Application of the Quincecare Duty of Care in Hong Kong

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In this client alert we discuss the UK Supreme Court's recent decision to uphold the first successful claim in negligence for a breach of the *Quincecare* duty of care owed by financial institutions to their customers. We also identify a number of practical tips to ensure that red flags are neither missed nor ignored by financial institutions in Hong Kong, so that they may avoid breaching of the *Quincecare* duty. The *Quincecare* duty has been recognised by the Hong Kong courts, so the Supreme Court's decision will be of interest to financial institutions based in Hong Kong.

Background

On 30 October 2019, the Supreme Court upheld the first successful claim in negligence for breach of the so-called Quincecare duty of care in *Singularis Holdings Ltd (In Official Liquidation) (A Company Incorporated in the Cayman Islands) v Daiwa Capital Markets Europe Ltd.*[1]

In its claim, Singularis Holdings Limited (**Singularis**) relied on the duty of care owed by a bank to its customers expounded in *Barclays Bank plc v Quincecare Ltd*[2] (**Quincecare**), in which the High Court in the UK held that a bank owes a duty to exercise reasonable skill and care in and about executing the customer's orders. Whilst the bank has the duty to execute its customers' orders promptly so as to avoid causing financial loss to the customer, it should refrain from executing an order if and for so long as it is put on inquiry by having reasonable grounds for believing that the order is an attempt to misappropriate funds.

The key issue before the Supreme Court was whether the *Quincecare* duty applies in the circumstances where the bank acted on fraudulent payment instructions made by the sole shareholder and the sole directing mind of the claimant.

The *Quincecare* duty of care has been applied in Hong Kong. Recent cases have also referred to the Court of Appeal judgment in *Singularis v Daiwa*, with one case ruling that a bank had breached such duty (the action failed on another ground). Banks operating in Hong Kong should therefore be aware of the Supreme Court's decision on the issue.

Facts of Singularis

Singularis is a Cayman Islands company set up to manage the personal assets of a Saudi Arabian businessman, Mr Maan Al Sanea. At all material times, Mr Al Sanea was the sole shareholder, a director, the chairman, president and treasurer of Singularis. The company had six other directors, but Mr Al Sanea was the dominant influence over the company's affairs.

[1] [2019] UKSC 50

[2] [1992] 4 All ER 363

Between June and July 2009, Mr Al Sanea gave Daiwa instructions to make eight payments, totalling US$204 million, to his related parties, and Daiwa duly made those payments.

On 20 August 2009, Mr Al Sanea placed Singularis, which was on the verge of insolvency, into voluntary liquidation. On 18 September 2009, the Grand Court of the Cayman Islands made a compulsory winding up order and joint liquidators were appointed. On 18 July 2014, the liquidators claimed against Daiwa for recovery of the eight payments made to third parties as instructed by Mr Al Sanea. One of the bases for the claim was the breach of the Quincecare duty of care to the company by giving effect to the payment instructions.[3]

At first instance, the High Court found that the eight payments instructed by Mr Al Sanea were a misappropriation of Singularis' funds and Mr Al Sanea had acted in breach of his fiduciary duty to the company which at that time was in serious financial difficulty. Having made these findings, the High Court held that Daiwa had breached its *Quincecare* duty of care to Singularis by giving effect to Mr Al Sanea's payment instructions, disregarding "*many obvious, even glaring, signs that Mr Al Sanea was perpetrating a fraud on [Singularis]*". Those signs, which Daiwa was clearly aware of included: (1) the dire financial straits which Mr Al Sanea, his group of companies (including Singularis) were in at the end of May and early June 2009; (2) the presence of other substantial creditors with an interest in the money held on Singularis' account; and (3) the convenient production of certain documents to justify a very substantial payment out of the account which suggested that the payment was possibly a front or cover rather than a genuine obligation.

The High Court accepted that the *Quincecare* duty did not require a bank to become paranoid about the honesty of its customers but it required the bank to do something more than accept at face value whatever strange documents and implausible explanations were proffered by the officers of a company facing serious financial difficulties.

Whilst holding Daiwa liable for breach of the *Quincecare* duty of care, the court, however, reduced the amount of damages which Daiwa should be liable for by 25% to reflect the company's contributory negligence.

Daiwa's Arguments

At first instance, interesting legal arguments were advanced by Daiwa in its defence against the *Quincecare* duty claim. These arguments formed the basis of the bank's subsequent appeals to the Court of Appeal[4] and the Supreme Court.

Daiwa sought to argue that Mr Al Sanea was the sole directing mind and will of Singularis. In the context of a claim by Singularis against the bank for breach of *Quincecare* duty, Mr Al Sanea's fraud should be attributed to the company in order to defeat the claim.

Were attribution to be established, Daiwa advanced three additional points of defence:

(A) It would be contrary to the public interest to enforce a claim which arises out of the claimant's own illegal act. The purpose of the prohibition on breach of fiduciary duty (the illegal act in this case) would be

[3] At first instance, Singularis also claimed that Daiwa had dishonestly assisted in Mr Al Sanea's breach of fiduciary duty in misapplying the company's funds. However, the High Court dismissed this dishonest assistance claim. Singularis did not pursue this ground on appeal.

[4] [2018] EWCA Civ 84

enhanced by preventing Singularis from claiming the money back (the **illegality defence**);

(B) Singularis' loss was caused by its own fault and not by the fault of Daiwa (the **causation defence**); and

(C) Daiwa paid out because of Mr Al Sanea's deceit for which Singularis would be vicariously liable and therefore would have a claim against the company. This cancelled out company's claim against them for negligence (the **countervailing claim defence**).

The UK High Court's Findings

The trial judge held that the existence of the *Quincecare* duty was predicated on the assumption that the person whose fraud was suspected was a trusted employee or officer. The purpose of the duty on the bank was to save the company from the fraudulent conduct of that trusted person. Therefore it would not be right to attribute the trusted person's fraud to the company so as to defeat the company's claim against the bank in negligence because such an attribution would denude the duty of any value in cases where it was most needed. In any case, the trial judge did not agree that Singularis was a one-man company as it had a board of reputable people and a substantial business, on which basis, the defence of attribution failed.

As the dishonest act of Mr Al Sanea should not be attributed to Singularis, the illegality defence failed.

In any case, the High Court held that it would not be contrary to the public interest to allow Singularis to enforce its claim nor would it be harmful to the integrity of the legal system for the claim to succeed. The purpose of the prohibition on breach of fiduciary duty was to protect the company from becoming a victim of the wrongful exercise of power by the officers of the company. Such purpose would not be enhanced by denial of the claim by Singularis against Daiwa. Recognising that the bank could also be a victim of the illegal act, the court was of the view that the balance between the competing interests between the customer and the bank could be struck by the carefully calibrated threshold of the *Quincecare* duty. Denial of a *Quincecare* claim would be an unfair and disproportionate response to the wrongdoing on the part of Singularis.

The High Court also held that Daiwa's breach of duty, and not Mr Al Sanea's fraudulent instructions, was the cause of Daiwa's exposure to the claim for Singularis' loss. This effectively disposed of the causation defence and the countervailing claim defence.

UK Supreme Court's Findings

Having lost its appeal to the Court of Appeal, Daiwa further appealed to the Supreme Court. The Supreme Court was asked to decide two broad issues: (1) when the actions of a dominant personality, such as Mr Al Sanea, could be attributed to the company; and (2) if they were attributed to the company, was the claim defeated by the three points of defence raised by Daiwa?

The Supreme Court held that Mr Al Sanea's fraud should not be attributed to Singularis for the purposes of the *Quincecare* claim. The *Quincecare* duty of care exists to protect bank customers against the bank's negligence in acting upon fraudulent payment instructions purportedly made on behalf of the customers. In a case where the instructions were given by the customer's trusted agent, if the fraud were attributed to the customer, the purpose of the *Quincecare* duty would be defeated. The Supreme Court also upheld the rulings of the lower courts on the three points of defence advanced by Daiwa.

Relevance to Hong Kong

In the case of *PT Tugu Pratam Indonesia v Citibank NA*,[5] the Court of First Instance (**CFI**) applied the Court of Appeal judgment in *Singularis v Daiwa* to clarify the *Quincecare* duty. Anthony Chan J opined that "*it is not the function of a bank to act as a fraud detector*". The *Quincecare* duty "*not to facilitate any fraud practised on its customer*" is only triggered when the high threshold for inquiry is met. Indeed, the *Quincecare* obligation should not be too irksome and unreasonably hamper the effective transacting of bank business.

In this case, the CFI ruled that Citibank NA breached its *Quincecare* duty to PT Tugu Pratam Indonesia. The pattern of payments (which suggested that the plaintiff's account had been used as a temporary repository of funds by the three directors), together with the lack of apparent business connection between the disputed payments and the plaintiff, and the fact that the payment instructions were signed by those who would benefit from them, put Citibank NA on inquiry, and Citibank NA was negligent in failing to make any enquiry. However, the action failed because it was time-barred.

Similarly, the CFI in *The Hong Kong and Shanghai Banking Corporation v SMI Holdings Group Ltd*[6] affirmed that the *Quincecare* duty applied in Hong Kong law. The Court of Appeal judgment in *Singularis v Daiwa*[7] was cited in that case. However, the CFI emphasised that a high threshold is needed to put a bank on inquiry such that the *Quincecare* duty be invoked because the law supports an element of trust in the banker-customer relationship. The claim of breach of Quincecare duty in this case was not successful based on its own facts.

The approach adopted by the courts in these two cases is not inconsistent with what has now been confirmed by the Supreme Court in *Singularis v Daiwa*. Whilst banks are not expected to question every payment instruction from their respective clients, they cannot turn a blind eye to signs that would be obvious and glaring to any reasonable banker that their clients' trusted agents are perpetrating a fraud. The *Quincecare* duty by its nature will only arise and be breached in exceptional circumstances.

[5] [2018] HKCFI 2233

[6] [2019] HKCFI 1948, paragraphs 20 – 39

[7] [2018] EWCA Civ 84

Practical steps

Vigilance is key. To ensure that red flags are neither missed nor ignored, banks should:

- Know your clients well so that any unusual features in their instructions can be readily identified;
- Review and refresh relevant systems and controls to ensure they can effectively assess client instructions so as to recognise and report factors which may indicate fraudulent activity;
- Review existing safeguards and procedures governing payment processing to ensure they are adequate;
- Evaluate the protocols in place for specifying the steps to be taken in the event that a red flag is raised. Such protocols should not necessarily be limited to refraining from making the payment, but extend to the taking of positive steps of investigation and the record-keeping of those steps; and
- Consider reviewing the standard form wording of client account agreements to include certain express terms, such that a *Quincecare* duty could not arise by operation of an implied term (because an implied term cannot be inconsistent with an express term), nor in tort (because the tortious duty is shaped, and can be excluded by, contractual terms).[8]

[8] See *JPMorgan Chase Bank, N.A. v The Federal Republic of Nigeria* [2019] EWCA Civ 1641, paragraph 40

Should you wish to discuss the above, please contact any of those listed below or your usual Slaughter and May contact.

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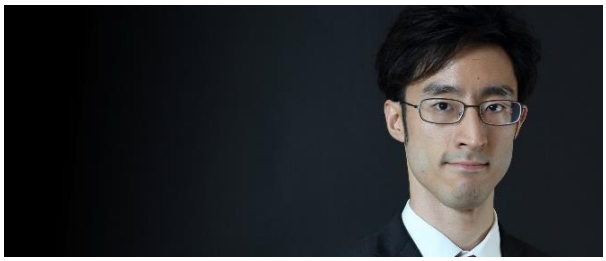

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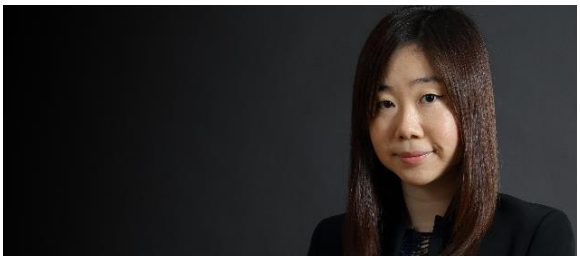

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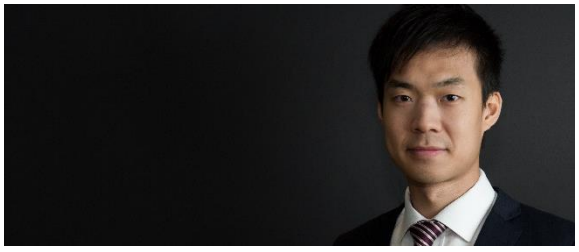

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