22/85

No. 41 of 1984

IN THE PRIVY COUNCIL

ON APPEAL

FROM THE COURT OF APPEAL OF HONG KONG

BETWEEN:-

TAI HING COTTON MILL LIMITED

Appellants
(Plaintiffs)

- and -

LIU CHONG HING BANK LIMITED

First Respondents
(Defendants)

- and -

THE BANK OF TOKYO LIMITED

Second Respondents
(Defendants)

- and -

CHEKIANG FIRST BANK LIMITED

Third Respondents
(Defendants)

CASE FOR THE APPELLANTS

RECORD

1. This is an Appeal by the Appellants, Tai Hing Cotton Mill Limited, from a Judgment and Order of the Court of Appeal of Hong Kong (Cons. J.A., Fuad J.A., Hunter J.) dated 27th January, 1984 dismissing with costs the appeal of the Appellants, and allowing the cross appeal of the First Respondents, from the Judgment and Order of Mantell J. dated 12th July 1983 whereby it was adjudged and ordered, inter alia,

(i) that the Appellants should be granted a declaration that the First Respondents were not entitled to debit the Appellants' account in the amount of H.K. $ 187,195.74 (being the sum of six cheques listed in Schedule A to the Further Re-Amended Statement of Claim as Nos. 1, 2, 3, 4, 5 and 10) and that the Appellants should be entitled to interest on the said sum at the rate of 1½% over the prime rate in force from time to time from 1st January 1978 to Judgment;

(ii) that the Appellants should pay the First Respondents' costs of the action from 14th April, 1983 and that the First Respondents should pay the Appellants' costs of the action in respect of the proceedings as between the Appellants and the First Respondents up to and including 13th April 1983;

(iii) that the Appellants' claims against the Second and Third Respondents be dismissed with costs.

2. For convenience, the following abbreviations are used:

"LCH" - the First Respondents, Liu Chong Hing Bank Limited

"BOT" - the Second Respondents, The Bank of Tokyo Limited RECORD

"CFB" - the Third Respondents, Chekiang First Bank Limited.

THE FACTS

3. The material facts may be summarised as follows:

(1) The Appellants commenced business as textile manufacturers in 1957. The Company comprises a number of divisions each of which is to some extent autonomous. The Managing Director of the Company is Mr. Chen Yuan-chu.

(2) At different times the Appellants had held a number of bank accounts with various banks including the three Respondent Banks:

(i) LCH

The Appellants opened an account with LCH in November 1962, the account being allocated to the Company's Spinning and Weaving Division. Mr Chen's letter to LCH dated 8th November 1962 requesting the opening of the account stated that the Company wished to open the account "..... subject to your Rules and Regulations for the conduct of such account." Rule 13 of the Rules and Regulations (which Mr. Chen saw at the time of making such request) provided at the material time as follows:

"A statement of the customer's account will be rendered once a month. Customers are desired:

(1) to examine all entries in the statement of account and to report at once to the Bank any error found therein,

(2) to return the confirmation slips duly signed.

In the absence of any objection to the statement within seven days after its receipt by the customer, the account shall be deemed to have been confirmed."

LCH was authorised to pay cheques drawn on behalf of the Appellants if such cheques were signed by Mr. Chen or by any two of four nominated signatories. No confirmation slips were in fact ever sent to the Appellants with the Bank statements and LCH never returned cleared cheques to the Appellants. No confirmation of any material bank statement was ever sent by the Appellants to LCH.

(ii) BOT

The Appellants opened an account with BOT in November 1961. By letter of 17th November 1961, Mr. Chen agreed on behalf of the Appellants to observe the provisions of an agreement which appeared on the reverse of the Bank's pro-forma letter and to undertake to hold the Bank free from any loss resulting from the Appellants' failure to abide by those provisions. Clause 10 of the agreement provided as follows:

"The Bank's statement of my/our account will be confirmed by me/us without delay. In the case of absence of such confirmation within a fortnight, the Bank may take the said statement as approved by me/us."

BOT was authorised to pay the Appellants' cheques if signed by Mr. Chen or by two authorised signatories. BOT never returned cleared cheques to the Appellants. No material bank statement was ever confirmed by the Appellants.

(iii) CFB

The Appellants opened an account with CFB in September 1957. The arrangements for signing cheques were the same as those subsequently adopted for the LCH and BOT accounts. By his request to CFB to open the account, Mr. Chen agreed on behalf of the Company "to comply with your Bank's rules and procedures in force from time to time governing the conduct of such account." Mr. Chen had sight of CFB's then current Rules at the time of making the request. Rule 7 provided, so far as is material, as follows:

> "A monthly statement for each account will be sent by the Bank to the depositor by post or messenger and the balance shown therein may be deemed to be correct by the Bank if the depositor does not notify the Bank in writing of any error therein within ten days after the sending of such statement ....."

From the opening of the account in 1957 until March 1978, the Appellants returned to CFB each month the confirmation slips signed by two authorised cheque signatories. No cleared cheques were ever returned to the Appellants.

(3) For the purposes of its annual audit, the Appellants sent to each of the Banks requests for confirmation of the balance in the account in a

RECORD

standard form prepared by the Company's auditors. The form requested the bank to confirm that the balance listed as at a particular date was correct, or should the bank disagree, to enter the bank's own figures. A form of certificate was provided for the bank to sign and return.

(4) Towards the end of 1972, the Appellants took into their employment an accounts clerk named Leung Wing Ling ("Leung") who was given responsibility for the books of two divisions of the Company with accounts at BOT and CFB. Leung was dishonest. He opened bank accounts in names similar to the names of the Appellants' suppliers and persuaded Mr. Chen to sign cheques which he paid into these accounts by showing him forged documents which purported to support the transactions. Leung subsequently began to forge Mr. Chen's signature on cheques: he passed forged cheques through the Appellants' account with BOT and CFB and, in November 1977, when his superior, Mr. Wang, retired though ill-health and Leung assumed responsibility for the Company's account with LCH, he drew forged cheques on that account also. The number and total value of the forged cheques drawn on the Respondent Banks are as follows:

(i) LCH

It was undisputed that there were 54 forged cheques drawn and paid between 5th November 1977 and 31st March 1978, the total value of which was H.K. $ 3,082,214.30.

(ii) BOT

The trial Judge found that 104 forged cheques were paid by the Bank with a total face value of

H.K. $ 790,842.89. All of these were drawn between 30th January 1975 and 1st February 1978.

(iii) CFB

The trial Judge found that a total of 136 forged cheques were paid by the Bank with a total value of H.K. $ 1,748,029.73. All of these were drawn between 30th November 1974 and 28th January 1978.

(5) By their Writ issued on 15th May 1978 the Appellants claimed against each of the Respondent Banks, inter alia:

(i) a declaration that the Bank was not entitled to debit the Company's account with the amounts of the forged cheques;

(ii) an order for payment by the Bank of the respective total amount of the forged cheques;

(iii) interest on the amounts of such cheques.

(6) The Banks by their Defences denied the forgeries, but the main ground of defence involved an allegation that the Appellants' own negligence debarred them from recovery. To support this the Respondents argued that the Appellants owed to each of them a duty of care. Two formulations of this duty were advanced, termed respectively "the wider duty" and "the narrower duty".

"The wider duty" was expressed to be a duty:

"to take such precautions as a reasonable customer in his position would take to

prevent such cheques (i.e. forged cheques) being presented to his bank for payment."

"The narrower duty" was expressed to be a duty:

> "to take such steps to check his monthly bank statements as a reasonable customer in his position would take to enable him to notify the bank of any items debited therefrom which were not or may not have been authorised by him."

(7) The action was tried before Mantell J. from 17th May 1983 until 9th June 1983. In a reserved judgment delivered on 12th July 1983, Mantell J. held, inter alia:

(i) The Appellants' system of internal control was inadequate to prevent or detect fraud. In particular, Mantell J. placed reliance on

(a) the lack of any proper division of function, Leung being in almost total control of the receipts and payments side of the accounts, including the handling of incoming cheques, the recording of receipts and, subject to being asked to produce supporting vouchers, the making and recording of payments; and

(b) the lack of supervision, including in particular the failure to check or supervise Leung's reconciliations of the monthly bank statements.

On the facts, as found, Mantell J. held that, assuming the existence of the "wider" and

"narrower" duties of care alleged by the Respondent Banks, the Appellants were in breach of both duties in relation to all three Banks.

(ii) However, neither the "wider" nor the "narrower" duty of care relied on by the Respondent Banks was in fact imposed on a customer either in contract or in tort.

(iii) The relevant provisions of the Respondent Banks' Rules and Regulations did not serve to exclude the liability of the Banks to the Appellants or to give rise to an account stated or settled as between the Banks and the Appellants.

(iv) Neither the failure of the Appellants to operate an efficient internal control system nor the failure of the Appellants to check their monthly Bank statements adequately or at all gave rise to an estoppel by negligence such as to preclude the Appellants from asserting that their account had been wrongly debited.

(v) The returning of the confirmation slips in the case of CFB and the failure of the Appellants to respond to the monthly Bank statements in accordance with the relevant provisions of the Rules in the case of LCH and BOT amounted to representations to the Banks that the statements were correct. Mantell J. held that each of the Respondent Banks had been induced to act, and had acted, to its detriment in reliance on the representations, the detriment being the willingness of the Bank to continue to oper-

ate the account and to expose itself to the risk of paying out on forged cheques. In the case of BOT and CFB but not in the case of LCH, Mantell J. found additional prejudice in that, through the passage of time, the Banks had lost their best opportunity for recovering from the Appellants' dishonest accounts clerk Leung. Mantell J. held that, accordingly, the Appellants were estopped by reason of their representations from asserting that their accounts had been wrongly debited, in relation to BOT and CFB, in respect of each of the forged cheques, and in relation to LCH, in respect of cheques forged after the date of the first "representation" which had been made following the month of December 1977.

(vi) Accordingly, judgment would be entered for the Appellants against LCH in the terms of the declaration sought in respect of the forged cheques debited to the Company's account for November and December 1977. The Appellants were entitled to interest in respect of such sums, notwithstanding the fact that the sum wrongly debited was in a non-interest bearing account. Judgment would be entered for BOT and CFB on the claim.

(8) By Notice of Appeal dated 26th July 1983, the Appellants appealed to the Court of Appeal of Hong Kong against the judgment and Order of Mantell J. Each of the Respondent Banks filed a Respondent's Notice (including, in the case of LCH, a Notice of Cross-Appeal) on the following

dates:

LCH - 6th August, 1983
BOT - 15th August, 1983
23rd August, 1983
(Supplementary)
CFB - 9th August, 1983.

(9) The Appeal was heard by the Court of Appeal (Cons. J.A., Fuad J.A., Hunter J.) from 12th December until 22nd December, 1983. In a reserved Judgment delivered on 27th January 1984, the Court of Appeal dismissed with costs the Appellants' Appeal and allowed the Cross-Appeal of LCH.

(10) The two main judgments in the Court of Appeal were those of Cons J.A. and Hunter J. The third member of the Court, Fuad J.A. agreed with both judgments save in relation to the construction of the Banks' Rules, as to which he inclined towards the views of Hunter J. In the judgments it was held, inter alia:

(i) that a customer owed to his Bank both in contract and in tort a duty "in the operation of [his] account, to take reasonable care to protect the interests of the Bank" (per Cons. J.A.) or a duty "..... to take reasonable care 'to ensure the proper working of his account' ....." (per Hunter J.);

(ii) that, on the unchallenged findings of Mantell J., (and on the evidence to which the Court of Appeal had been referred - per Cons. J.A.) the Appellants were in breach of such duty of care and were in consequence not

entitled to the relief sought against any of the Respondent Banks;

(iii) (per Hunter J. and Fuad J.A.) that, on their true construction, none of the relevant provisions of the Rules of the Banks sufficed to exclude the Banks' liability to the Appellants or to give rise to an account settled;

(iv) that the Appellants, being in breach of their duty of care owed to the Banks, were estopped by reason of their negligence from asserting that their accounts had been wrongly debited;

(v) that the Appellants were additionally estopped from so asserting as against CFB by reason of the representation to the Bank contained in the confirmation slips which were returned by the Company to CFB;

(vi) that there existed no ground for challenging the finding of Mantell J. that interest would properly be payable in the circumstances of the present case;

(11) By Order dated 14th February 1984, the Court of Appeal (Cons J.A., Fuad J.A., O'Connor J.) granted to the Appellants provisional leave to appeal to the Privy Council from the Judgment of the Court of Appeal given on 27th January 1984 on condition that

(i) the Appellants entered into sufficient security to the satisfaction of the Registrar in the sum of H.K. $ 100,000 within 21 days; and

(ii) the Appellants prepared and dispatched the Record to England on or before 31st July, 1984.

The said conditions being satisfied by the Appellants, the Court of Appeal granted unconditional leave to appeal to the Privy Council by Order dated 27th July 1984.

10

THE ISSUES

4. The following are the principal questions raised in the Appeal:

(1) Whether the Appellants, as customers of the
20 Respondent Banks, owed to the Banks a duty of care in contract or in tort with regard to the operation of their account and whether, if so, the Court of Appeal correctly defined the scope of such duty;

(2) whether the Rules of the Respondent Banks were, on their true construction, sufficient to exclude
30 the Banks' liability to the Appellants for paying on the forged cheques or to give rise to an account stated or settled between the Respondent Banks and the Appellants;

(3) whether the Appellants were and are estopped as against any or all of the Respondent Banks from
40 alleging forgery or from asserting that their account was wrongly debited either by reason of negligence or by reason of representations made to the Respondent Banks that the Bank statements were correct;

(4) whether Mantell J. applied the correct standard of

50

proof in determining whether the cheques drawn on BOT and CFB were forged;

(5) whether, assuming that the Appellants were entitled to the relief claimed against the Respondent Banks, interest would be properly awarded to the Appellants on the amounts debited to the accounts in respect of the forged cheques.

(1) Duty of care

5. In their submissions before Mantell J. and before the Court of Appeal, the Respondent Banks contended that a customer of a Bank owed to the Bank duties of care both in contract and tort in relation to the operation of his account. As stated above the duty of care was formulated by the Respondents in two alternative ways, the two formulations being characterised as "the wider duty" and "the narrower duty" respectively. The "wider duty" as formulated was a duty

> "to take such precautions as a reasonable customer in his postion would take to prevent such cheques (i.e. forged cheques) being presented to his bank for payment."

The "narrower duty" was defined as a duty

> "to take such steps to check his monthly bank statements as a reasonable customer in his position would take to enable him to notify the bank of any items debited therefrom which were not or may not have been authorised by him."

6. Mantell J. concluded that neither in contract nor in tort was the wider or the narrower duty of care imposed on a customer of a bank. In reversing the decision of Mantell J.,

and in holding that there existed a duty of care in both contract and tort, neither Cons. J.A. nor Hunter J. defined the duty in terms of the wider or narrower duty contended for by the Respondents, but instead formulated the duty as a general duty of care owed by a customer to his bank in relation to the operation of his account (see para. 3 (10)(i) above). In so holding, the Court of Appeal made clear that it was seeking to apply principles of English common law, the circumstances in relation to the maintaining of current bank accounts in Hong Kong being held to be identical with those in England (per Cons J.A.).

RECORD

P. 629 lines 26-30

7. It is submitted that the Court of Appeal erred in so holding and that, for the reasons set out below, neither the wider nor the narrower duty, nor any broad duty of care to protect the interests of the Respondent Banks, was imposed on the Appellants either in contract or in tort.

(a) Contract

8. Both Mantell J. and the Court of Appeal (per Cons. J.A.) rejected the submission that either the wider or the narrower duty of care could be implied into the contracts between the Appellants and the Respondent Banks by applying a test of the presumed intention of the parties or on the ground that the implication of such a duty of care was necessary for the purpose of giving "business efficacy" to the contract. It is submitted that this conclusion was plainly correct: there could be no justification for imputing to the parties an intention to place upon the customer a duty, the existence of which has not only been unrecognised in any English authority but has, on the contrary, been expressly rejected in a series of judicial authorities over a period of more than seventy years. For the same reason the implication of such a duty could not be considered necessary for the purpose of giving business efficacy to the contract.

P.581 lines 1-45; pp. 616-7 lines 7-6

RECORD

9. The Court of Appeal nevertheless held that duties or obligations might be implied or imposed by law, independently of the presumed intention of the parties to the contract, as a necessary incident of the contractual relationship between the parties and that the relationship between a banker and a customer was one such relationship. Relying, inter alia, on the decision of the House of Lords in Liverpool City Council v. Irwin [1977] A.C. 239, Cons J.A. concluded "after a great deal of hesitation", that it was a "necessary" condition of the relation of the banker and customer that the customer should take reasonable care to see that in the operation of the account the bank was not injured: such a duty was said to be a necessary reciprocal duty to the duty of skill and care imposed on a bank in handling the customer's account. Hunter J. reached the same conclusion by treating the implied or "imposed" contractual duty of care as being indistinguishable from a duty of care in tort, both depending on the proximity of the relationship: he concluded that in determining whether a duty of care existed as an implied term of the contract or in tort, the only relevant questions were those posed by Lord Wilberforce in Anns v. Merton London Borough Council [1978] A.C. 728, at p. 751. Applying this test, Hunter J. held that there was to be implied, as one of the mutual obligations arising from the contractual relationship, a duty on the customer to ensure the proper working of the account.

P. 622 lines 11-41

P. 650 lines 7-25

P. 650 lines 28-39; pp. 658-9 lines 41-10

10. It is respectfully submitted that both judgments are erroneous in having failed to take any proper account of the complete absence of support in any previous English authority for the implication or "imposition" in a banking contract of a general duty of care on the part of a customer. In the Irwin case (on which both judgments in the Court of Appeal were substantially based) it was emphasised that it was not permissible to imply terms on grounds of reasonableness and that it was only possible to read into a contract such obligations as the nature of the contract implicitly required: "a

test, in other words, of necessity." (per Lord Wilberforce [1977] A.C. 239, at p. 254F). It is submitted that a test of necessity is not satisfied and that a contract between a customer and his bank cannot "require" or "demand" the implication of a duty of care on the part of a customer which has not only been previously unrecognised but has been expressly rejected in a series of judicial authorities in different jurisdictions. In particular:

(a) In Kepitigalla Rubber Estates v. National Bank of India [1909] 2 K.B. 1010, Bray J. expressly rejected an argument that there should be implied into the banking contract the wider duty of care. Bray J. considered that the implication of such a term was not supported by authority and could not be supported in principle (ibid. at pp. 1023 - 1026).

(b) In London Joint Stock Bank v. Macmillan and Arthur [1918] A.C. 777 there is nothing in the speeches to suggest any disapproval by the House of Lords of Bray J.'s rejection of any wider duty of care; on the contrary, two passages in the speech of Lord Finlay (pp. 795, 801) suggest at least tacit approval of Bray J.'s conclusion that, as between customer and banker, there was no obligation on the customer to take precautions in the general carrying on of his business or in examining and checking the pass-book and that the only duty of care arose in connection with the drawing of cheques or orders.

(c) In Wealden Woodlands (Kent) v. National Westminster Bank, 11th March 1983 (unreported) McNeill J. cited the decision and judgment in the Kepitigalla case with approval.

RECORD

(d) In National Bank of New Zealand v. Walpole and Patterson [1975] 2 N.Z.L.R. 7, the Court of Appeal of New Zealand approved and followed the Kepitigalla decision.

(e) The Kepitigalla decision was approved and followed by the High Court of Hong Kong, expressly, by Leonard J. in Asien-Pazifik Merchant Finance v. Shanghai Commercial Bank (1978) (unreported), and, implicitly, by Fuad J. in Lam Yin Fei v. Hang Lung Bank [1982] H.K.L.R. 215.

(f) In Big Dutchman (South Africa) (Pty). Ltd. v. Barclays National Bank Ltd. (1979) (3) S.A. 267, Philips A.J. held that, save in respect of drawing documents to be presented to the bank and in warning of known or suspected forgeries, a customer owed no duty to the bank to supervise employees to run his business carefully or to detect frauds, and no duty to the bank to check his bank statements.

11. The importance of the statements of principle in these authorities is not, in the submission of the Appellants, diminished by the fact, on which reliance was placed by the Court of Appeal, that the statements may have been obiter or made without the benefit of all the arguments advanced, or authorities cited, in the Court of Appeal. It is submitted that in the light of these clear and consistent statements, it cannot in any event justifiably be asserted (as Cons. J.A. asserts) that, in the absence of a general duty of care being imposed on a customer, a banking contract would be "futile, inefficacious or absurd".

pp. 622-3 lines 42-7; P. 655 lines 6-12

P. 622 lines 27-34

12. It is further submitted that, contrary to the view expressed by Hunter J., no support for the implication of the wider duty or of a general duty of care as formuated by

pp. 652-655

RECORD

the Court of Appeal is to be found in the United States' authorities. The general statement of principle in Trustees of Morgan v. U.S. Mortage and Trust Co. 208 N.Y. 218 (1913) at 224, on which reliance was placed by the Respondent Banks was, as Cons J.A. observed, made in the context of the examination and verification of the customer's account with his bank when his pass book and vouchers were returned. Similarly, as Cons J.A. further noted, the concept underlying the statement of principle in Screenland Magazine Inc. v. The National City Bank of New York 42 N.Y.S. (2d) 286 (1943) at 290 appears to have been the responsibility of a customer to detect a long continued series of forgeries by checking the bank statements or returned cheques. Moreover, it is clear both from the Screenland Magazine case and from Pacific Coast Cheese Inc. v. Security First National Bank of Los Angeles 286 P. (2d) 353 (1955) that reliance could in any event only be placed by a bank on a breach of duty on the part of its customer so as to excuse it from liability to the extent that the bank could establish "as an affirmative defence" that it was itself free from negligence in failing to detect the forgery (Pacific Coast Cheese case, at p. 355). CFB was the only one of the Respondent Banks which attempted to prove that it had sought to verify the genuiness of the signatures on the Appellants' cheques, but the witness which it called for this purpose was disbelieved by Mantell J. The other two Respondent Banks did not attempt to show that they were free from negligence in failing to detect the forgeries.

P. 629 lines 1-4

P. 629 lines 8-19

P. 571 lines 14-21

13. There similarly exists no foundation for the implication in a banking contract of the narrower duty of care as formulated by the Respondent Banks. As was observed by Mantell J., the authorities referred to in paragraph 10 above are as strong in denying the existence of the narrower duty as an implied term of the contract as they are in denying the existence of the wider duty. Moreover, the United States and Canadian authorities to which reference is made in the judgments in the Court of Appeal provide no sound basis for

P. 584 lines 28-31

RECORD the implication of the narrower duty as formulated.

(i) The decision in Leather Manufacturers Bank v. Morgan 117 U.S. 96 (1885), which established a duty on the part of a customer to examine the pass-book and vouchers and to report to the bank any errors which might be discovered in them, was expressly considered by the Court in the Kepitigalla case, in which it was noted that it had ".....never been acknowledged by a Court or judge in this country as correctly stating our law." [1909] 2 K.B. 1010, (1028).

(ii) The principle as stated in the Leather Manufacturers Bank case does not in any event provide support for the narrower duty formulated by the Respondents Banks, which is considerably more extensive than that imposed in the United States authorities. The principle in the Leather Manufacturers Bank case now has statutory force in the United States, being embodied in section 4-406 of the Uniform Commercial Code. Under section 4-406(1) a customer's obligation to exercise reasonable care and promptness in examining his bank statement to detect forgery arises only where the statement and "the items" supporting the debit entries (e.g. cheques or vouchers) are sent or made available to the customer. The Canadian authorities referred to by the Court of Appeal likewise suggest that the customer's duty to examine his pass-book or statements so as to detect forgeries is dependent on the paid items being made available to the customer for inspection: see Arrow Transfer Co. Ltd. v. Royal Bank of Canada (1971) 27 D.L.R. (3d) 81 at pp. 99-101 per Laskin J., citing section 4-406 of the Uniform Commercial Code; and Canadian Pacific

Hotels v. Bank of Montreal (1981) 122 D.L.R. (3d) 519 at p. 532. The narrower duty, as formulated by the Respondents, contains no such qualification and would extend beyond the duty imposed on a customer in the North American jurisdictions by requiring the customer to examine his statements for the purposes of detecting forgeries even in the absence of the forged items themselves, from which the existence of forgery could be most readily detected. In the present case, none of the Respondent Banks made a practice of returning the supporting cheques or vouchers to their customers together with the relevant bank statements (see finding of Mantell J.). Accordingly, even if the principles contained in the North American authorities were to be adopted, the Appellants would not be precluded by reason of any breach of duty from asserting the forgeries against the Respondent Banks.

RECORD

P. 586 lines 28-31

(b) Tort

14. In the Court of Appeal, Cons J.A. held that there was good sense in an argument that a duty in tort could not be more extensive than a duty in contract insofar as it concerned acts or omissions in the actual performance of the contract itself. However, he concluded that there was no reason why there should in principle be any restriction upon liability for conduct which, although it would or might not have occurred without the existence of the contract, was otherwise independent of it. Hunter J. elided the contractual and tortious duties of care and treated the proximity test as being the sole test for determining whether such a duty existed in contract or in tort.

P. 623 lines 19-27

P. 650 lines 7-25

15. In the submission of the Appellants, both findings of the Court of Appeal were erroneous. While a duty of care in tort

RECORD

may co-exist with a duty of care implied as a necessary incident of a contract, it is submitted that the duties, and the test for determining whether either or both duties exist, remain distinct. Moreover, it is submitted that, in the case of a contractual relationship, the duties owed by one party to the other in tort in the performance of the contract cannot extend more widely than those which have been expressly or by necessary implication agreed by the contract between them and the scope of the duty in tort is to that extent reduced or limited. (cf. William Hill Organisation Ltd. v. Bernard Sunley & Sons Ltd. 22 B.L.R. 1 at pp. 29-39, per Cumming-Bruce L.J.). In this regard the act or omission of which complaint is made by the Respondent Banks in the present case, namely, carelessness in the handling of the Appellants' bank accounts or in the checking of their bank statements, is properly to be regarded as an act or omission in the performance of the contract itself and not, as Cons J.A. suggested, conduct which might not have occurred but for the existence of the contract but was otherwise independent of it.

16. It is further submitted that the Court of Appeal erred in holding that the test of the existence of a duty of care adumbrated by Lord Wilberforce in the Anns case was satisfied on the facts of the present case.

P. 627 lines 30-31; P. 650 lines 28-39

17. As to the first question posed in the test, both Cons J.A. and Hunter J. concluded that an affirmative answer should be given, notwithstanding the fact that the damage was caused by the independent and criminal act of a third party for whose conduct no liability in general attaches to another person. As was observed in the judgments in the Court of Appeal, the effect of the decisions the House of Lords in Dorset Yacht Co. Ltd. v. Home Office [1970] A.C. 1004, and of the Court of Appeal in Lamb v. Camden London Borough Council [1981] Q.B. 625 and Perl (P.) (Exporters) Ltd. v. Camden London Borough Council [1984] Q.B. 342 is that liability for the acts of a third party may, as an

P. 625 lines 11-24; P. 643-4 lines 25-3

exception to the general rule, be imposed on a defendant in a case where there exists a special relationship between the defendant and the third party such as to impose a duty on the defendant to exercise control over the third party and there exists a high degree of forseeability that damage would be caused by the third party as a result of the act or omission of the defendant.

RECORD

18. It is submitted that the Court of Appeal erred in holding (per Cons. J.A. and per Hunter J.) that, on the facts of the present case, there existed such a "special relationship" and a high degree of forseeability that damage would occur, for the following reasons:

pp. 625-6 lines 25-22
pp. 643-4 lines 33-3

(1) The relationship between the Appellant Company and its accounts clerk was not such as to impose a duty on the Company to exercise "control" as that concept has been explained and developed in the cases referred to above: the relationship between an employer and his employee is of a wholly different character from that between a parent and child or prisoner and prison officer in which context the concept of control was discussed and explained in the Dorset Yacht case.

(2) There is no principle of law which would require the Appellants to be on their guard against acts of dishonesty when there are no grounds for suspicion (London Joint Stock Bank v. Macmillan and Arthur [1918] A.C. 777 at pp. 815-816, per Lord Haldane; Lewes Sanitary Laundry Co. v. Barclay Bevan & Co. (1906) 11 Com. Cas. 255, at pp. 267-269, per Kennedy J.; Pringle of Scotland Ltd. v. Continental Express Ltd. [1962] 2 Lloyd's Rep. 80 at p. 87). The fact that the Appellants' internal accounting system was inadequate to prevent or detect fraud did not, in the submission of

RECORD

the Appellants, give rise to a high degree of foreseeability that an accounts clerk (whose honesty the Appellants had no reason to doubt) would commit forgery. In this regard, contrary to the view expressed by Cons J.A., it is submitted that the position is not comparable to that which existed in the Macmillan case in which the alteration of validly signed cheques which were entrusted to a clerk was held to be the "very natural consequence" of drawing the cheques in such a way as to enable them to be easily altered.

P. 626 lines 9-22

19. As to the second question posed in Lord Wilberforce's formulation of the test, the Court of Appeal concluded (per Cons J.A. and per Hunter J.) that there were no considerations which served to negative or to reduce or limit the scope of the general duty of care in tort which was found to be owed by a customer to his bank in the operation of his account. It is submitted that this conclusion was erroneous and that, for the following reasons the scope of the duty owed in tort should, in any event, be confined to a duty to take reasonable care in the drawing of cheques and should not be extended so as to impose a wider duty of care on a bank's customer in relation to the handling of his accounts:-

P. 627 lines 30-34; pp. 658-9 lines 42-10

(1) As submitted in paragraph 15 above, there is no justification in principle for extending a general tortious duty of care to parties to a contract when the contract itself, which governs the relationship between the parties, does not by its express terms or by necessary implication impose such a general duty.

(2) There is an unbroken line of English and Commonwealth authority over a period of 70 years against the imposition of such a general duty of

care. Contrary to the conclusion of Hunter J. it is respectfully submitted that the recent English authorities do not support the imposition of such a general duty on a Bank's customer and that the United States and Canadian authorities to which reference is made in the Judgments in the Court of Appeal provide only limited and qualified support for the imposition of such a general duty.

RECORD
pp. 658-9
lines 43-2

10

(3) There is similarly an unbroken line of English authority over the same period against the imposition of the narrower duty of care. Support for such a duty in North America is limited to cases where the paid items are returned, or made available to the customer.

20

(4) As was pointed out by the Court of Appeal of New Zealand in National Bank of New Zealand v.Walpole and Patterson [1975] 2 NZLR 7 (at pp. 18-19, per Richmond J. and at p. 22, per Woodhouse and Macarthur JJ.) Bankers and customers have long conducted their business on the understanding that the risk of forgery falls on the bank in cases such as the present: it is open to banks, if they so desire, to transfer the risk to the customer by means of a verification agreement or by introducing express terms into the contract imposing on the customer the wider or narrower duties contended for by the Respondent Banks. In the absence of such express terms, it is submitted that there is no proper basis for extending the established scope of the duty of care owed by a customer to his bank so as to defeat the customer's settled cause of action against the bank.

30

40

(5) Since banks and customers have consistently

50

conducted their affairs on the footing that the risk of forgeries should, in the absence of express provision to the contrary in the contract, fall on the bank, it is submitted that such a major alteration in the banking relationship as that contended for by the Respondent Banks should be a matter for legislation. In this connection, it is noted that in the United States, such legislative intervention was required: the duties of a bank's customer are now regulated by the Uniform Commercial Code which was itself required to replace varying statutes in 40 different jurisdictions imposing and defining the duties of care of a customer.

(2) Banks' Rules

20. In the proceedings before Mantell J. and in the Court of Appeal the relevant Rules were relied on by the Respondent Banks in two respects: first, as excluding the liability of the Bank to the Appellants for paying on the forged cheques and secondly, as giving rise to an account stated or settled as between the Bank and its customer.

21. It is submitted that none of the Rules was sufficient on its true construction to exclude the liability of the Banks or to give rise to an account stated or settled for the following reasons:

(i) The relevant provisions of the Rules of each of the Respondent Banks are properly to be treated as exclusion clauses in that, if effective, they would relieve the Banks of what would otherwise be their liability. Accordingly the Rules should be construed contra proferentem and must be clearly and unambiguously expressed if they are to be effective to exclude the liability of the Banks for

paying on forged cheques.

RECORD

ii) None of the Rules was sufficiently clearly or explicitly expressed to bring home to the customer an intention on the part of the relevant Bank to exclude liability not merely for arithmetical errors which were not corrected by the customer but for any items debited in the payment of forged cheques. The Appellants respectfully submit that the approach to the interpretation of the Rules taken by Mantell J. and by Hunter J. with whose approach and conclusion Fuad J.A. agreed, was correct. In contrast to the Canadian authorities on which reliance was placed by the Respondents (Arrow Transfer Co. Ltd. v. Royal Bank of Canada (1971) 27 D.L.R. (3d) 81; and Syndicat des Camionneurs Artisans du Quebec Metropolitain v. Banque Provinciale de Canada (1968) 11 D.L.R. (3d 610), the relevant provisions of the Rules did not clearly exclude the liability of the Banks in respect of the debiting of the customer's account with the amount of a forged cheque: in none of the terms or rules were forgery or fraud expressed to be risks of the customer; each of the terms or rules had subject-matter without reference to fraud or forgery; and none of the terms or rules referred to the account becoming "conclusive evidence" as against either or both parties.

pp. 585-90; P.659 P.638 lines 33-36

(iii) Even if, contrary to the contention of the Respondents, Cons. J.A. was correct in holding that the relevant provisions of the Rules did not constitute an exclusion clause but rather a clause of limitation and that the approach to interpretation suggested in Ailsa Craig Fishing Co. Ltd. v. Malvern Fishing Co. Ltd. [1983] 1 W.L.R.

RECORD

P. 633-4 lines 1-11

964 should accordingly be followed, it is submitted that the words used in the Rules were not sufficiently clear or unambiguous to exclude the liability of the Respondent Banks for paying on forged cheques or to render the Banks' statements "conclusive evidence" of the state of the account between the parties.

10

P. 658 lines 18-38

(iv) It is further submitted that, for the reasons given by Hunter J., the omission of the Appellants to notify the Respondent Banks of any "errors" in the Bank statements in accordance with the relevant provisions of the Rules, could not and did not give rise to an account stated or to an account settled between the parties so as to preclude the Appellants from claiming that the amounts debited in respect of forged cheques were incorrectly debited.

20

(3) Estoppel

22. Before Mantell J. and in the Court of Appeal two grounds were relied on by the Respondents for contending that the Appellants were estopped from asserting the forgeries against the Banks: (i) it was contended that the Appellants were estopped from asserting that their account had been wrongly debited by reason of their own negligence; and (ii) it was alleged that the Appellants were estopped from so asserting by reason of their representation that the bank statements were correct. These "representations" were alleged to consist, in the case of CFB, in the return of the confirmation slips by the Appellants, and in the case of LCH and BOT, in the Appellants' failure to object to the statements within the period provided in the Rules. In addition, it was argued by the Respondent Banks that the Company's requests to the Banks for confirmation of the balance in the account for audit purposes were similarly representations giving rise to an estoppel.

30

40

50

(i) Estoppel by negligence

RECORD

23. In the Court of Appeal Cons J. A. found that "the matters already mentioned" by him in his judgment were clearly grounds on which the Banks could base an estoppel by negligence and that the Respondent Banks had acted to their detriment by continuing to operate the accounts with the attendant risk of further forgeries. Hunter J. held that, upon his conclusion on duty and the findings of Mantell J., an estoppel arose in favour of all the Respondent Banks.

P. 634 lines 29-32

P. 659 lines 38-39

24. It is respectfully submitted that the Court of Appeal erred in holding that the Appellants were estopped by reason of their negligence from asserting the forgeries against the Respondent Banks, for the following reasons:

(1) Estoppel by negligence requires the existence of a duty of care and, for the reasons set out in paragraphs 5-19 above, no such duty was owed by the Appellants to any of the Respondent Banks.

(2) Even if it were established that the Appellants were in breach of a duty of care owed to the Respondents, this fact would not, of itself, give rise to an estoppel. The neglect of a legal duty gives rise to a cause of action but cannot as such operate as an estoppel. Such a breach of duty can only have an effect as an estoppel if it induces in the mind of the person to whom this duty is owed a belief in the existence or non-existence of some state of affairs, in which belief he adopts a course of action, to his detriment, which he would not otherwise have adopted: "In other words, it is not the negligence, per se, which estops, but only the representation implied from it." (Spencer Bower and Turner: Estoppel by Representation, 3rd Edn., pp. 72-73). It is

RECORD

pp 592-3 lines 35-2

submitted that Mantell J. correctly concluded that the failure to operate an effecient internal control system, even if stigmatised as negligent, could not give rise to an estoppel since there was no implied representation to the Respondent Banks on which they could be said to have relied to their detriment.

(ii) Estoppel by representation

25. It is implicit in the judgments of the Court of Appeal that neither Cons J.A. nor Hunter J. would have concluded that the Appellants were estopped from asserting the forgeries against the First or Second Respondents (LCH and BOT) by reason of representations made to the Banks concerning the state of the Appellants' accounts. It is submitted that this conclusion is correct since

P. 635 lines 19-38; P. 659 lines 39-42

(1) the Appellants' failure to confirm the balances shown in the statements or to object to items contained in the statements did not, in the submission of the Appellants, amount to a clear or sufficient representation to give rise to an estoppel;

(2) even if such failures could be said to constitute representations of fact, they could not amount to representations that there were no erroneous debits in respect of forged cheques: if, as the Appellants contend and the majority of the Court of Appeal found, the relevant provisions of the Banks' Rules did not on their proper construction relate to the erroneous debiting of forged cheques, there exists no basis for treating the failure of the Appellants to object to the statements as amounting to a representation that the statements contained no such debits.

RECORD

26. As to the Third Respondents, CFB, it is submitted that the Court of Appeal erred in holding (per Cons J.A. and per Hunter J.) that the Appellants were estopped by reason of the representations contained in the account confirmation slips: for the reasons set out in paragraph 25 (2) above the return of the confirmation slips did not constitute a representation that the statements contained no debits in respect of forged cheques.

P. 635 lines 30-32; P. 659 lines 39-41

10

(iii) Audit requests

27. In the submission of the Appellants, the Court of Appeal were correct in unanimously rejecting the defences of estoppel based on the annual audit requests. The audit requests did not on their true interpretation amount to representations to the Respondents at all, still less to representations on which the Banks were intended to rely or could reasonably have relied. Even if the audit requests could be so construed, it is submitted that Cons J.A. was clearly correct in holding that no detriment resulted to the Respondents from merely checking the balance and returning the certificate in accordance with the requests.

pp. 634-5 lines 35-17; P. 659 lines 41-42

20

30

(4) Standard of proof

28. In determining whether forgery of the cheques drawn on BOT and CFB had been proved, Mantell J. said that he had

> " .....sought to apply the civil standard as defined in Khawaja's case bearing in mind at all times the aphorism of Lord Denning in Blyth v. Blyth [1966] A.C. 643 at p. 669: "In proportion as the offence is grave, so ought the proof to be clear ....."

40

29. It was the contention of BOT and CFB before Mantell J. and in the Court of Appeal that the strict criminal standard of proof should be applied to allegations of forgery even where

P. 569 lines 17-21

50

RECORD

such allegations arose in civil proceedings. In support of this contention reliance was placed on dicta in two decisions of the Privy Council, namely, The People of the State of New York v. The Heirs of John M. Phillips [1939] 3 All E.R. 952, 954 F-G and Narayan Chettyar v. Official Assignee 28 A.I.R. 1941 P.C. 593.

30. It is submitted that the Court of Appeal were correct in rejecting the Respondents' contention and in unanimously approving the approach of Mantell J. (per Cons J.A. and per Hunter J.) for the following reasons:

pp. 635-7 lines 40-13; P. 660 lines 1-14

(i) As was noted by Cons J.A. the dicta in the two Privy Council decisions are irreconcilable with the modern approach reflected in the decision of the House of Lords in Reg. v. Home Secretary, ex parte Khawaja [1984] A.C. 74, 112C - 114C per Lord Scarman which approved the more flexible application of the civil standard of proof adopted by the Court of Appeal in Hornal v. Neuberger Products Ltd. [1957] 1 Q.B. 247 and Bater v. Bater [1951] P. 35.

(ii) The insistence on proof to a criminal standard would in any event have been inappropriate in a case such as the present in which it was common ground that Leung was dishonest and had forged cheques and where the issue was not whether cheques were forged by Leung but which of many cheques were forgeries.

31. It is further submitted that the Court of Appeal were correct

(a) in rejecting the Respondents' further complaint that Mantell J. had erred in failing to indicate the exact standard of proof, between the extremes of

"balance of probabilities" and "beyond reasonable doubt", which he thought would be appropriate in the particular circumstances (per Cons J.A.); RECORD P. 637 lines 14-20

(b) in holding that, on the evidence, there were no grounds for challenging the findings of Mantell J. or for contending that he had misapprehended or failed to evaluate correctly the evidence of the handwriting experts (per Cons J.A. and per Hunter J.). P. 637 lines 21-26 P. 660 lines 12-14

(5) Interest

32. Before Mantell J. and in the Court of Appeal the Respondent Banks objected to any award of interest on three grounds:

(i) that, since the claim was for a declaration there was no jurisdiction to award interest;

(ii) that the Appellants had no right to payment of the monies in the accounts until demand for payment had been made;

(iii) that interest was not recoverable because the accounts were all non-interest bearing current accounts.

33. It is submitted that the Court of Appeal were correct in rejecting each of these arguments and in holding that interest could properly be awarded on the sums claimed for the following reasons: pp. 637-8 lines 23-24 P. 660 lines 16-17

(i) the Appellants' claim was not merely a claim for a declaration but included a claim for payment of the sums wrongly debited in respect of the forged cheques; P. 11

RECORD

(ii) the issue of the Writ itself constituted a sufficient demand for payment (see Joachimson v. Swiss Bank Corporation [1921] 3 K.B. 110) and the Appellants only claimed interest from the date of the Writ;

(iii) by being deprived of the monies wrongfully debited to its accounts, the Appellant Company lost the opportunity of placing these monies at interest and this was sufficient to justify an award of interest to compensate the Company for this loss.

CONCLUSION

34. In the premises, the Appellants respectfully submit that the decision and Order of the Court of Appeal were wrong and ought to be reversed and that this Appeal ought to be allowed with costs in the Privy Council and in the Courts below and that it should be ordered that the Respondent Banks pay to the Appellants the amounts of the cheques found to have been forged (paragraph 3 (4) above) with interest thereon calculated from the date of the Writ, for the following among other

REASONS

(1) BECAUSE the Court of Appeal erred in holding that a general duty of care in the operation of their account was owed in contract or tort by the Appellants to the Respondent Banks;

(2) BECAUSE the Court of Appeal erred in holding that the Appellants were estopped by reason of their negligence from asserting against the Respondent Banks that their accounts had been

wrongly debited with the amount of the forged cheques;

(3) BECAUSE the Court of Appeal erred in holding that the Appellants were estopped from so asserting against the Third Respondents, CFB, by reason of representations contained in the account confirmation slips which were returned by the Appellants to CFB.

(4) BECAUSE the Appellants were not precluded by the Rules of any of the Respondent Banks from claiming from the Respondents any amounts wrongly debited in respect of forged cheques;

(5) BECAUSE the findings of Mantell J. with regard to which cheques were forged were right and were arrived at by the application of the correct standard of proof;

(6) BECAUSE the Appellants were entitled to be awarded interest on such amounts as were found to have been wrongly debited to their account with the Respondent Banks.

F.P. NEILL

NICOLAS BRATZA

ROBERT TANG

No. 41 of 1984

IN THE PRIVY COUNCIL

ON APPEAL

FROM THE COURT OF APPEAL OF HONG KONG

BETWEEN:–

TAI HING COTTON MILL LIMITED
Appellants
(Plaintiffs)

– and –

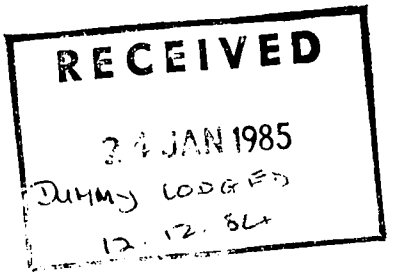
LIU CHONG HING BANK LIMITED
First Respondents
(Defendants)

– and –

THE BANK OF TOYKO LIMITED
Second Respondents
(Defendants)

– and –

CHEKIANG FIRST BANK LIMITED
Third Respondents
(Defendants)



CASE FOR THE APPELLANTS

KINGSFORD DORMAN
14 Old Square
Lincoln's Inn
LONDON WC2A 3UB

Tel: 01 242 6784
Ref: DLW

Solicitors for the Appellants