24</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 282.

be made, the bank is free to choose the method of payment.<sup>25</sup> However, this freedom to choose must be exercised with due diligence. In instances where there are specifications by a consumer, the bank is not bound to that method unless the specification is deemed to be the essence of the instruction and the originator's bank may, if necessary, employ services of a reliable intermediary.<sup>26</sup> Put differently, the originator's bank has a duty to carry out each transaction with due diligence and they are free to deviate from the consumer's instruction if and when necessary to do so.<sup>27</sup>

The Code sets out the minimum standards with regard to what a consumer can expect from a bank in terms of the services they offer. The Code imposes a duty on consumers to take reasonable care and skill to keep their cards, pin and password safe and secure at all times and never disclose such information to anyone.<sup>28</sup> The predicament is that we are not able to verify the identity of an individual when a transaction occurs as long as the correct details are entered. In other words, any transaction can be carried out by any person.

There is no contractual relationship between the originator's bank and the beneficiary's bank and as a result, the originator's bank does not have any duty of care towards the beneficiary. Therefore, the originator's bank will not be held liable to the beneficiary where there was negligence that could possibly lead to delictual liability.<sup>29</sup> Only in circumstances where the intermediary bank was appointed by the originator's bank, will there be a duty of care that needs to be adhered to.

The beneficiary's bank is regarded to be acting on behalf of and as an agent of the originator's bank when it receives payment instructions from the originator's bank. However, the moment when the beneficiary's bank executes the instruction, the position becomes different in that the principal is no longer the originator's bank but the beneficiary's bank, who becomes entitled to the funds.<sup>30</sup>

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<sup>25</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 282.

<sup>26</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 282.

<sup>27</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 282.

<sup>28</sup> Code of Banking Practice (2012) para 7.7.3.

<sup>29</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 285.

<sup>30</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 285.

The relationship between the originator and the beneficiary's bank is problematic because there is no duty of care between them on the basis that there is no contractual relationship. However, Malan and Pretorius submit that there must be a duty of care on the beneficiary's bank in handling the transaction to match the name of the account holder with the account number in which payment is to be deposited.<sup>31</sup>

Accordingly, this can also be compared with the situation regarding cheques as addressed in the case of *Kwamashu Bakery Ltd v Standard Bank of South Africa Ltd*.<sup>32</sup> The court pointed out that the collecting banker will have a duty of care to contact the drawee bank when in doubt, to ensure that the proceeds are not credited to someone who is not entitled thereto. There must be a legal duty between an originator's bank and the beneficiary in this regard to avoid causing the consumer economic loss.

## 2.4 Completion of payment

The moment of payment in EFTs takes place instantly. There is no real period of delay between the time a payment order is given and the time when the beneficiary's account is credited.<sup>33</sup> With no legislation regulating the moment of payment between the parties, the underlying agreement between the parties is used to determine their rights and obligations and thereby determining when payment takes place.

Geva elucidates that the finality of payment has brought with it diverse meanings. In one sense, it comes to denote the irreversibility of the payment process, particularly in connection with insolvency. It can also signify the loss of the right to recover a mistaken payment while it has also been used to mark the accountability to the payee or the beneficiary by a bank.<sup>34</sup> Further, he briefly explains that a fund transfer is considered to be complete at the last bank communication chain, which by reference to the payment instruction may be referred to as the destination bank.<sup>35</sup>

Where an electronic payment takes place through the electronic system, completion of payment is determined by the rules of that system. Consequently, there

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<sup>31</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 286.

<sup>32</sup> 1995 (1) SA 147 (D) 147.

<sup>33</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 289.

<sup>34</sup> B Geva "Payment finality and discharge in Funds Transfers" (2008) 83 *Chi-Kent LR* 663-675 637.

<sup>35</sup> B Geva "Payment finality and discharge in funds transfers" (2008) 83 *Chi-Kent LR* 663-675 637.

is no need for specific clauses to be included in the agreement between the parties.<sup>36</sup> In circumstances where payment does not take place through the system, the court will adopt the standards of banking practice to determine the moment of payment, provided there is no underlying agreement between the parties.<sup>37</sup>

## 2.5 Conclusion

The introduction of EFTs as a method of payment has, without a doubt, brought with it many advantages. However, the lack of legislation to regulate the different aspects has raised many legal issues, which also remain open questions. Although the law of general application as well as the Code guides the regulation of EFTs, the underlying agreement between the bank and the consumer will likely be a deciding factor in cases of disputes.

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<sup>36</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 290.

<sup>37</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 290.



## Chapter 3

# The regulation of recovery and reversal of electronic funds transfers

### 3.1 Introduction

As mentioned above, banks usually unilaterally establish the terms and conditions by which electronic payments may be utilised.<sup>1</sup> ECTA provides for a general framework for the facilitation and regulation of electronic banking, including financial services.<sup>2</sup> However, a number of aspects surrounding the use of electronic payments are not covered by ECTA. The rapid development of electronic banking has disclosed many legal issues in the market regarding the use of EFTs. For instance, there is no guidance in any legislation about the reversal and recovery of EFTs. Instead, the current legal position in South Africa is solely based on case law. This chapter will therefore address issues surrounding the reversal and recovery of EFTs.

### 3.2 Reversal of electronic funds transfers

Due to the instantaneous nature of EFTs, the issue of reversal has left many open questions as different opinions are raised by different authors. Meiring elucidates that by looking at the fast nature of EFTs, an electronic payment should be irrevocable.<sup>3</sup> Further, she suggests that a reversal should only be possible until the payment order has reached the beneficiary's bank. However, she argues that it should not generally be possible to reverse the transfer.<sup>4</sup>

According to Meiring, there must be an exception to the irrevocability of EFTs between the receiving bank and the consumer. She argues that a payment may be reversed by the sender if it was received and accepted in a manner sufficient to afford the receiving bank sufficient opportunity to act.<sup>5</sup>

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<sup>1</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 295.

<sup>2</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 296.

<sup>3</sup> I Meiring "Electronic Funds Transfers" (1998) 6 *JBL* 36-41 41.

<sup>4</sup> I Meiring "Electronic Funds Transfers" (1998) 6 *JBL* 36-41 41.

<sup>5</sup> I Meiring "Electronic Funds Transfers" (1998) 6 *JBL* 36-41 41.

The arguments submitted by Meiring were also accepted in case law as seen in *Take and Save Trading CC v Standard bank of South Africa Ltd*,<sup>6</sup> In this case, a customer attempted to reverse a credit transfer by instructing its bank to reverse electronic payments made to another party subsequent to the credit transfer having been affected. The court briefly explained that once funds have been transferred by X to Y's account, the money belongs to Y and as such must be kept at Y's disposal.<sup>7</sup>

Further, the court stipulated that they cannot reverse payment once it has reached the account of the third party. The only possible way to recover the funds would be to request the third party to consent to the reversal of the payment. It is *prima facie* evident from the remarks made in *Take and Save* that an originator will require the cooperation of the third party in order to reverse the payment.

Chan describes a reversal of an electronic payment as the revocation of a payment instruction given by a consumer to its bank. He submits that since reversal nullifies the original instruction, the consumer can succeed in reversal of the payment only if the instruction to reverse is given in time for the bank to act on it.<sup>8</sup> Reversal of payment cannot be possible where payment is complete.<sup>9</sup> Therefore, the point when the reversal ceases to be available (so that the payment instruction is irrevocable) will always be no later than the point when payment is complete.<sup>10</sup>

Schulze suggests that it is generally accepted that once the instruction has been given by a consumer to the bank to transfer a certain amount to a third-party, reversal of payment will not be possible.<sup>11</sup>

The Code stipulates that consumers should take care when entering numbers while doing banking and in particular with telephone and cell phone banking so that when consumers make payments, they transfer the correct amounts to the correct accounts or beneficiaries. Banks cannot reverse duplicate or erroneous payments you make to other accounts without the specific consent of those account holders.<sup>12</sup>

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<sup>6</sup> [2004] 1 All SA 597 (SCA) 10.

<sup>7</sup> [2004] 1 All SA 597 (SCA) 17-18.

<sup>8</sup> E Chan "All about time: Finality and completion and completion of payment by funds transfer" (2005) 17 *SAC LJ* 84-140 94.

<sup>9</sup> E Chan "All about time: Finality and completion and completion of payment by funds transfer" (2005) 17 *SAC LJ* 84-140 94.

<sup>10</sup> E Chan "All about time: Finality and completion and completion of payment by funds transfer" (2005) 17 *SAC LJ* 84-140 94.

<sup>11</sup> WG Schulze "Countermanding fund transfer: The Supreme Court of Appeal takes a second bite at the cherry" (2004) 16 *SA Merc LJ* 667-684 674.

<sup>12</sup> The Code of Banking Practice (2012) para 9.3.13.

In view of case law, it is evident that a reversal is only possible by obtaining the consent of the third party to whom the money was transferred, and the bank is not at liberty to unilaterally reverse the payment. However, the court of first instance in *Nedbank v Pestana* had a different view.<sup>13</sup> The salient facts of the case are as follows. The South African Revenue Service (SARS) issued a section 99 notice in terms of the Income Tax Act 58 of 1962, to Nedbank on the 4 February 2004 at 8:44 am. In terms of the section 99 notice, banks act as agents in possession of funds of third parties on which SARS has a claim to pay over such an amount to SARS. Pastana owed SARS over R340 million. The 1<sup>st</sup> Pestana instructed a Nedbank employee (who was unaware of the notice issued by SARS) on 4 February 2004 at 11: 33 am to transfer the money from his account to the 2<sup>nd</sup> Pestana.

The transfer was done internally because both the Pestanas were clients of Nedbank. Upon discovery of the error, Nedbank reversed the amount from the 1<sup>st</sup> Pastana to SARS unilaterally. The 2<sup>nd</sup> Pestana approached the court on the basis that Nedbank had no right to reverse the payment without his consent.<sup>14</sup> Therefore, the question before the court was whether the bank, and having regard to its appointment in terms of section 99 of the SARS Act, was entitled to reverse the payment of R480 000 without the authority of the plaintiff.<sup>15</sup>

The court of first instance ruled in favour of Nedbank on the basis that the employee had no knowledge of the section 99 notice that had been issued by SARS and as such did not know that there was a claim against the money.<sup>16</sup> The Supreme Court of Appeal, however, ruled in favour of Pestana and briefly explained that Nedbank intended to make full payment unconditionally on behalf of the second Pestana. The bank's appointment as agent of SARS in terms of section 99 did not justify the bank's actions in relation to the respondent as its customer. As a result, Nedbank was not entitled to reverse the payment unilaterally.<sup>17</sup>

The general principle accepted in our law is that, once an amount has been validly transferred by X to the credit of Y's bank account, that money belongs to Y and the bank has to keep it at Y's disposal. It cannot simply be reversed without any

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<sup>13</sup> [2009] 2 All SA 58 (SCA) para 14.

<sup>14</sup> (2009) (2) SA 189 (SCA) para 14.

<sup>15</sup> (2009) (2) SA 189 (SCA) para 16.

<sup>16</sup> (2009) (2) SA 189 (SCA) para 17.

<sup>17</sup> (2009) (2) SA 189 (SCA) para 19.

legitimate reason and without the consent of Y. The Supreme Court of Appeal qualified theft and fraud as reasons for a legitimate reversal of payment.

Evidently, banks are willing to reverse an electronic payment only on the grounds of fraud and theft, not an error made by the consumer. Erroneous payments will only be reversed if the third party consent to the reversal of such payment.

While our courts are willing to accept reversal of a credit transfer in circumstances where there is fraud, the court in *Nissan South Africa (Pty) Ltd v Marnitz*,<sup>18</sup> set a new legal precedent by introducing the law of unjustified enrichment as a possible ground for reversal of payment. In this case, a transfer intended for the transferor's creditor was made to another party, because the transferor supplied a wrong account number to its bank. The third party who received the funds knew that the funds did not belong to him as the transferor did not owe him anything.<sup>19</sup> The court ordered a reversal of the payment from the bank that held the funds and based it on the law of unjustified enrichment.<sup>20</sup> However, the court did not specify which enrichment action should be used to institute the claim.

Roestoff points out that in the case of an instruction to pay a customer at the same bank, a reversal is possible only until the time when the funds have been transferred or credit given to the beneficiary. However, where a customer instructs its bank to pay another bank, a reversal is possible only before the beneficiary bank accepts the payment order from the originator's bank, by returning an acceptance message or by acting on the payment instructions.<sup>21</sup>

In principle, reversal of EFTs is based on the same as principles as those governing cheques. Banks require an instruction to be unambiguous and be given before the time that one wishes to reverse payment. When the cheque is reversed, the duty to pay is superseded by a duty to refuse payment.<sup>22</sup>

However, I am of the opinion that the situation with cheques should be distinguished from the situation with EFTs. Payment by means of an EFT takes place fast and instantly. Therefore, banks should actually adopt standards that will be in line with recent developments and technology. Put differently, banking apps can possibly have

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<sup>18</sup> 2005 (1) SA 441 (SCA) para 2.

<sup>19</sup> 2005 (1) SA 441 (SCA) para 2.

<sup>20</sup> 2005 (1) SA 441 (SCA) para 20.

<sup>21</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 289.

<sup>22</sup> J Moorcoot & LR Raft *Banking law and practice* (2009) 34.

a feature that will permit a consumer to reverse an electronic payment unilaterally in cases of erroneous payments. However, a possible reversal of an EFT via online banking unilaterally may be considered as unlawful interference of a third party's account. Therefore, the possible introduction of such a feature will require banks to adopt new standards which will permit a consumer to reverse the electronic payment lawfully.

The evolution of payment methods has brought about new challenges that demand an innovative response from banks as service providers and from the law. Currently, the position seems to suggest that the reversal of payment can only be possible prior to the completion of the payment and it is not possible to reverse the payment without the third party's prior consent. The factor that the third party was never entitled to the amount is not taken into consideration by our courts.

Schulze argues that the current legal position is flawed and not practical.<sup>23</sup> In my view, to require consent from a third party who was never entitled to the funds might seem to be unfair. However, the contract between banks and consumers is based on mandate, which entails that the bank cannot unilaterally transfer funds from a third party's account without first consulting him or her.

### **3.3 Recovery of electronic funds transfers**

The concept of reversal of payment is closely related to the issue of recovery. South African law relies on the principle of unjustified enrichment to recover payment of a credit transfer. The principles relating to unjustified enrichment are often invoked by the drawee bank to recover the payment.<sup>24</sup>

Importantly, the court in *ABSA Bank v Lombard Insurance*,<sup>25</sup> addressed the issue of recovery by considering one the principles of unjustified enrichment. In this case, an employee of the respondent fraudulently caused money belonging to a customer of the respondent to be transferred electronically to various other accounts, *inter alia* to her overdrawn account with ABSA, which had the effect of extinguishing the overdraft and leaving her account with a considerable positive balance.

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<sup>23</sup> WG Schulze "A South African code of electronic payments" in C Visser & J Pretorius (eds) *Essays in honour of Frans Malan* (2014) 294-319 316.

<sup>24</sup> M Roestoff "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 7 382.

<sup>25</sup> 2012 (6) SA 569 (SCA) paras 5-6.

The respondent sought to recover the full amount from the bank, using the *conditio op turpem vel iniustam causam*. The Supreme Court of Appeal invoked the principle of *suum recipit*, which entails that a debtor suffers no loss by making the payment because, although the recipient is enriched, such enrichment is justifiable. A debt extinguishing agreement will be invalid where both parties knew that the debt would be discharged with stolen money. However, this will not be the case if the creditor is in good faith and unaware of the fact that debt is to be discharged with stolen funds.

Further, when the funds were transferred to the employee's account, they were in debit and at the time the banks had no knowledge of their theft. Absa was in the same position as any other creditor and were entitled to appropriate the funds transferred to extinguish the debts. Thus, it was the employee who was enriched and not Absa. The enrichment claim against the bank in this case was not successful.

Similarly, the court in *Absa Bank v Intensive Air (Pty) Ltd & other*,<sup>26</sup> held that had the thief paid off his overdraft account with stolen money, the company would have no claim for the repayment thereof against the bank. However, there would be a claim against the thief and a possible enrichment action against anyone who knowingly received or retained the stolen money.

It is acceptable in our law to recover payment based on the principles of unjustified enrichment. However, where the consumer owes the bank in anyway and the bank receives such payment as creditor without prior knowledge that the money does not belong to the consumer, the claim of enrichment will not succeed against the bank. This entails that the enrichment claim should be brought against the third party who received the money erroneously or fraudulently, not the bank who received the payment in good faith.

The originator's right of recovery is one of the questions that has been addressed in our law.<sup>27</sup> The opportunity to determine whether the beneficiary owes a duty of care towards the originator of a payment instruction was addressed in *Gilbey's Distillers and Vintners (Pty) Ltd v Absa Bank*,<sup>28</sup> where the plaintiff instructed its bank to conduct eight transfers to another bank into a specified bank account, which account later

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<sup>26</sup> 2011 (2) SA 275 (SCA) para 22.

<sup>27</sup> C van Heerden "Unauthorised cheque payments and electronic fund transfers" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 384.

<sup>28</sup> Unreported case (CPD) 12698/94 (4 December 1998) para 59.

transpired to belong to another entity. The court held that there was no probity of contract between the originator's bank and the beneficiary bank. The court further stated that where there is a series of mandates, it is necessary to give effect to a payment instruction. Thus, there was no direct nexus between the first principal and the second mandatory or any further mandataries.<sup>29</sup>

Malan and Pretorius argue that the court was correct to conclude that there is no contractual relationship between the originator and the beneficiary's bank. However, they also point out that the court's approach to the issue of liability in respect of pure economic loss does not represent jurisprudential thinking on the subject. Thus, they submit that since the beneficiary's bank is undertaking professional services, the beneficiary bank would be expected to exercise reasonable care and skill when making payment or crediting the account of the named beneficiary.<sup>30</sup>

It is evident that our courts have not yet recognised the duty of care owed by the beneficiary's bank to the originator of an EFT, which can lead to delictual liability if a beneficiary's bank is negligent. The absence of a statutory obligation on the beneficiary's bank to match the account number with the name of a beneficiary is not practical. The beneficiary's bank is a party to the transaction and thus it is only reasonable for the originator, consumer and the beneficiary's bank to practice due diligence to ensure that the funds are credited to the correct account number.

### **3.4 Conclusion**

The issue of reversal and recovery of EFTs is primarily based on case law. Thus, reversal of a credit transfer can only be possible by obtaining prior consent from the third party who has received the funds. However, judicial precedent seems to suggest that banks can reverse a credit transfer without prior consent of a third party where it was a fraudulent credit transfer. However, the courts distinguish between error and fraud on the basis that a thief has no entitlements to what never belonged to them.

In my view, even an erroneous payment should be treated the same because the third party was also not entitled to the amount that they are credited with. Importantly, being credited with a certain amount to your account does not entail that you are entitled to those funds, especially when nothing was owed to you. With the

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<sup>29</sup> C van Heerden "in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 385.

<sup>30</sup> C van Heerden "Payment systems" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 386.

issue of recovery, the court is willing to invoke the principles of unjustified enrichment to allow a prejudiced party to recover the amount that is owed to him or her. However, there is no clear indication in terms of which principle of unjustified enrichment should be invoked in order to recover the funds from the enriched party.



## Chapter 4

### Unauthorised transactions

#### 4.1 Introduction

The law of banking proper is the law of the relationship between a banker and its consumer. Basically, the relationship is that of a mandator and mandatory, which relationship embraces mutual duties and obligations.<sup>1</sup> The most serious concern relating to the use of EFTs is the high security risk that the consumer has to bear when compared to the low risk that the bank has to bear. The Code by implication reinforces the measures taken by banks to protect themselves from liability and as a result, consumers bear the risk for loss.<sup>2</sup> This chapter generally aims to address the nature of the bank and consumer relationship and the apportionment of liability between the parties in cases of unauthorised EFTs.

#### 4.2 The nature of bank-customer relationship

The bank and consumer relationship is formed when a bank agrees to open an account on behalf of a person and accepts him as a customer.<sup>3</sup> The person purporting to represent the bank in concluding the contract must have the authority to do so. The lack of authority to conclude the contract on behalf of the bank might result in an invalid contract. However, the bank may be held bound to the agreement if it is ratified or estopped from denying that the agent had the necessary authority to act on their behalf.

The relationship is classified as complex and, in essence, is one that exhibits elements of different types of contract, depending on what the bank offers the consumer.<sup>4</sup> Due to its complexity, the relationship is often classified as *sui generis*.<sup>5</sup> The relationship between the parties in respect of a current account is one of a debtor

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<sup>1</sup> QC Malek & QC Odgers *Paget's Law of banking* (14 ed 2014) 29.

<sup>2</sup> C van Heerden "Unauthorised cheque payments and electronic fund transfers" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 372.

<sup>3</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 120.

<sup>4</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 115.

<sup>5</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 115.

and creditor. The bank becomes the owner of the money deposited by the consumer. The bank does not hold the money as an agent or trustee for the consumer but holds it in its own right and can use the money immediately for its own purposes.<sup>6</sup> The consumer merely holds a personal right that can be exercised by withdrawing the money or by instructing the bank to make payment.<sup>7</sup>

The court pointed out in *Absa Bank v Hanley*,<sup>8</sup> that the relationship between a bank and its customer is unique and involves a debtor and creditor relationship. The relationship is contractual and may involve several agreements establishing different accounts. The contract generally requires the bank to perform certain services for the customer. Whether it relates to one or more of banking services, the agreement giving rise to them is an agreement of mandate.

Further, the relationship invariably incorporates a mandate in terms of which the bank agrees to carry out one or more banking services on behalf of the consumer.<sup>9</sup> The bank may extend the range of its duties to the consumer by agreeing to conduct other services, which may include providing the consumer with electronic banking facilities, issuing the consumer with debit or credit cards as well as paying debt orders on behalf of the consumer.

The bank acts as a mandatory of its customer and as such must at all times act in good faith.<sup>10</sup> The classic description of the bank-consumer contract was given in *Joachmson v Swiss Bank Corpn*,<sup>11</sup> namely that the bank undertakes to receive money and collect bills on behalf of the consumer. The proceeds so received are not to be held in a trust for the consumer, but the bank borrows the proceeds and undertakes to repay them.<sup>12</sup>

The court in *Foley v Hill*,<sup>13</sup> stipulated that once a customer deposits money with the bank, there is a debt owed by that bank (debtor) to the consumer (creditor).

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<sup>6</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 117.

<sup>7</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 117.

<sup>8</sup> [2014] 1 All SA 249 (SCA) para 25.

<sup>9</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 119.

<sup>10</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 127.

<sup>11</sup> 1921 3 KB 110 127.

<sup>12</sup> 1921 3 KB 110127.

<sup>13</sup> (1848) 2 CHL Cas 28, 9 ER 1002.

Conversely, where the bank provides funds to the consumer in the form of loan or overdraft, the bank is the creditor and the consumer the debtor.

Meiring points out that the underlying principles stay the same, irrespective of whether the procedure is paper-based or purely electronic in nature. The bank acts as a mandatory of the consumer, so that their legal relationship is governed by the contract of mandate.<sup>14</sup> An apparent question is: what then are the legal implications of the instructions given by consumer to the bank? How are they regarded as a matter of law? The court in *Royal Products Ltd v Midland Bank Ltd*,<sup>15</sup> pointed out that instructions from a consumer are to be regarded simply as authority from the consumer to the bank, to transfer an amount standing to the credit of that consumer with that bank to the credit of its account with another bank.

### 4.3 Rights and duties of the parties

Generally, the relationship between the bank and the consumer is regulated by the laws of contract and mandate and as such the parties rely on the terms of the agreement to determine their rights and duties. It is not necessary to give a comprehensive list of all the rights and duties of the parties. Therefore, I will focus on the rights and duties that are relevant for present purposes.

The bank has a duty of reasonable care and skill. This duty requires the bank to correctly ascertain and interpret its consumer's instructions and ensure that any applicable legislation is complied with.<sup>16</sup> The court in *McCarthy Ltd v Absa Bank Ltd*,<sup>17</sup> held that the contract between the bank and the consumer imposes a duty on the bank to act prudently. Further, the court in *Selangor United Rubber Estates Ltd v Craddock*,<sup>18</sup> held that the bank's duty of care to its customer does not only require the bank to interpret the consumer's instructions but may in certain circumstances require that the bank should make enquiries before acting.<sup>19</sup>

A question that was raised in relation to the duty of reasonable care and skill by the bank, was whether a bank has assumed an advisory duty to someone by agreeing

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<sup>14</sup> I Meiring "Electronic funds transfers" (1998) 6 *JBL* 36-41 39.

<sup>15</sup> [1981] 2 *Lloyd's Rep* 194.

<sup>16</sup> A Ramdhin "The bank-customer relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 132.

<sup>17</sup> 2010 (2) SA 321 (SCA) para 22.

<sup>18</sup> [1968] 2 All ER 1073 (Ch) 1111.

<sup>19</sup> [1968] 2 All ER 1073 (Ch) 1111.

to take care of their affairs.<sup>20</sup> Legal precedent suggests that the duty to exercise reasonable care and skill does not include the duty to give financial advice to consumers.

Accordingly, in *Shioler v National Westminster Bank Ltd*,<sup>21</sup> the court held that the defendant bank does not owe any duty of care to advise or warn its consumer of the possible tax repercussions of remitting to England a warrant denominated in Malaysian dollars. However, the Court of Appeal held that the fact that a bank accepts a request for advice would be strong evidence of an assumption of responsibility. The court, however, held that where a bank assumes a duty to exercise reasonable care in giving advice and complies with the duty, it does not assume a further continuing obligation to keep the advice under review and, if necessary, to correct it in light of supervening events.

In *Woods v Martins Bank Ltd and Another*,<sup>22</sup> the court held that, based on the relationship between the bank and the consumer, the ordinary question of assumption of responsibility must be applied. Put differently, the court suggested that it would be reasonable for a consumer to assume that as part of the bank's duty to exercise reasonable care and skill, it would include the duty to advise them on their financial decisions. Thus, in such circumstances the law imposes an obligation on the bank to advise a consumer with reasonable care and skill.

The duty of reasonable care and skill is further supported by section 54(1)(b) of the Consumer Protection Act 68 of 2008, stipulates that consumers are entitled to have the services that are rendered to them performed in a manner and quality that persons are generally entitled to expect. Ramdhin points out that in circumstances where the bank fails to perform its services to the standard expected, the consumer may require the bank to remedy any defect or refund the consumer a reasonable portion of the price paid for the services performed having regard to the extent of the failure.<sup>23</sup>

Where the bank breaches its duty to act with reasonable care and skill, it may be held liable for breach of contract and the consumer may also institute action in terms

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<sup>20</sup> Malek QC & QC Odgers *Paget's Law of banking* (14 ed 2014) 94.

<sup>21</sup> (1970) 2 QB 719 3 All ER 177.

<sup>22</sup> (1958) 3 All ER 166 147.

<sup>23</sup> A Ramdhin "Bank-customer-relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 134.

of the law of delict.<sup>24</sup> The court in *IPF Nominees (Pty) Ltd v Nedcor Bank Ltd*,<sup>25</sup> stipulated that, in other circumstances, a failure by the bank to comply with its own regulations may be regarded as *prima facie* proof that it has acted negligent in rendering its services.

As part of the consumer's duty to act with reasonable care and skill when drawing payment instructions, the Code requires a consumer to take reasonable steps to keep their cards, pin, password and other unique means of personal identification secret, safe and secure at all times.<sup>26</sup>

Consumers are required to act with due diligence at all times and refrain from acts that will facilitate fraud or alteration. Ramdhin submits that in circumstances where the consumer acts in breach of this duty and a payment instruction is altered and subsequently paid by the bank, the consumer's account may be debited with such an amount, provided that the consumer's negligence was the real, direct or immediate cause of the bank being misled.<sup>27</sup>

Banks require a consumer to report any suspected forgeries on their accounts. The failure to uphold this duty entitles the bank to debit the account of the consumer should there be any amount paid out due to fraud.<sup>28</sup> Additionally, the consumer has a duty to indemnify the bank against liability that may be incurred in carrying out its mandate. The obligations between the parties are generally based on the underlying agreement between them. As mentioned above, banks unilaterally draft these contracts and with limited protection given to consumers, it becomes a reality that consumers might not be protected adequately.

Closely linked to the duty of reasonable care and skill by the bank, is the bank's duty to act in good faith. At common law, a mandatary owes a duty of good faith towards the mandator to be honest and fair in their dealings.<sup>29</sup> The same principles

have been applied to a bank to the extent that it may owe a fiduciary duty to a consumer. The duty to act in good faith is not a fiduciary duty but rather one that is

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<sup>24</sup> A Ramdhin "Bank-customer-relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 134.

<sup>25</sup> 2002 (5) SA 101 (w) at 109.

<sup>26</sup> The Code of Banking Practice (2012) para 7.7.3.

<sup>27</sup> A Ramdhin "Bank-customer-relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 143.

<sup>28</sup> A Ramdhin "Bank-customer-relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 145.

<sup>29</sup> A Ramdhin "Bank-customer-relationship" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 4 140.

based on the debtor-creditor relationship. In other circumstances, however, a bank may owe a fiduciary duty to the consumer and must therefore always act in good faith when rendering its services.

#### **4.4 The risk of loss**

While using EFTs is convenient for consumers and eliminates many of the risks that were traditionally related to cheques, there is little or limited statutory protection. Banks are at liberty to unilaterally determine the rules and conditions of the underlying agreement.<sup>30</sup> Banks are also able to exempt themselves from liability in certain circumstances by relying on the provisions of the contract.

The Code has the effect of protecting banks by affording them extensive protection from the bank-consumer contract.<sup>31</sup> It must be noted that although a credit transfer is affected electronically, the payment instruction is not always given electronically. The instruction can be given in writing, which has the effect that in certain circumstances the handwritten payment instruction may be replaced with an electronic key that is used to authenticate the message. Schulze submits that in the absence of proper security, the credit transfer can be transferred to another medium without the bank realising it. However, the Code does not directly address the liability of the bank in such circumstances.<sup>32</sup>

It is important to note that electronic payments are processed on the basis of an account number only. Banks do not have a system in place whereby they will verify if a payment instruction matches that of the consumer.<sup>33</sup> However, the Code requires consumers to take care when entering numbers while doing their banking and in particular with telephone and cell phone banking.<sup>34</sup> The bank will be liable for any loss when they have acted negligently, provided it can be proved. Put differently, the bank must be satisfied that the consumer acted with due diligence in the circumstances.<sup>35</sup>

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<sup>30</sup> C van Heerden "Unauthorised cheque payments and electronic fund transfers" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 370.

<sup>31</sup> C van Heerden 'Unauthorised cheque payments and electronic fund transfers' in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 370.

<sup>32</sup> Code of Banking Practice (2012).

<sup>33</sup> C van Heerden 'Unauthorised cheque payments and electronic fund transfers' in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 371.

<sup>34</sup> Code of Banking Practice (2012) para 9.3.13.

<sup>35</sup> Code of Banking Practice (2012) para 7.8.

As mentioned above, in the absence of governing legislation, banks insert provisions into the bank-consumer contract to escape liability and therefore attributing liability to the consumer for any loss that may be suffered due to unauthorised payments.<sup>36</sup> It is generally accepted that where a paying bank debits a consumer's account without the necessary mandate, they are to be held contractually liable.<sup>37</sup> However, the bank-consumer contract will still need to be consulted to ascertain whether or not it indemnifies the bank and it may happen that the risk is allocated to the consumer in certain circumstances.<sup>38</sup>

The bank-consumer contract will always be the deciding factor where the courts are faced with a dispute relating to the apportionment of liability. They are always willing to accept the provisions of the underlying agreement between the parties. In the case of *Diners Club v Singh*,<sup>39</sup> Diners Club issued a credit card to the two defendants over the weekend of 4 and 5 March in 2002 and a total of 190 successful ATM cash withdrawals were made in London during that weekend.

Singh contended that the money had been withdrawn with the co-operation of an insider of either Standard Bank or the Diners Club organisation and raised a defence challenging a clause in the underlying agreement with a bank. The clause in the agreement stipulated that the consumer as the card holder would be liable for amounts credited regardless of who used the card and the pin.<sup>40</sup> He explained that the clause was against good morals, unfair, unreasonable thus invalid. The court seemed convinced that Singh had conspired with the syndicate to provide them with his card and pin to withdraw the money in London on that weekend. The court then upheld the clause in the agreement, which basically attributed all the risk to the consumer and not the bank.<sup>41</sup>

Additionally, the court explained that Singh accepted the credit card knowing that he would be bound by contractual terms and conditions. He was thus under no obligation to accept the credit card and apply for a pin. As part of the duty that a

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<sup>36</sup> C van Heerden 'Unauthorised cheque payments and electronic fund transfers' in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 372.

<sup>37</sup> C van Heerden 'Unauthorised cheque payments and electronic fund transfers' in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 373.

<sup>38</sup> C van Heerden "Unauthorised cheque payments and electronic fund transfers" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 373.

<sup>39</sup> 2004 (3) SA 630 (D) 571.

<sup>40</sup> 2004 (3) SA 630 (D) 631.

<sup>41</sup> 2004 (3) SA 630 (D) 631.

consumer has to exercise reasonable care and skill, he ought to know the rules governing the use of the pin.

Importantly, the court made reference to *Van Rensburg v Straughan*,<sup>42</sup> where the court briefly explained that although a contract can be one sided, as it favours one party over the other, those who enter into one-sided agreements have only themselves to blame. Thus, this entails that consumers who enter into agreements knowing exactly what it entails cannot later approach the court and seek to remedy a situation which they knew about from the start.

I doubt the court can remedy a situation where a consumer failed to exercise reasonable care and skill as part of its duty under the underlying agreement. The law cannot assist them merely because the results are harsh. The court reasoned that Diners Club ought to have protected itself by placing the risk of a wrongful user on its consumer. Further, the court considered the accepted South African principle that contracts seriously entered into must be enforced. However, the concept of public policy was also considered. It was stated that not all agreements will be enforced without exception. The surrounding circumstances of each case will be considered before enforcing an agreement between the parties considering what would be fair and reasonable.

In *Sasfin v (Pty) Ltd v Beukes*,<sup>43</sup> a certain contractual term was found to be illegal for being unconscionable and incompatible with the public interest and therefore contrary to public policy. The court had to balance potentially conflicting considerations of the law of contract with finding justice between man and man. Schulze submits that there was little doubt that the clause in the *Diners Club* case was potentially unfair in placing the risk of loss for unauthorised credit card on the consumer.<sup>44</sup> The court upheld the contractual provision that stated that the consumer will be liable for amounts credited regardless of who used the card. An emphasis was placed on the duty to always act with due diligence as per the contractual agreement. The consumer was seen as negligent and maybe also dishonest in this case and was held liable for the transactions.<sup>45</sup> It is apparent from legal precedent that courts are not willing to

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<sup>42</sup> 1914 AD 317 328.

<sup>43</sup> 1989 (1) SA 1 (A) paras 13-14.

<sup>44</sup> H Schulze "Unauthorised cash withdrawals with a credit card & unfair contract terms" 12 JBL 143-146 145.

<sup>45</sup> H Schulze "Unauthorised cash withdrawals with a credit card & unfair contract terms" 12 JBL 143-146 145.



deviate from the provisions of the agreement between the parties easily. There must be strong grounds of potential unfairness before a court will do this. Harsh results for the consumer will not be sufficient. However, it should be noted that the *Diners Club* case was decided prior to the operation of the Consumer Protection Act 68 of 2008. However, in instances where the Act applies, courts will be able to scrutinise the provisions of a bank-customer relationship.<sup>46</sup>

The bank-consumer agreement generally provides that a consumer will also bear the risk of loss in circumstances where the card was stolen and the consumer failed to report it within a reasonable period.<sup>47</sup> This will include circumstances where a third party has knowledge of the consumer's pin as well as where the consumer knew that there was forgery and failed to report it to the bank. However, in *Absa Bank Ltd v Hanley*,<sup>48</sup> a defendant who kept an investment account at the bank, alleged that he did not authorise a transaction from his account but rather that it was affected fraudulently by another consumer at the bank via a document that belonged to the defendant.

The bank alleged that the consumer failed to act with due diligence, implying that he was negligent by allowing another consumer to be in possession of the document that was signed by the defendant. The court did not agree with the bank in this case and briefly explained that the principal duty of a bank effecting a credit transfer is to perform its mandate timeously, in good faith and without negligence.<sup>49</sup>

Although the consumer also had a duty to exercise reasonable care and skill, the court stated that, in the present case, the bank was negligent based on a number of factors: the bank did not call to confirm the consumer's signature, made payment on the basis of a fax and not the original form, and opened a bank account for the other company without the resolution of the company authorising the account.<sup>50</sup> Further, the court held that the consumer could not reasonably have foreseen that the amount on the second stage would be altered.<sup>51</sup> The risk of loss in this case was attributed to the

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<sup>46</sup> C van Heerden "Unauthorised cheque payments and electronic fund transfers" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8.

<sup>47</sup> C van Heerden "Unauthorised cheque payments and electronic fund transfers" in R Sharrock (ed) *The law of banking and payment in South Africa* (2016) Ch 8 372.

<sup>48</sup> [2014] 1 All SA 249 (SCA) para 4.

<sup>49</sup> [2014] 1 All SA 249 (SCA) para 25.

<sup>50</sup> [2014] 1 All SA 249 (SCA) paras 33-36.

<sup>51</sup> [2014] 1 All SA 249 (SCA) para 37.

bank on the basis of the negligence of its employee who failed to notice that the payment instruction has been altered.

#### **4.5 Conclusion**

In terms of banking practice and the contractual relationship between the consumer and the bank, the consumer is likely to bear the risk of loss. Granted, it is fair for consumers to be liable where loss was due to their own negligence. However, certain standards that lead to the consumer being held liable for loss are not practical. There is a duty on the consumer to report the loss of a card within a reasonable period but there is no clear indication of what constitutes a reasonable period.

While banks have extensive protection, ECTA is currently the only piece of legislation that seeks to protect consumers. Section 43(5) of ECTA stipulates that a supplier must utilise a payment system that is sufficiently secure with reference to accepted technological standards at the time of the transaction and the type of transaction concerned. This obliges the bank to make sure that their banking systems are always functioning adequately. Thus, any loss which may result due to their system malfunction will be borne by the bank.

Another aspect that I find to be unfair on the part of the consumer is the risk of loss that the consumer has to bear in the case of a result of a natural disaster. Neither the bank nor the consumer was negligent in this aspect. The appropriate standard in this aspect would be apportionment of liability between the parties. It is impractical for the consumer to bear this risk alone.

Currently, there is no contractual relationship between the originator's bank and the beneficiary's bank. Consequently, the beneficiary's bank has no duty to match an account number with the name of a consumer to ensure payment is credit to the correct account. This is beneficial to banks because their responsibility is less and as such it is unlikely for the bank to act negligent.

Thus, the risk of loss will be attributed to the consumer. Banks as service providers should have standards in place which will seek to protect the interests of their consumers. Currently, in terms of the banking standards, the apportionment of liability is not on an equal scale. The unilateral conduct by banks to decide the standards of banking is highly beneficial to them. There are no consultations involved

with consumers and as such they cater for their interests more than those of consumers.

## Chapter 5

### Summary and recommendations

The introduction of smart card technology has eliminated many disadvantages associated with magnetic strips and cash. However, there is at present no legislation that regulate the use of EFTs and as a result we have many legal issues associated with EFTs.<sup>1</sup> As Schulze correctly elucidates, the banking sector is inherently fragile and sensitive to new and changing forces and as such it requires careful consideration to avoid failures and prevent or cure systematic risks.<sup>2</sup>

While it cannot be denied that EFTs are safer and cheaper to use, there is little protection that consumers enjoy compared to consumers who used the traditional methods of payments such as cheques. It is clear from the Bills of Exchange Act 34 of 1964, as well as other judicial precedents interpreting the provisions of the Act, that using cheques as a method of payment has less risks associated with them than EFTs. Unfortunately, using an EFT is no longer a choice but compulsory due to the decision by banks to no longer accept cheques in excess of R5 million.<sup>3</sup> It is clear that a number of legal issues associated with EFTs are a direct result of the new developments in the banking sector, which necessitates the introduction of legislation to regulate modern methods of payment.

Generally, the standard of care that the law demands is that which a reasonable person would exercise in the same position. Thus, conduct will constitute negligence where an individual foresees the reasonable possibility of his conduct causing patrimonial loss and fails to take reasonable steps to prevent it.<sup>4</sup> The Code points out instances where a consumer will be considered to have acted negligent.<sup>5</sup> However, Pretorius correctly points out that there can be no hard and fast rules formulated on what actually constitutes negligence or a failure to exercise reasonable care what will be considered to be negligence will be a question of fact. Thus, he who

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<sup>1</sup> H Schulze “Unauthorised cash withdrawals with a credit card & unfair contract terms” 12 JBL 143-146 143.

<sup>2</sup> H Schulze “Unauthorised cash withdrawals with a credit card & unfair contract terms” 12 JBL 143-146 143.

<sup>3</sup> H Schulze “Unauthorised cash withdrawals with a credit card & unfair contract terms” 12 JBL 143-146 145.

<sup>4</sup> JT Pretorius “Section 72B of the Bills of Exchange Act 34 of 1964” (2005) 17 *SA Merc LJ* 56-70 66.

<sup>5</sup> Code of Banking Practice (2012) para 7.7.

alleges must prove. In my view, for a consumer to be held liable for loss, the bank must not only prove that the consumer acted negligent but also needs to prove that the negligence was the proximate cause of the loss.

For the purposes of this dissertation, I recommend that the legislature introduce legislation that will exclusively deal with the regulation of EFTs. The aim should be to cater for the interest of both the bank and the consumer considering the interests of justice, fairness and equality using a balancing approach. In the first instance, the legislature must recognise a legal nexus between the originator and beneficiary's bank. Thus, it must include a statutory obligation on the part of the beneficiary's bank to match the name of the designated payee with that of the designated account number to which the payer wishes to transfer or effect payment. This statutory obligation will compel banks to act with due diligence in handling transactions to avoid being held delictual liable.

In the case of a reversal of a credit transfer, a bank must be able to reverse payment without prior consent of a third party. However, to ensure that the bank does not interfere with an account of a third party unlawfully, the bank should contact the third party to notify him or her about the intention to reverse the payment. Where possible, the bank can also send a notice to the third party, informing him or her of the intentions to reverse the payment. The third party cannot be placed in a position to consent to the reversal of the payment because they have no entitlements to it as nothing was owed to him. For practical purposes, where there is a dispute regarding the payment, such payment must be frozen by the bank until the dispute is resolved.

It is evident from legal precedent that our courts are prepared to invoke the principles of unjustified enrichment to allow the prejudiced party to recover any amount from the enriched party. However, there is no clear indication of which principle will be used to recover the amount. I submit that the *condictio sine causa* should be used for losses erroneously paid to be applied in the instances of recovery of EFTs. Consumers bear the loss resulting from failure to report within reasonable time that they lost their bank card or that someone knows their Pin.<sup>6</sup> What is reasonable time is a question of fact. The legislature must expressly state what constitutes reasonable time in this regard. Banks are able to exempt themselves from liability by merely stating that a consumer failed to notify the bank within a reasonable period.

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<sup>6</sup> Code of Banking Practice (2012) para 7.7.

Further, the legislature must address the issue of contributory negligence. There must be apportionment of liability between the bank and the consumer. Currently, in terms of the Code, banks are not liable should a loss result from a natural disaster and thus the consumer must bear the loss. This is impractical as the consumer did not cause the disaster. Another aspect which will have to be considered in this aspect is whether the Apportionment of Damages Act 58 of 1971 can be applied in circumstances where we have contributory negligence.

While methods of payments evolve and banks introduce new developments in the banking sector, uncertainty remains regarding some of the legal issues that have not yet been dealt with by our courts. The only possible way that I believe will eliminate the legal issues and doubts associated with the use of EFTs will be the introduction of legislation to exclusively deal with the regulation of EFTs.

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