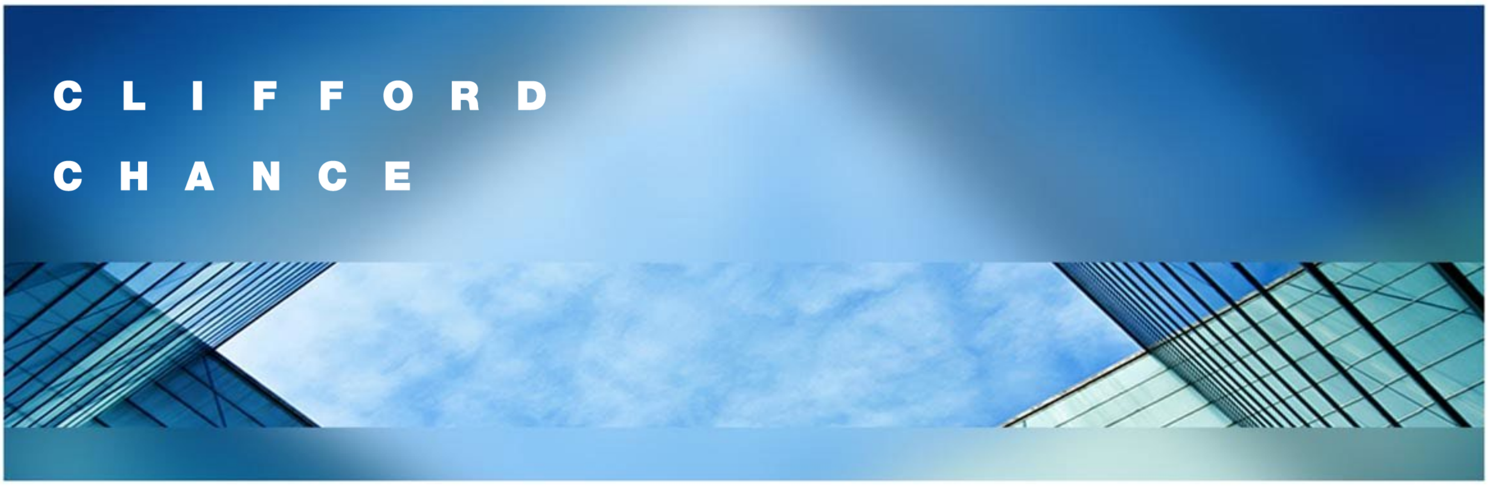

THE CASE OF FRAUDULENT PAYMENT INSTRUCTIONS – HAVE BANKS' DUTIES BEEN EXTENDED TOO FAR?

The Court of Final Appeal (CFA) in Hong Kong has recently handed down a decision concerning what it described as "*one of the oldest and most litigated questions in commercial law, namely the rights of a corporate customer against a banker who has paid money out of its account on the dishonest instructions of authorised signatories*". This decision has significant ramifications for banks in Hong Kong and potentially other common law jurisdictions, notably in their day-to-day handling of payment and other instructions, how long banks are to remain liable to their customers, and their record-keeping policies.

INTRODUCTION AND KEY TAKEAWAYS

On 6 February 2023, the CFA handed down judgment in the long-running case of PT Asuransi Tugu Pratama Indonesia Tbk ("**Tugu**") v Citibank N.A. (the "**Bank**") [2023] HKCFA 3[1]. Tugu was the largest insurer in Indonesia in the 1990s. It maintained an account with the Bank (the "**Account**"), which was closed in 1998. Almost a decade later, in 2007, Tugu commenced proceedings against the Bank in relation to a series of unauthorised payments made from the Account in 1994 to 1998 on the fraudulent instructions of its rogue directors, who were authorised signatories. Tugu made a claim in debt for reconstitution of the account excluding the wrongful debit entries or in the alternative, breach of the Bank's duties of care including its *Quincecare* duty.

In both the Court of First Instance (CFI) and the Court of Appeal (CA), the Bank prevailed essentially on the issue of the limitation period, which was held to have run from closure of the Account in 1998. The CFA, however, overturned the CA's decision and found that Tugu's cause of action did not accrue until it made its demand in October 2006. Thus, 25 years after account closure, the Bank was held to remain indebted to Tugu to the extent of the unauthorised payments (save for the first two payments).

Further, the lower courts' apportionment of Tugu's fault at 50% based on, amongst others, Tugu's own admission that it should have discovered the fraud by 1995 (which would have avoided 72% of the loss), was also rejected

Key issues

- Banks' *Quincecare* duties to corporate customers have traditionally been framed narrowly limited in application to payment instructions by authorised signatories or agents where fraud or misappropriation against the corporate customer is reasonably suspected, in which case, banks must refrain from executing such instructions unless satisfactory inquiry has been made
- However, this recent Hong Kong CFA decision has the potential (if not limited to its specific facts) to extend bank duties and put banks on inquiry for reasonable suspicion of want of authority in relation to administrative instructions including closure of account
- The CFA's classification of the claim as a debt claim also has significant implications in extending the limitation period and the non-availability of contributory negligence as a defence
- This case has important ramifications for banks in Hong Kong and potentially other common law jurisdictions and their day-to-day handling of payment and other instructions, and record-keeping policies

[1] Clifford Chance acted for the Bank in this case.

by the CFA. The CFA ruled that contributory negligence is not applicable to Tugu's claim in debt.

Key takeaways

- Traditionally, courts in England and Hong Kong have framed banks' *Quincecare* duty narrowly, namely, limiting the application of the duty to payment instructions whereby banks must refrain from following such instructions unless satisfactory inquiry has been made where there are clear and reasonable grounds to suspect fraud or misappropriation against the customer by an authorised signatory or agent.
- However, this recent Hong Kong CFA decision was decided not based on a breach of duty of care, but want of authority and being put on inquiry for reasonable suspicion of want of authority in relation to instructions to close the account in question. The CFA found that the instruction to close the Account was outside the authorised signatories' apparent authority. The closure of the Account could not be separated from the unauthorised payments and the whole operation of the Account was unauthorised.
- If courts in the future do not limit the application of this case to its specific facts, banks' duties may be widely (and unduly) extended such that they (as outsiders) are expected to detect patterns in the operation of the account which indicate impropriety and wrongdoing by agents and not only in relation to payment instructions, but also administrative instructions such as closure of account. Based on recent indication from the English Supreme Court as discussed below, we expect the English courts to keep the *Quincecare* duty within narrow bounds. However, the Hong Kong CFA decision (being a judgment being given by Lord Sumption NPJ with all the other justices agreeing with His Lordship) certainly has persuasive value in England and other common law jurisdictions and there is a possibility of it being followed.
- The Hong Kong CFA also set an expectation for banks to contact parties beyond the authorised signatories (i.e. the banks' usual and sometimes only contacts) such as independent directors to obtain an explanation for the payment, closure or other instruction, which may not be practical and raises concerns such as confidentiality.
- The CFA also accepted Tugu's classification of its claim for reconstitution of the Account as a debt claim and found that the limitation period did not run until demand had been made by the customer. If a demand is not made until years later and becomes stale, this has implications for banks' record keeping and ability to respond.
- The other consequence of the classification of the claim as a debt claim is that contributory negligence may not be relied upon such that a customer will not be held liable to account for any failure on its part to detect and prevent the impropriety or wrongdoing.

WHY WAS THE BANK LIABLE?

By way of background, between 1994 and 1998, substantial sums (purportedly dividends) were received into the Account from Tugu's various operating subsidiaries. Within short periods of time, they were then paid out to Tugu's officers personally by way of a total of 26 transfers made from the Account with payment instructions signed by two of the officers who were also authorised signatories and in accordance with the mandate of the Account.

The judgment described the sole purpose of the Account as serving as "*a temporary repository of funds en route from the operating subsidiaries into the pockets of the four individuals*".

Neither the CFI nor the CA found dishonesty, recklessness or wilful breach of duty on the part of the Bank, but a breach of duty was found. By the time of the third transfer, a pattern had emerged indicating impropriety in the operation of the Account. The Bank was put on inquiry. The Court of Appel found that whilst the Bank had made inquiries of the authorised signatories, these were inadequate as it should have contacted independent directors.

Tugu accepted before the CFA that its breach of duty claim (including the Bank's *Quincecare* duty) was statute-barred. However, it argued (and the CFA accepted) that the same set of facts which justified the lower courts' findings of breach of duty of care also justified its claim for want of authority. The CFA held that the critical question (whether in determining breach of duty or want of authority) was whether the Bank had sufficient notice of a want of actual authority to require the Bank to make inquiries before acting in accordance with the customer's mandate. In other words, it is not enough for a bank to take instructions in accordance with the mandate from the customer, it must also assess whether there appears to be impropriety or wrongdoing and whether the instructions by authorised signatories or agents are against the customer's interest. Further, unlike the *Quincecare* duty, which is limited to payment instructions, lack of authority calls into question the whole operation of the account, including account closure.

Coupled with the ruling on the inapplicability of contributory negligence and on the limitation period, the CFA's decision means that a bank will have a high price to pay if it fails to detect fraud by authorised signatories, if it is put on inquiry of a lack of authority.

This can be a very onerous burden given banks are "outsiders" and have limited ability to assess the nature and purpose of unauthorised instructions like those in this case, let alone legitimacy. Further, this has potential implications not only for corporates, but also individuals, and transactions by their authorised signatories, for example, where they have delegated authority by way of power of attorney. Whilst the compliance and control environment in the 1990s was very different from what it is today, even now with automated and computerised transaction monitoring systems, this decision places a significant burden on banks, particularly in view of the speed and volume of transactions in this digital age. Relatedly, question marks are raised regarding the extent of banks' duties where transactions are done without the involvement of bank staff, for example, online.

The CA had found that whilst inquiries had been made with authorised signatories regarding the operation of the Account, these were inadequate as inquiries should have been made with independent directors contacted. The CFA agreed that there was indication the whole operation of the Account was improper and unauthorised and inadequate inquiries had been made. It can be impractical to expect independent directors to be familiar with specific transactions in a company's bank account. Potential issues, such as confidentiality, may also arise for the bank to reach out to individuals other than the authorised signatories to confirm payment or other instructions. The international nature of banking and the practical challenges in obtaining cooperation overseas can be another hurdle.

HOW LONG DOES THE BANK REMAIN LIABLE?

The lower courts both held that the limitation period started to run from the time of account closure for different reasons: that the account closure was validly authorised (first instance) versus the banker-customer relationship had been terminated as a fact, regardless of the validity of the account closure (CA).

The CFA ruled the opposite. It concluded that the account closure was invalid due to lack of authority. Further, even if the account closure was valid, the banker-customer relationship could not have been terminated if the debt, in the form of unauthorised payments, was not discharged by the Bank. As such, Tugu was entitled to make a claim of debt "on demand without limit of time", and the limitation period would only start to run from the time of its demand. The CFA noted that "*this may be inconvenient to banks, but it is a fundamental incident of their business*".

The potential consequences of such findings are that banks may be vexed by stale claims as the present one, brought long after documentary evidence is destroyed or lost and memories (both institutional and individual) have faded with the passage of time.[2]

Aside from the costs associated with retaining documents indefinitely, other legal requirements have the potential to conflict, for example, Data Protection Principle (DPP) 2 under the Personal Data (Privacy) Ordinance (Cap. 486) requires the retention of personal data for no longer than necessary to fulfil the purpose for which the data is or is to be used.

QUINCECARE DUTY – ENGLISH CONTEXT AND CAUTIOUS EXTENSION

As discussed above, whilst the CFA's decision was stated to turn on a pure question of authority and not the Bank's duty of care including its *Quincecare* duty, it did hold that the crux is the same, as "*the law cannot coherently treat compliance with an authorised instruction as a breach of duty; or treat a transfer made in breach of duty as authorised*". It further relied on findings of the courts below in relation to breach of duty of care in terms of the pattern that had emerged by the time of the third transfer.

By way of background, the traditional *Quincecare* duty is a duty on banks to refrain from following payment instructions without inquiry where objectively, there are reasonable grounds to suspect that there is an attempted fraud or misappropriation of funds from the bank's customer by an authorised signatory or agent. The English Court of Appeal emphasised in the *Lipkin Gorman* case[3] that such reasonable grounds of suspicion would only arise in rare circumstances.

Further, in the *Quincecare* case[4] itself, it was emphasised that such a duty on the part of banks should be balanced against the risks they face by not acting in accordance with instructions which comply with the customer's mandate, namely, liability for consequential loss to the customer. The law should not

2 On the facts, the Bank was not able to recover bank statements for the 1990-1994 period; as the transactions in this period were not disputed by Tugu, they could have established a pattern consistent with transactions in 1994-1998 and this could have justified the disputed payments in 1994-1998.

3 *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340

4 *Barclays Bank Plc v Quincecare Ltd* [1992] 4 All ER 363

impose overly burdensome or impractical obligations on banks to the extent that the effective transacting of banking business is unnecessarily hampered.

Whilst the *Singularis* case[5] appears to have extended the applicability of the *Quincecare* duty to non-bank financial institutions,[6] even where the agent is the sole shareholder and the only director influencing management, there is later case law that declined to extend the application of the *Quincecare* duty to other scenarios.[7]

There is a danger that at least in the context of payments, this CFA decision, if followed in Hong Kong, England or other common law jurisdictions, will extend the *Quincecare* duty in the unduly onerous and impractical way discussed above and banks will essentially be expected to detect and prevent misappropriation and fraud by rogue directors. In the established English authorities, either the banks in question were not held liable or the indications of misappropriation or fraud were much clearer (see footnote 6 as discussed in relation to the *Singularis* case above). Indeed, one court has stated that banks are not required to act as amateur detectives.[8]

There is also a danger that the *Quincecare* duty, established in relation to payment instructions, is extended beyond this to put banks on inquiry even for closure of accounts or other administrative instructions which might not have a detrimental economic or commercial effect on the customer.

CONCLUSION

As discussed above, this case has wide-ranging implications on all banks and potentially other financial institutions in Hong Kong and potentially other common law jurisdictions, not only in relation to the duty to verify instructions, but also record-keeping.

The interplay with other laws such as anti-money laundering and data protection law also needs to be carefully considered.

It will be important when this CFA decision is raised in future cases for courts to be aware of the specific facts (such as the lack of other significant transactions in the account and that the payments were made to the rogue

---

5 *Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe Ltd* [2020] AC 1189

6 The court recognised that this was an unusual case where the concerns of impracticality and imposing too heavy a duty on banks did not apply, as the financial institution in question was a stockbroker and it was not administering hundreds of bank accounts with thousands of payment instructions every week. Money from its segregated client accounts would usually be paid back to another account in the client's name. However, other signs clearly put the financial institution on inquiry including the press reports regarding the dire financial straits of the sole shareholder and his group of companies on which the financial institution's customer relied on for funding even if not consolidated within the group.

7 The appeal of the Court of Appeal decision in *Philipp v Barclays Bank UK Plc* [2022] EWCA Civ 318 to the Supreme Court is awaited, which will consider whether to extend the scope of the *Quincecare* duty to where instructions are given by an individual customer and not through an agent. However, by way of indication of the outcome of such appeal, in the first case concerning the *Quincecare* duty to reach the Supreme Court since the *Singularis* case (albeit not regarding the scope of the duty itself, but rather whether loss had been suffered), the court commented: "*The Quincecare duty should be kept within narrow bounds, lest it interfere unduly with the conduct of commerce. … The impact of the Quincecare duty should be kept within bounds by a strict approach … and by careful analysis of the scope of the duty…*" (See *Stanford International Bank Ltd (in liquidation) v HSBC Bank Plc* [2022] UKSC 34.) See also the Privy Council case of *Royal Bank of Scotland International v JP SP 4* [2022] 3 WLR 261 where the duty was *not* extended to a third-party beneficiary investment fund engaging in litigation funding whose loan manager was the bank's customer.

8 *Lipkin Gorman v Karpnale Ltd* [1987] 1 WLR 987

directors' personal accounts) and consider whether they can be distinguished, such that banks' duties are not made excessive.

It also remains to be seen whether the Hong Kong Monetary Authority or other regulators will clarify banks' duties in this respect.

C L I F F O R D
C H A N C E

CONTACTS

Hong Kong

Donna Wacker
Partner

T +852 2826 3478
E donna.wacker
@cliffordchance.com

Jonathan Wong
Partner

T +852 2825 8841
E jonathan.wong
@cliffordchance.com

Michael Wang
Partner

T +852 2826 3564
E michael.wang
@cliffordchance.com

Helen Fu
Senior Associate

T +852 2825 8823
E helen.fu
@cliffordchance.com

Isaac Lam
Associate

T +852 2825 8836
E isaac.lam
@cliffordchance.com

Felicia Cheng
Professional Support Lawyer

T +852 2826 3526
E felicia.cheng
@cliffordchance.com

England

Helen Carty
Head of Litigation & Dispute Resolution, London

T +44 207006 8638
E helen.carty
@cliffordchance.com

Kate Scott
Partner

T +44 207006 4442
E kate.scott
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 27th Floor, Jardine House, One Connaught Place, Hong Kong