LEGAL UPDATE

CASE UPDATE

5 November 2019

A BANK'S LIABILITY FOR EXECUTING A CUSTOMER'S FRAUDULENT INSTRUCTIONS

***Singularis Holdings Ltd (in Official Liquidation) v Daiwa Capital Markets Europe Ltd* [2019] UKSC 50**

SUMMARY

The UK Supreme Court in *Singularis Holdings Ltd (in Official Liquidation) v Daiwa Capital Markets Europe Ltd* [2019] UKSC 50 upheld an earlier decision that a bank was liable to a customer for breach of its *Quincecare* duty (named after *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363). Under this duty, a bank must refrain from executing a customer's instruction where the bank is put on inquiry and has reasonable grounds for believing the instruction is an attempt to misappropriate the customer's funds.

In *Singularis*, the sole shareholder and chairman of a company gave instructions to transfer US$204 million to other companies he controlled. The Court held at first instance that Daiwa had breached its *Quincecare* duty to Singularis, and no defences were established. This decision was upheld in the English Court of Appeal and by the Supreme Court.

Although liability for breach of the *Quincecare* duty appears to be rare, banks and financial institutions should be aware of this duty, and ensure that their internal legal and compliance processes and policies adequately take this into account.

BACKGROUND FACTS

The appellant ("**Singularis**") was a Cayman Island company which managed the assets of a Saudi Arabian businessman ("**Mr Al Sanea**"). He was the sole shareholder, a director, and chairman of the company. Singularis had six other directors who did not exercise any influence over management of the company. Mr Al Sanea also owned the Saad group, a Saudi Arabian conglomerate. Singularis was not part of the Saad group.

Mr Al Sanea had extensive powers to make decisions on behalf of Singularis, and was authorised signatory for its bank accounts. Singularis conducted business for many years, and borrowed substantial sums of money from third parties under funding arrangements.

The respondent ("**Daiwa**") had a loan financing arrangement with Singularis for the purchase of certain shares. In June 2009, all the shares were sold, the loan was repaid, and a further sum of US$80 million was deposited by Singularis, such that Daiwa held a total sum of approximately US$204 million for Singularis.

In June and July 2009, Mr Al Sanea gave instructions on behalf of Singularis for the total sum of US$204.5 million to be transferred to other companies in the Saad group. Although Mr Al Sanea was an authorised signatory, this was a misappropriation of Singularis' funds.

Shortly thereafter, Singularis was placed into voluntary liquidation. In 2014, the liquidators of Singularis brought a claim against Daiwa for dishonest assistance of Mr Al Sanea's breach of fiduciary duty, and for breach of the *Quincecare* duty. At first instance the Chancery Division of the High Court dismissed the claim for dishonest assistance, but held Daiwa liable for negligence for breach of the *Quincecare* duty.

Daiwa's appeal to the English Court of Appeal was dismissed, and they appealed to the Supreme Court. At the Supreme Court, their appeal was again dismissed.

The issues argued by Daiwa on appeal were that Mr Al Sanea's fraud was attributable to Singularis, and that for this reason Singularis' claims against Daiwa would be defeated by the defence of illegality, by a lack of causation, or by an equal and countervailing claim in deceit by Daiwa against Singularis.

The *Quincecare* Duty

The "*Quincecare* duty" is named after the decision in *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363 ("***Quincecare***"). This is an aspect of a bank's duty to its customer, which requires the bank to refrain from executing an instruction in circumstances where they should have been put on inquiry, in the sense that they have reasonable grounds for believing that the instructions are an attempt to misappropriate funds.

At first instance (see *Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe Ltd* [2017] EWHC 257 (Ch) at [193]-[205]), the High Court held there was evidence that should have put Daiwa on inquiry and Daiwa had failed to make proper inquiry. This included:

(a) knowledge that Mr Al Sanea and the Saad group were in dire financial straits;

(b) knowledge that Singularis might have other creditors with interest in the monies in Singularis' account;

(c) the sudden appearance of US$80 million in Singularis' account shortly after Mr Al Sanea and the Saad group's other accounts were frozen;

(d) the manner in which an agreement was produced to justify payment of US$180 million to Saad Specialist Hospital Company. An earlier request to transfer US$180 million had been explained as settlement of a debt owed by Singularis to a company called Saad trading, and internal emails suggested that Daiwa had been concerned about the possibility that the payment was a front rather than settlement of a genuine obligation; and

(e) the manner in which the disputed payments were processed compared to other payment requests. Certain payment requests were discussed between management and in-house legal or compliance, or otherwise subject to extensive discussions at a senior level, whereas the disputed transfers were made without any consultation or discussion.

The High Court noted that there were many emails sent by senior executives to each other about how great care and extreme caution should be exercised, but no one in fact exercised care or caution. No one had explained to the Daiwa employees who actually executed the transactions what they needed to do, or told them about the concerns that senior management had about the account.

Fraud and Attribution of Fraudulent Knowledge or Intention

On appeal to the Supreme Court, Daiwa argued that because Singularis was a one-man company, and because Mr Al Sanea was its controlling mind and will, that his fraud should be attributed to Singularis. The result of this would have been to defeat Singularis' claim on grounds of illegality, causation or an opposing claim for deceit.

The Supreme Court noted the decision in *Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23 ("***Bilta (No 2)***") where the Supreme Court held unanimously that where a company has been the victim of wrongdoing by its directors, the wrongdoing of the directors cannot be attributed to the company as a defence to a claim brought by the company against those directors.

The Supreme Court agreed that there is no principle of law that where a company is suing a third party for breach of duty owed by that third party, that fraudulent conduct of a director is to be attributed to the company if it is a one-man company.

The purpose of the *Quincecare* duty was to protect the company against misappropriation of its funds, via fraud of a trusted agent of the company who is authorised to withdraw money from the company's account. The Supreme Court emphasised that to attribute fraud of that trusted agent to the company in those circumstances would denude this duty of any value in cases where it is most needed.

The Supreme Court dismissed the appeal and held that Mr Al Sanea's fraud was not to be attributed to Singularis, in the context of the *Quincecare* duty of care owed by Daiwa to Singularis.

Comments

The *Quincecare* duty

The English Court of Appeal (see *Singularis Holdings Limited (in official liquidation) v Daiwa Capital Markets Europe Limited* [2018] EWCA Civ 84) had noted that this may be the first case where a court has found against a bank for breach of the *Quincecare* duty. This was because it is rare for a bank to be put on inquiry, as the threshold is high.

The Singapore Court of Appeal in *Hsu Ann Mei Amy (personal representative of the estate of Hwang Cheng Tsu Hsu, deceased) v Oversea-Chinese Banking Corp Ltd* [2011] 2 SLR 178 ("***Amy Hsu***") appeared to recognise the existence of the *Quincecare* duty, although that particular case involved a claim against a bank for a refusal to execute instructions. The decision in *Quincecare* was cited for the proposition that a bank is in breach of duty if it fails to comply with its client's instructions under circumstances where a reasonably prudent bank would not have been put on notice.

The Court of Appeal in *Amy Hsu* also noted that a bank has a duty to comply with a customer's instructions, but this is subject to the bank's duty to take reasonable care in all the circumstances.

The decision in *Singularis* demonstrates that a failure to recognise red flags and a failure to take sufficient care when executing instructions from a customer's authorised signatory can result in significant legal liability. This highlights the importance and value of having sufficient legal and compliance procedures and other safeguards in place, when executing a customer's instructions.

Attribution

The House of Lords in *Stone & Rolls Ltd (in liquidation) v Moore Stephens* [2009] UKHL 39 ("***Stone & Rolls***") had dealt with a case involving a one-man company, where the controller of the company Mr Stojevic had used the company to defraud banks. In a claim by the company's liquidators against the company's auditors for failing to detect the fraud, the House of Lords held by a majority that Mr Stojevic's knowledge of his fraud was to be attributed to his company, such that the illegality defence defeated the claim against the auditors.

In the Supreme Court's decision in *Bilta (No 2)*, the earlier decision in *Stone & Rolls* was described as having "*no majority ratio decidendi*", and that it stood only as authority that the illegality defence succeeded in that particular case, on those particular facts.

In *Bilta (No 2)*, the Supreme Court held unanimously that where a company has been the victim of wrongdoing by its directors, the wrongdoing of the directors cannot be attributed to the company as a defence to a claim brought by the company against those directors.

However, a majority of the Supreme Court in *Bilta (No 2)* also appeared to accept the proposition that a defence of illegality would be available where there are no innocent directors or shareholders. This led to arguments in *Singularis* which focused on what the term "*innocent*" director meant, and whether this included innocent but inactive directors such as the six other directors of Singularis.

The Supreme Court in *Singularis* therefore clarified that in determining whether knowledge of a fraudulent director should be attributed to his company, the Court must have regard to the context and purpose of the attribution. This also applies in relation to a "*one-man company*" where the director is the company's controlling mind and will. The Supreme Court further took the opportunity to reiterate that the earlier decision of the House of Lords in *Stone & Rolls* can "*finally be laid to rest*". The Supreme Court cited the judgment of Lord Neuberger in *Bilta (No 2)*, where he stated that it would not be in the interest of future clarity of the law for the decision in *Stone & Rolls* to be treated as authoritative or of assistance.

There is less scope for alternative interpretations of *Singularis*, as there is only one judgment by Lady Hale, with which the other members of the Supreme Court (Lord Reed, Lord Lloyd-Jones, Lord Sales and Lord Thomas) agreed.

On the issue of attribution, the Singapore Court of Appeal in *Ho Kang Peng v Scintronix Corp Ltd (formerly known as TTL Holdings Ltd)* [2014] 3 SLR 329 ("***Scintronix***") held that a director's unlawful conduct would not be attributed to the company in the context of a claim by a company against that director for breach of duty. However,

where an innocent third party sues the company, the director's knowledge will be attributed to the company.

In *Scintronix*, the Court of Appeal mentioned that the applicant company was not a "*one-shareholder company*" but was a publicly listed company (at [70]).

This aspect of the decision in *Scintronix* has been described as an exception to the other rules of attribution in respect of a company controlled by a single individual, where that single individual's fraud may be attributed to the company (see *eg* SAL Annual Review Chapter 9, Company Law (2014) 15 SAL Ann Rev 168 at [9.13], and *Ong Bee Chew v Ong Shu Lin* [2019] 3 SLR 132 ("***Ong Bee Chew***") at [146]).

In determining the question of attribution, the High Court in *Ong Bee Chew* noted that the portion of the Court of Appeal's decision in *Scintronix* which suggested an exception for a "*one-shareholder company*" was in obiter. The High Court applied the UK Supreme Court's decision in *Bilta (No 2)* that where a company has been the victim of wrongdoing, the wrongdoing cannot be attributed to the company as a defence against a claim brought by the company's liquidators against the directors for their wrongdoing.

It remains to be seen whether the Singapore Court of Appeal will clarify this issue, and whether they will apply the reasoning in *Bilta (No 2)* and *Singularis*.

Contractual Defences

In *Quincecare*, the Court had noted that the bank's duty to exercise reasonable care in executing instructions is generally subordinate to the bank's other conflicting contractual duties.

The scope of these conflicting duties and how contractual clauses may affect liability for breach of the *Quincecare* duty remains mostly unresolved. This is tricky given the apparent conflict between a bank's duty to use reasonable care when executing instructions and its duty to execute the customer's instructions promptly.

In *JP Morgan Chase Bank NA v The Federal Republic of Nigeria* [2019] EWCA Civ 1641, Nigeria brought a claim against JP Morgan for the sum of US$875 million. The payments had been made pursuant to instructions given by persons authorised to give such instructions, but Nigeria argued that the payments were made in breach of the bank's *Quincecare* duty. The bank applied to strike out the claim, and this failed at first instance and on appeal. In its application, JP Morgan relied on clauses of its terms and conditions including an entire agreement clause, an exemption clause, and an indemnity clause.

The English Court of Appeal held that the entire agreement clause did not prevent the *Quincecare* duty from arising, the exemption clause was not sufficiently clear to lead to the conclusion that parties intended to exclude liability for breach of the *Quincecare* duty, and that the indemnity clause was similarly insufficiently clear. The English Court of Appeal noted that very clear words are needed to establish that parties intended an indemnity to cover liability for breach of a duty specifically aimed at protecting the customer from fraud of its trusted employee or officer (*ie* the *Quincecare* duty).

Although a bank may be protected by its contractual terms if it executes instructions in good faith believing those instructions to be from the authorised signatory (see *eg Major Shipping & Trading Inc v Standard Chartered Bank (Singapore) Ltd* [2018] SGHC 4), the existence of the *Quincecare* duty suggests that a bank may in some situations be held liable for executing instructions from an authorised signatory where those instructions are attempts to misappropriate money, and the bank has been put on notice.

One possibility is that liability should be equivalent whether a bank executes an authorised signatory's instructions which had been given for fraudulent purposes (like in *Singularis*), or executes instructions from a fraudulent third party which appear to be genuine. In both cases, the bank is executing what appears to be a genuine instruction, and the inquiry should arguably be whether the bank has been put on notice that the instruction is an attempt to misappropriate the customer's funds.

It would be prudent for banks and other financial institutions to review their terms and conditions to take into account the possibility of fraud by an officer or other authorised signatory of a customer. Standard exclusion or indemnity clauses may need

to be drafted in a way that specifically addresses such situations. Banks that deal with private investment companies should also exercise great care, given the easy blurring of the line between the customer-company and its ultimate beneficial owner.

As a banking hub, Singapore is inherently exposed to risks of financial fraud, and public policy may dictate that banks assume a role in protecting not just themselves but their customers against fraud, whether internal or external.

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