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SEMINAR PAPER

THE LEGAL IMPLICATIONS OF BANKING PRACTICE IN THE RELATIONSHIP BETWEEN BANKER AND CUSTOMER: SOME NEW DEVELOPMENTS

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NOTE ON THE LEGAL IMPLICATIONS OF BANKING PRACTICE IN THE RELATIONSHIP BETWEEN BANKER AND CUSTOMER: SOME NEW DEVELOPMENTS

A. INTRODUCTION

1. A special relationship exists between a banker and its customers which is primarily contractual in nature. The relationship involves certain incidents, rights and liabilities arising by the express or implied terms of the contract. Where a person is a customer of a bank the bank will owe him certain duties but these duties may also be owed to a person who is not strictly a customer. Further, depending on the circumstances or the terms of the contracts, a bank may owe varying duties to different customers.

2. For the purposes of this discussion, I propose to use the term banker in its traditional sense of a person who conducts a business the essential elements of which are the maintenance for customers of current accounts, the payment of cheques, and the collection of cheques for customers. *U.D.T. v. Kirkwood [1986] 2 Q.B. 431.* Section 2(1) of the Banking Act defines "banking business" as meaning -

> "the business of receiving from the public, on current account or deposit account, money which is repayable on demand by cheque or order and which may be invested by way of advances to customers or otherwise; and such other business of a like nature as the Minister may, by order prescribe".

However a customer with a savings or deposit account or a credit card account may also be regarded as a customer. The Act does not define the term "customer" but implies who is a

customer in the definition of "credit facilities" which states that -

> "'credit facilities' includes loans, advances, comfort letters, standby and commercial letters of credit and any other arrangement whereby a customer of a bank has access to funds or financial guarantees of the bank or the bank undertakes on behalf of a customer financial liability to another person."

The additional important feature of the relationship is that if the customer's account is in credit he is a creditor and the bank a debtor and if in debit, the positions are reversed, but he remains a customer. *Clarke v. London and County Banking Co. [1897] 1 Q.B. 552.* The banker may agree to perform additional functions such as holding goods or documents for safe-keeping, issuing letters of credit, giving investment advice and selling insurance services.

3. Although the relationship between the banker and the customer is primarily and essentially contractual, the terms of the contract are usually unwritten and are largely implied. In this respect banking practices which are generally followed may be material in assessing what should be implied. Although banking has become an increasingly transnational operation, it appears that many of the actions of local banks diverge from the practices of foreign and international banks. Equally important, is the fact that among Jamaican banks there is great divergence in banking practice. It is submitted that this absence of uniformity makes it more difficult for banking practices to influence the terms

which will be implied in the contractual relationship between one banker and a particular customer unless there is a sufficiently clear course of dealing and conscious acquiescence.

4. In *Joachimson v. Swiss Bank Corpn. [1921] 3 K.B. 110* Atkin, L.J. mentioned the following as terms usually implied in the banker/customer relationship:

(i) the bank undertakes to receive money and to collect bills for its customer's account, and it borrows the proceeds and promises to repay them;

(ii) the bank promises to repay at the branch of the bank where the account is kept (and not at any other branch) and during banking hours;

(iii) it promises to repay any part of the amount due against the customer's written order at the branch (though whether a written order is necessary was not decided);

(iv) it promises not to cease to do business with the customer except on reasonable notice (because cheques, etc., may be outstanding for two or three days); and

(v) the customer promises to exercise reasonable care in executing his written orders so as not to mislead the bank or to facilitate forgery.

5. It is the normal though not the invariable practice of banks to ask the intending customer to sign the bank's form of mandate for opening an account. This form does not contain all the contractual terms of the relationship which is brought into being when the account is opened. Generally special loans will be dealt with in special loan documents and

in those cases the document will govern the agreement. There are however no statutory rules relating to general unfair contract terms or any Bankers' Code of Conduct, (such as exist in the United Kingdom and Europe) which govern the fairness of the terms which may be incorporated in the standard form documents.

B. A BANKER'S PRACTICE VERSUS CONTRACTUAL TERMS

6. The practice of Bank's unilaterally altering the contractual terms of their relationship with their customers which is endemic in Jamaica is not approved by judicial authority. In *Burnett v. Westminister Bank Ltd. [1965] 3 W.L.R. 863* the bank printed on the covers of cheque books (containing magnetic ink characters) a warning that cheques and credit slips in the books must be applied only to the account for which they had been prepared. The customer had accounts at two branches of the bank. One branch used the magnetic-ink system and the other did not. The customer used one of the cheques which he paid into the former branch, but he altered the numbers in ordinary ink so to draw on the "prohibited" account at the latter branch. He then ordered the latter branch to stop payment, but the cheque was routed to the former branch, because of the magnetic ink coding, and it was paid, no one there noticing the alterations. The customer brought an action against the bank claiming £2,300 either -

(i) as damages for breach of contract;

(ii) as money had and received by the defendants to the plaintiff's used; or

(iii) as money lent to the defendants.

By their defence the bank alleged, *inter alia*, that the words on the cover of the plaintiff's

cheque book contained expressed terms in the relationship of banker and customer existing between the parties. The Court held that the two sentences on the cheque book cover, assuming that the plaintiff had not read them, were not adequate notice to the plaintiff of any proposed variation in the already existing contract between the parties; and that, although the plaintiff had seen that the cover contained printed words, since the covers of cheque books had never previously been used for the purpose of containing contractual terms, the plaintiff could reasonably assume that the cover contained no conditions. As the defendants had failed to prove that the plaintiff had either read the words on the cover or signed any acceptance of the proposed variation, the plaintiff was entitled to succeed; and, accordingly, there would be a declaration that he was entitled to have his Borough account credited by the defendants.

7. An extension of this principle is that even the express terms promulgated by Banks as a matter of practice will not alter their basic contractual obligations if those terms are not brought to the customer's attention. In *Tai Hing Cotton Ltd. v. Liu Chong Bank Ltd. and Others [1985] 3 W.L.R. 317* the Tai Hing company had current accounts with three Hong Kong banks, which were authorised to honour cheques bearing certain signatures. A dishonest employee of the company forged some 300 cheques over six years, his employers having left him unsupervised and having no proper financial control. The banks all had terms of business by which monthly statements were deemed to be correct unless the customer notified the bank of any error within a specified period. Under the general law the customer's account could not be debited on a forgery. One question, however, was as to the

effect of the express terms. These differed in phrasing, but one read -

> "A statement of the customer's account will be rendered once a month. Customers are desired: (i) to examine all entries in the statement of account and to report at once to the bank any error found therein. (ii) to return the confirmation slip duly signed. In the absence of any objection to the statement within seven days after its receipt by the customer, the account shall be deemed to have been confirmed."

These rules were made known to the company when it opened the accounts. On one account, the company was sent and returned confirmation slips, on another account no slips were issued (the bank did not say it would) and the customer did not otherwise confirm, and on the third the bank said it would send slips, but did not, and the customer did not confirm. The Privy Council held that these terms of business did not protect the banks. They were contractual in effect, but "in no case do they constitute what has come to be called "conclusive evidence clauses." Their terms were not such as to bring home to the customer the importance of the inspection he had to make, or the conclusive effect of the statements. If the banks wished to impose an obligation on the customer to inspect his account, etc., and to make the statements unchallengeable for failure to do so, "the burden of the obligation and of the sanction imposed must be brought home to the customer."

8. Although a basic contract exists between bank and customer, there may be several subsidiary contracts. Different segments of a customer's loan portfolio may be governed by different contracts, some applying to one part of the indebtedness and others to

other parts. There may be a variety of types of instruments; letters of commitment, loan contracts, mortgages, debentures, promissory notes and commercial papers,and for the last type of instrument the bank may be acting as a broker or intermediary. In many cases the banks ignore the variations in the terms of different instruments and assume wrongly that they have the same powers with respect to all parts of the indebtedness.

C. BANKING PRACTICE AS CONTRACTUAL TERMS

9. It is a well established principle that a contract may be subject to terms that are sanctioned by custom. In *Hutton v. Warren (1836) 1 M. & W. 466,* Baron Parke stated:

> "It has long been settled, that, in commercial transactions, extrinsic evidence of custom and usage is admissible to annex incidents to written contracts, in matters with respect to which they are silent. The same rule has also been applied to contracts in other transactions of life, in which known usages have been established and prevailed; and this has been done upon the principle of presumption that, in such transactions, the parties did not mean to express in writing the whole of the contract by which they intended to be bound, but a contract with reference to those known usages."

It has been pointed out that banking practices have varied greatly in Jamaica. In the *Century National Bank Case*, Ellis, J. stated that for a usage or custom to be incorporated in the contractual relationship between banker and customer, it must have the following four characteristics: (i) notoriety, (ii) certainty, (iii) reasonableness and (iv) lawfulness.

10. One of the most controversial areas in the banker/customer relationship is the unilateral imposition of high interest rates and penal charges by banks. This problem has been aggravated by the difficulties in the national economy which have not only driven up interest rates but caused the Bank of Jamaica to impose restrictions on banks. Where there are express contracts for interest they should specify the role, the method of computation and whether or not it is to be compounded. Paget's, Law of Banking described three generally recognised basis for computing annual interest as follows:

> "365/365. Under this method the rate of interest is divided by 365 to produce a daily interest factor. The number of days that the loan is outstanding is then multiplied by this factor. Under this method different amounts of interest are charged for months of different lengths.
>
> 360/360. Under this method each month is treated as having 30 days, with the consequence that interest for each month is the same. However, for a calendar year the interest is exactly the same as that calculated by using the 365/365 method.
>
> 365/360. This method is a combination of the first two. The interest rate is divided by 360 days (30 days for each month) to create a daily factor. The number of days that a loan is outstanding is then multiplied by this factor. Interest charged for months of different lengths is different, and interest charged for a calendar year is greater than

interest charged under the 365/365 or the 360/360 methods."

11. There are also different ways of compounding interest, depending primarily on the selection of the periodic rests. The law has traditionally leaned against compound interest. Thus in the absence of express agreement simple interest only can be charged on a mortgage loan. *Daniell v. Sinclair (1881) 6 App. Cas. 181 (P.C.)*. In the unreported case of *Bank of Credit and Commerce International, S.A. v. Blattner (November 20, 1986)* the English Court of Appeal held that a mortgage under which the mortgagor covenanted to pay to the mortgage bank all monies due 'so that interest shall be computed according to the agreement" or failing agreement "**to the usual mode of the Bank**"did not entitle the Bank to charge compound interest even if that was the Bank's usual practice.

12. Similarly, it is common for loan agreements to specify a rate of interest which is to be charged in the event of default. The Court has the power to decide whether the default rate of interest is imposed *in terrorem* and is not a genuine pre-estimate of the likely damages so as to be an illegal and irrecoverable penalty. In *Lordsvale Finance v. Bank of Zambia [1996] 3 W.L.R. 688*. In *The Angelic Star [1988] 1 Lloyd's Rep. 122*, Lord Donaldson, M.R. at p. 125 observed that a clause which provided that a long term loan could become immediately payable in the event of any breach of contract and that interest for the entire term could be payable constituted a penalty which could not be enforced.

13. In the landmark case of *National Bank of Greece v. Pinios Shipping Co. [1989] 3 W.L.R. 1330* the House of Lords laid down the following principles:

(1) It is no longer relevant to ask whether an account is current for mutual transactions.

(2) The basis of any implied contractual right to capitalise interest is the custom and usage of banks.

(3) The usage is not restricted to accounts which are current for mutual transactions. It prevails as between bankers and customers who borrow from them and do not pay interest as it accrues.

(4) An implied right to capitalise interest is not terminated by the banker's demand for payment, the commencement of legal proceedings or the losing of the account.

The issues which the *Century National Bank Case* exposed is the absence of any uniformity in Jamaican banking practice and the extent to which the right to charge compound interest is dependent on express contract rather than custom. While in England yearly, half-yearly and quarterly rests have been recognised, there is no parallel to the attempts by some Jamaican banks to charge on the basis of daily rests. See *Yearell v. Hibesnian Bank Ltd. [1918] A.C. 372* and *Pinios Case (ante)*.

D. BANKING PRACTICE ND TORTIOUS LIABILITY

14. Normally as a lender, a bank is under no duty to advise the borrower/customer of the imprudence of any transaction which the customer is undertaking with financing provided by the bank. *Williams & Glyn's Bank v. Boland [1981] A.C. 487.* However in the Court of Appeal Ralph Gibson, L.J. suggested that if it can be shown that the bank knew of

the imprudence of the borrowing, what the money was to be used for and the likelihood of damage to the borrower then it may be possible for the borrower to succeed on the basis of an implied representation by the bank that the transaction was sound if it is reasonable for the borrower to rely on it and the bank represented itself offering financial guidance.

15. The duty of care of the lending bank was considered by the English Court of Appeal in *Lloyds Bank plc v. Cobb [1992] J.B.L. 419* where Scott, L.J. said:

> "If a customer applies to the bank for a loan for the purposes of some commercial project, and the bank examines the details of the project for the purpose of deciding whether or not to make the loan, the bank does not thereby assume any duty to the customer. It conducts the examination of the project for its own prudent purposes as lender and not for the benefit of the proposal borrower. If the borrower chooses to draw comfort from the bank's agreement to make the loan, that is the borrower's affair. In order to place the bank under a duty of care to the borrower the borrower must, in my opinion, make clear to the bank that its advice is being sought. The mere request for a loan, coupled with the supply to the bank of the details of the commercial project for whose purposes the loan is sought, does not suffice to make clear to the bank that its advice is being sought..."

16. In the intensity of competition between banks it frequently happens that banks represent themselves as offering sound financial advice and a range of services. Commercial banks have tended in recent years to operate in conjunction with subsidiaries which are merchant banks, investment companies and stock-brokers, among other things. In these situations it is much easier to imply a duty of care to advise customers on the prudence of their investment or business ventures. If there is a specific undertaking to provide this guidance there is no doubt that the bank may be liable in contract as well as tort. *Negril Negril Holdings Ltd. and Another v. C.N.B. Suit nos. C.L. 88 & 89/91 (July 18, 1997).*

17. Where the contractual terms are comprehensive it is unlikely that any duty of care which is wider than that imposed by the contract will be found to exist in tort. *Tai Hing Case, ante; Peabody Donation Fund (Governors) v. Sir Lindsay Parkinson & Co. Ltd. [1985] A.C. 210.* In *Yuen Kun-yeu v. Att-Gen of Hong Kong [1988]* the Commissioner for deposit-taking companies in Hong Kong was held not to be liable in negligence to an investor in one such company (who lost money when the company collapsed through fraud), because there was a lack of proximity between the parties.

E. CONCLUSION

18. It seems clear that there are great uncertainties in the scope, nature and effect of the practices of bankers in Jamaica with respect to their relationship with their customers. This situation is neither in the interest of the bank and the stability of the banking sector nor the customer and the viability of commercial enterprises. There is a strong case for the introduction of statutory rules relating to fair contract terms as well as Code of Conduct

providing guidelines for banking activities.

19. For example, the British Code of Good Banking Practice has not only led to the widespread use of written terms and conditions in contracts between bankers and customers but, on the vexed question of interest charges, to the giving of clear explanations to customers of the nature of the transactions. Thus the Code requires banks to tell customers of the interest rate applicable on their accounts, the basis on which interest is calculated and when it will be changed or varied. When banks charge interest with immediate effect they must publicise those charges effectively, e.g. by notice in their branches and in the press. In the absence of such sound practices or protective legislation the Courts will be forced to expand the range of judicial protection as has occurred in other common law jurisdictions, such as Australia, Canada and the United States as well as some of the Nordic countries.

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