HFW LITIGATION

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FRAUDULENT BANK TRANSACTIONS: HONG KONG COURT OF FINAL APPEAL EXAMINES CUSTOMER REMEDIES AND BANKERS' DUTY OF CARE

The Hong Kong Court of Final Appeal has handed down the appeal judgment in *PT Asuransi Tugu Pratama Indonesia Tbk*[1], a decision of significant interest to banks, financial institutions and their customers, which discusses the remedies available under Hong Kong law when unauthorised payments are discovered, including the nature and scope of bankers' duty of care, the availability of a claim for repayment of a debt, and limitation.

Background

This appeal arises from an action by the Appellant (**Tugu**), for whom Holman Fenwick Willan (**HFW**) acted throughout, seeking recovery of monies paid out of its bank account (the **Account**) maintained with the Respondent bank, Citibank N.A. (the **Bank**), on the dishonest instructions of two of Tugu's authorised signatories (the **Instructing Officers**).

The Account mandate provided that any two of Tugu's officers could give instructions in relation to the Account. Between 1994 and 1998, 26 payments totalling US$51.64 million, were made from the Account (the **Disputed Payments**) and paid into accounts held by four of Tugu's officers (the **Fraudulent Officers**). Although the Disputed Payments were all effected in accordance with the mandate, they had no apparent connection with Tugu's business. The Hong Kong Court of First Instance (**HKCFI**) found that the Account's sole purpose was to serve as a "*temporary repository of funds*" from Tugu's operating subsidiaries into the pockets of the Fraudulent Officers personally.

In July 1998, in compliance with written instructions received from the Instructing Officers, the Bank transferred the remaining balance in the Account to certain of the Fraudulent Officers' personal accounts and closed the Account.

On 6 October 2006, upon discovering the existence of the Account and the Disputed Payments, Tugu informed the Bank that the Disputed Payments were unauthorised transfers, and demanded payment of their aggregate amount. Payment was not made. In early 2007, Tugu therefore commenced proceedings against the Bank in Hong Kong seeking (amongst other things):

1. reconstitution of the Account and the reversal of the Disputed Payments (i.e. a debt claim); and / or

2. damages for breach of duty of care (i.e. breach of the so-called Quincecare duty).

Trial: The HKCFI held that the Bank breached its duty to Tugu. A pattern had emerged by the time the third transfer was instructed, a pattern which indicated impropriety in the operation of the Account, and the Bank ought to have carried out investigations. Tugu was therefore entitled to reconstitution of the Account by reversing all but the first two of the Disputed Payments. However, the Bank argued that the claim was statute-barred and the HKCFI agreed. The HKCFI held that the closure of the Account in 1998 was authorised and, because Tugu's cause of action arose upon closure of the Account, Tugu had failed to bring the claim within the applicable six-year limitation period[2].

Appeal: Tugu appealed. The Hong Kong Court of Appeal (**HKCA**) agreed with the HKCFI that a pattern had emerged and held that the Bank ought to have made the "*necessary inquiries*". However, the HKCA agreed with the HKCFI's finding that the claim was statute-barred, albeit on slightly different grounds. Although the HKCA disagreed with the HKCFI and held that the closure of the Account in 1998 was, in fact, unauthorised, the HKCA's view was that the closure of the Account amounted to repudiation of the banking contract, was effective in bringing the banker / customer relationship to an end and operated as a waiver of the need for a demand for payment of sums owed to

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1 *PT Asuransi Tugu Pratama Indonesia Tbk (formerly known as PT Tugu Pratama Indonesia) v Citibank N.A.* [2023] HKCFA 3 (***Tugu v Citibank***).
2 Limitation Ordinance (Cap. 347).

Tugu. As such, the HKCA concluded that the six-year limitation period began in 1998 (upon the closure of the Account) and the claim was therefore statute-barred.

Final Court of Appeal: Leave was granted to appeal to the Hong Kong Court of Final Appeal (**HKCFA**) on two issues[3]:

> "1. *In the context of a contract between banker and customer (debtor / creditor), if the banker invalidly terminates the contract, thereby evincing an intention no longer to be bound by the banker / customer relationship, whether the invalid termination (unless and until such termination being accepted by the customer as bringing the contract to an end) is of any relevance in identifying (for the purposes of the Limitation Ordinance) the date of accrual of the customer's cause of action to recover back the amount, which ought to be standing to its credit in its account, or any cause of action for damages for breach of the banker's Quincecare duty*[4].
>
> 2. *Whether a customer's claim to recover the balance which ought to be standing to his credit in his account with the banker, which account has been emptied by unauthorised payments, ought properly to sound in debt (to which contributory negligence is not a defence).*"

The first issue arose due to the Bank's limitation arguments regarding Tugu's failure to demand payment when the Account was closed in 1998. In short, this question amounts to whether, in circumstances where the termination of the banker / customer contract by the bank is invalid, the termination date is relevant to the question of limitation in respect of the customer's contractual claim for recovery of sums paid out of their account, or any claim for damages for breach of duty.

The second issue centres on whether customer claims for recovery of missing funds can be pleaded as straightforward debt claims, and, if so, the availability of a contributory negligence defence.

Given the circumstances of this case, and the alternative remedy sought (damages), the HKCFA also considered the laws of agency, ostensible authority and the Bank's duties. Lord Sumption delivered the unanimous decision of the HKCFA which, given the issues ventilated before the courts below, is an important Hong Kong law authority in respect of, amongst other things, bankers' Quincecare duty.

Debt Claim

The HKCFA held that Tugu's primary claim, a debt claim seeking payment of the reconstituted balance of the Account, was good in law and was not statue-barred.

Repudiation of the contract: The Bank argued that the banker / customer relationship came to an end when the Account was closed in 1998 and, therefore, the right to claim the balance of the Account as a debt had been extinguished and replaced by a right to claim damages for breach of contract. This proposition was rejected by the HKCFA:

- the closure of the Account, which was unauthorised, showed an intention on the part of the Bank to no longer be bound by its banking contract with Tugu. However, without Tugu's acceptance this was insufficient to bring the parties' contract to an end and it therefore followed that the banker / customer relationship had not been terminated; and
- in any event, there was no legal principle which entitled the Bank to unilaterally abrogate its liabilities or write off or otherwise discharge a debt without paying it. Tugu was entitled to insist in performance of the contract, namely the return of its monies held by the Bank, before the Bank could terminate the contract.

Given that the bank / customer relationship between Tugu and the Bank continued to subsist, and the unauthorised withdrawals were nullities, the Disputed Payments in the sum of US$51.64 million (being the outstanding balance on the Account) constituted a debt which was payable by the Bank on Tugu's demand.

Limitation: It is a settled principle of Hong Kong law that a cause of action in debt arises at the time of the customer's demand for payment which, in Tugu's case, was made in 2006, shortly before the claim was filed in 2007 and well within the applicable 6-year limitation period.

Contributory Negligence: At trial, the Bank also argued that Tugu was contributorily negligent. The HKCFI held (and the HKCA agreed) that Tugu's contributory fault should be assessed at 50%. Having concluded that Tugu's debt claim was not time-barred, the HKCFA considered the question of contributory negligence[5]. Having considered the relevant legislation and the decision of the English Court of Appeal in *Forsikringsaktieselskapet Vesta v Butcher*[6], the HKCFA held that Tugu's debt claim is not a claim arising out of "*damage*" as defined by the relevant Hong Kong (and English) legislation and interpreted by the courts. This is an unsurprising conclusion given that, in its debt claim, Tugu was not alleging any fault on the part of the Bank. Such debt claims simply proceed on the basis of the funds

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3 *PT Asuransi v Citibank* at paragraph [12].
4 Being the duty of case established in the decision of the English High Court in *Barclay Bank plc v Quincecare Ltd and another* [1992] 4 All ER 363 (***Quincecare*** and the **Quincecare duty**).
5 Section 21 of the Law Amendment and Reform (Consolidation) Ordinance (Cap.23) sets out the position under Hong Kong law, which is identical to the equivalent English law provision in the Law Reform Contributory Negligence Act 1945.
6 [1986] 2 All ER 488.

deposited with the bank and owed to the customer and, as such, a contributory negligence defence is not available to the defendant bank under Hong Kong law.

Breach of Bankers' Duty

The Quincecare duty, being the bank's duty of skill and care when executing its customer's instructions which arises in both contract and tort, is a familiar legal concept in common law jurisdictions.

However, it remains a hot topic because, from time to time, claimants seek to expand the scope of the duty in order to pursue recovery of lost sums and, in turn, banks seek to restrict the duty to defeat such claims. Further, novel circumstances arise which require the courts to examine the duty afresh (i.e. the advent of new technology and / or new banking practices).

We have published various briefings on this topic which can be found **here**. Our briefings of **March 2020** and **June 2022** set out the background and development of E&W law and, in relation to evolving banking technology, our **briefing** on the *Philips* decision discusses the approach taken by the English Court of Appeal in claims involving "*authorised push payments*" and fraud. The Quincecare duty has also been applied by the DIFC courts, as explained in this **briefing** by our Dubai team.

The HKCFA confirmed that the nature and scope of the Quincecare duty under Hong Kong law is as set out by Steyn J in the *Quincecare* decision (and other familiar E&W authorities[7]). In short, the standard of care is that owed by an agent, it includes the duty to exercise reasonable skill and care and applies to "*interpreting, ascertaining and acting in accordance with the instructions of a customer*".

On the question of what amounts to "*sufficient notice of a want of actual authority*" (e.g. fraud) and the circumstances in which a bank ought to make inquiries before paying out the customer's funds in accordance with its mandate, the HKCFA again referred to the leading English authorities[8] noting that:

> "*a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company...*"

This test has been framed differently by certain judges[9] and this has, it seems, caused "*[a] certain amount of confusion*" as to the threshold for investigations being carried out by banks in order to meet their Quincecare duty. Helpfully, Lord Sumption clarified that the test is, in fact, the same in Hong Kong (notwithstanding the terminology used in *Akai No. 2*) and the test is, and remains, whether the bank could reasonably rely on the apparent authority of the customer's agent (e.g. a company director) given the bank's knowledge of the situation. The HKCFA also clarified that in Hong Kong, as is the case under English law, regard can be had to the "*commercial context and the exigencies of business*". As such, whether the bank ought to investigate before paying out customer funds will depend on the circumstances of each case.

Conclusion

The judgment in *Tugu v Citibank* provides welcome clarification of certain Hong Kong law remedies available to victims of fraud and to other parties, such as liquidators and trustees, who seek to recover misappropriated funds.

This decision also provides guidance to banks and financial institutions on the scope of their duty to customers, highlighting circumstances in which the bank ought to make appropriate investigations into whether a transaction is legitimate and discussing the extent of reasonable inquiries.

Given the availability of a straightforward debt claim, and the position on limitation and contributory negligence, banks and financial institutions should take steps to manage their risk by putting in place systems to flag and investigate potentially fraudulent transactions.

HFW acted for the claimant throughout these proceedings and have significant global expertise in this area[10]. Should you need further information or require specific advice our **Disputes** team would be delighted to assist.

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7 E.g. *Foley v Hill* (1848) 2 HLC 28; *Selangor United Rubber Estates Ltd v Cradock (No. 3)* [1968] 1 WLR 1555.

8 E.g. the Privy Council decision in *East Asia Co Ltd v PT Satria Tirtatama Energindo* [2020] 2 All ER 294; [2019] UKPC 30 (***East Asia***); *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340; *Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe* Ltd [2020] AC 1189.

9 The test formulated by Lord Neuberger in the HKCFA decision in *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No. 2)* (2010) 13 HKCFAR 479 (***Akai No. 2***) referred to circumstances in which it would be "*irrational*" for the bank to make the instructed payment without inquiry, whereas the language traditionally used refers to the reasonableness of proceeding without investigating matters (see e.g. *Quincecare* and *East Asia*).

10 See our further briefings in this area: **Quincecare Duty: Privy Council Rules that Duty of Care is not Owed to Non-customers of a Bank**, May 2022 which discusses duties owed to third party victims of fraud and **English Commercial Court Gives Further Clarification of the Quincecare Duty**, June 2022 which discusses the standard of a "*reasonable and honest banker*".

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