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Liability of Hong Kong banks acting on dishonest payment instructions of corporate customers' authorised signatories

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On 6 February 2023, the Court of Final Appeal (the "**CFA**") handed down its judgment in **PT Asuransi Tugu Pratama Indonesia Tbk v Citibank N.A.** [2023] HKCFA 3 concerning *"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 an authorised signatory"*.

Facts

In 1990, PT Asuransi Tugu Pratama Indonesia Tbk ("**Tugu**") opened a bank account with Citibank N.A. ("**Citibank**"). Between 1994 and 1998, Tugu's authorised signatories gave 26 dishonest instructions to Citibank causing a total of US$51.64 million to be paid out of Tugu's account to four Tugu officers. On 30 July 1998, after all funds in the account were paid out, Citibank closed the account as instructed by Tugu's authorised signatories.

On 6 October 2006, Tugu informed Citibank that all 26 transfers had been dishonestly authorised and demanded payment of their aggregate value. On 2 February 2007, Tugu commenced proceedings against Citibank seeking, amongst other things:

- **the debt claim:** reconstitution of the account by reversing the 26 disputed transfers, on the basis that such transfers and the closure of the account were unauthorised and of no effect;
- **the breach of *Quincecare* duty claim:** further or alternatively, damages for breach of a duty of care in contract and/or tort not to give effect to the payment instructions in circumstances where Citibank knew of facts which would lead a reasonable and honest banker to consider that *"there was a serious or real possibility that* [Tugu] *might be defrauded…by the giving of that payment instruction"*.

Decisions in the Courts below

The Trial Judge found that all 26 transfers were fraudulent on the part of the signatories and held as follows:

- **Duty:** Citibank breached the *Quincecare* duty of care by failing to make inquiries. By the time of the third transfer, a reasonable and prudent banker would have been put on inquiry when a pattern had emerged indicating the improper character of the way that the account was operated. Accordingly, Tugu was entitled to have the account reconstituted by reversing all but the first two transfers.
- **Limitation:** Notwithstanding the above, Tugu's claim was statute-barred as the six-year limitation period began to run from 30 July 1998 when the account was closed and the banker-customer relationship ended.
- **Contributory negligence:** Had Tugu's claim not been statute-barred, Citibank would have been entitled to rely on the defence of contributory negligence.

The Court of Appeal dismissed Tugu's appeal and upheld the Trial Judge's findings (albeit on slightly different grounds in respect of duty and limitation) as follows:

- **Duty:** Citbank had been put on inquiry from the time of the third payment instruction. However, contrary to the Trial Judge's finding, the Court of Appeal considered that some inquiries had been made but not the necessary inquiries, that is, Citibank should have contacted directors independent of the operators and beneficiaries of the fraud rather than contacting the signatories only.
- **Limitation:** Tugu's claim was statute-barred. The Court of Appeal noted that a cause of action in debt ordinarily arises when a customer demands from the bank the balance in its account. However, it held that the unauthorised and repudiatory closure of the account brought an end to the banker-customer relationship and operated as a waiver of the need for a demand, irrespective of whether the customer accepted the repudiation. It followed that the cause of action for the wrongful payments accrued in 1998.
- **Contributory negligence:** Had Tugu's claim not been statute-barred, Citibank would have been entitled to rely on the defence of contributory negligence.

The CFA's decision

Issues before the CFA

Tugu was granted leave to appeal on two issues (with the first issue reformulated by Lord Sumption in more general terms in his judgment) before the CFA:

- Does a cause of action for sums debited without authority to the account arise upon the closure of the account, without the need for a demand?

- 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 CFA allowed Tugu's appeal (with Lord Sumption giving the leading judgment and agreed by the rest of the CFA panel). We set out below a summary of the CFA's findings.

Duty/Authority

There are two juridical sources for a bank's duties in making payments out of an account. Firstly, a banker's duty is to make such payments only with the authority of the customer, that means in accordance with the customer's mandate, and secondly, the bank also owes a duty as the customer's agent. The standard of duty is the same under either head. The duty of care is a duty in the performance of the mandate. The critical issue, whether one looks at a bank's duty of care to exercise reasonable skill and care (i.e. the *Quincecare* duty) or the law relating to ostensible authority of the authorised signatories of an account, is what constitutes sufficient notice of a want of actual authority, so as to require a bank to make inquiries before paying out in accordance with its mandate. Lord Sumption gave guidance as follows:

> *"There is no general obligation spontaneously to inquire into an agent's authority and no rule that fixes the third party with notice of what might be discovered upon such an inquiry. The starting point is what is actually known to the third party without inquiry (or would actually be known to him if he appreciated the meaning of the information in his hands). The question is whether the information which he actually has calls for inquiry. If, even without inquiry, the transaction is not apparently improper, then there is no justification for requiring the third party to make inquiries. But if there are features of the transaction apparent to a bank that indicate wrongdoing unless there is some special explanation, then an explanation must be sought before it can be assumed that all is well. In other words, if a bank actually knows of facts which to their face indicate a want of actual authority, it is not entitled to proceed regardless without inquiry."*

On the facts of the case, Lord Sumption held that it was open to the Court of Appeal to find that on the face of the information in Citibank's hands by 1998, the whole operation of the account was unauthorised, including its closure.

Limitation

It is well settled that a customer has no proprietary interest in funds deposited with a banker. The obligation of a banker is to pay to or to the order of the customer on the latter's demand. It follows that a cause of action in debt arises only when that demand is made, and not before. Further, the closure of the account did not discharge the debt represented by the reconstituted balance, and for as long as that debt remained outstanding, the relationship of banker-customer relationship subsisted.

In the present case, it was held that the closure of the account was unauthorised and the purported closing in 1998 amounted to a repudiatory breach on the part of Citibank, which was not accepted by Tugu. As long as the debt remained outstanding, the Citibank's and Tugu's banker-customer relationship subsisted. There is no principle of law which entitles Citibank unilaterally to abrogate its outstanding liabilities or to discharge a debt without paying it. To effectually terminate the relationship, it must pay (or at least tender) the outstanding reconstituted balance, which Citibank has not done. Accordingly, the debt, undiminished by the unauthorised withdrawals, still subsisted in 2006 when Tugu demanded payment from Citibank, and time did not begin to run for limitation purposes until then.

Contributory negligence

A claim in debt is not a claim in respect of "damage" for the purpose of on section 21 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23), which only provides the defence for claims for damages, and not claims for debt. Accordingly, the defence of contributory negligence was not available to Citibank as Tugu was simply seeking repayment of a debt.

Implications

The CFA decision reminds banks of their duty to customers and provides guidance on when it puts them "on inquiry" before debiting customers' accounts. Although there is no general obligation to inquire into the authority of their customers' agents, in order to allow banks to comply with their mandate with customers, they should be vigilant in assessing whether the

information in hand calls for inquiry. As such, banks should put in place policies and systems enabling them to flag impropriety and potential fraudulent transactions.

Victims who are out of pocket should consider the availability of a straightforward debt claim against the relevant bank. The CFA has clarified that time to bring a debt claim does not begin to run for limitation purposes until a demand for the balance in the account has been made. For such debt claims, the banks cannot run a defence of contributory negligence.

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