

O N A P P E A L
FROM THE COURT OF APPEAL OF HONG KONG

B E T W E E N :

TAI HING COTTON MILL LIMITED Appellant

- and -

LIU CHONG HING BANK LIMITED First Respondent

THE BANK OF TOKYO LIMITED Second Respondent

CHEKIANG FIRST BANK LIMITED Third Respondent

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CASE FOR THE THIRD RESPONDENT

RECORD

The Facts

1. The circumstances of this appeal and the facts common to all the Respondents are contained in paragraphs 1 to 23 of the Case for the First Respondent. The Third Respondent, Chekiang, adopts paragraphs 1 to 23 inclusive of the First Respondent's Case so far as they affect Chekiang and adopts the definitions contained therein.

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2. As regards the inadequacy of Tai Hing's system of internal control referred to in paragraphs 19 and 20 of the First Respondent's Case, Chekiang relies particularly on the following facts which were either admitted or found by the Judge :-

(a) Chen signed cheques without striking out "or bearer" with the consequent risk of abuse. This was not an isolated occurrence as is evidenced by the fact that

p.157 11.27-31
p.370 11-9-15

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(i) 34 out of 37 cheques listed in Part D

p.25 1.39 -
p.33 1.30

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- p.160 11.12-34 (ii) 70 out of 85 cheques listed in Part E; and
- p.161 11.7-13 (iii) 62 out of 70 cheques listed in Part F
- of the Amended Particulars of Tai Hing's Second Further Re-Amended Statement of Claim, being genuine cheques drawn by Tai Hing and converted by Leung to his own use, were bearer cheques.
- p.370 11.2-33 (b) No receipt was required from the suppliers 10 to whom bearer cheques were delivered through Leung.
- p.201 11.1-19 (c) Leung had easy access to the cheque books of Tai Hing and no record was kept of when he took them.
- p.351 11.21-38
- p.134 11.32-35 (d) Leung was permitted to present cheques for signature by Tai Hing signatories after they had been detached from their counter-foils.
- p.201 11.17-31
- p.201 11.32-34 (e) Cheque counterfoils were not usually completed. 20
- p.202 1.9- (f) No inspection of cheque counterfoils was made prior to May 1978.
- p.204 1.7
- p.283 11.4-9
- p.574 11.44-46 (g) Cheques were not necessarily drawn in serial number order or even taken from one cheque book at a time.
- p.310 11.2-5
- p.199 1.36- (h) Chen did not inquire why cheques were drawn out of order or from different cheque books.
- p.200 1.14
- p.350 1.30-
- p.351 1.17
- p.193 1.11 - (i) It was not the practice of Tai Hing to compare Bank statements with its official journal. 30
- p.194 1.3
- p.235 1.23 - (j) It was not the practice of Tai Hing to check its ledger entries against the documents.
- p.236 1.9
- p.574 11.1-5 (k) Tai Hing failed to notice that approximately 500 fraudulent cheques, of which 300 were forged, with a total face value of approximately H.K.\$7,000,000, were passed through its accounts with the 40

Respondents.

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3. The special facts relevant to the Third Respondent (which were either undisputed or were found by the Judge) can be very shortly summarised as follows :-

- (1) Tai Hing opened the relevant account with Chekiang in September 1957. p.570 11.28-29
- 10 (2) The Chekiang account was used by the garments division of Tai Hing in the early 1970s and, after that division closed down in 1976, became the General Office bank account. p.94 1.6 -
p.95 1.8
p.360 11.14-18
- (3) The request for the opening of the account was signed by Chen. p.570 11.30-31
Pt.II p.159
- (4) By such request Tai Hing (inter alia) p.570 11.32-34
- 20 (a) required Chekiang to debit the account with "all checks or orders drawn thereon provided such checks or orders are signed in accordance with the specimen signature or seal" and Pt.II p.159
- (b) agreed to comply with Chekiang's "Rules and procedures" in force from time to time governing the conduct of such account.
- (5) At the date of the said request and at all material times thereafter Rule 7 of Chekiang's Rules provided as follows :- p.556 1.23-
p.557 1.32
- 30 "7. 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. Except for the months of June and December no monthly statement for an account will be sent if there is no entry passing through it in the month". p.570 1.30-
p.571 1.8
Pt.II pp.165
and 167
- 40 (6) Chen was aware of the Rules when he opened the account. p.570 11.44-45

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p.571 11.9-12
p.360 1.22-
p.361 1.4

(7) A monthly statement of Tai Hing's account was regularly sent to Tai Hing in accordance with Rule 7 during the period of some 20 years from the date of the opening of the account (27th September 1957) to the date of the last cheque to which this appeal relates (28th January 1978).

Pt.II pp.192-312

(8) Each of the monthly statements relevant to this appeal bore the following printed statement "If no errors or omissions are reported within 10 days this statement of the account will be considered as correct". 10

(9) Throughout the said period of 20 years it was the procedure of Chekiang to send with the monthly statement a printed acknowledgment form worded as follows :-

"Kindly sign and return this certificate"

p.360 1.22-
p.361 1.4
p.558 11.10-21
p.571 11.9-12

"I/We acknowledge receipt of your monthly statement of my/our current account with you showing the following balance which has been examined and found correct 20

Pt.II pp.169-182

A/C No..... ending.....balance \$
.....H.K.Currency
To: Chekiang First Bank Ltd.
Hong Kong

.....
Signature to be in conformity with specimen signature deposited. " 30

p.360 1.22-
p.363 1.9
p.571 11.9-12

(10) Throughout the said period of 20 years Tai Hing regularly returned the acknowledgment form signed by two authorised cheque signatories.

p.365 1.25-
p.367 1.6
p.571 11.12-14
p.634 1.34-
p.635 1.3
Pt.II pp.183-191

(11) In addition, in each year before audit (and in particular on the 12th August 1975, 19th August 1976 and 24th August 1977) Tai Hing requested Chekiang to certify that the balances stated in the relevant request were in accordance with Chekiang's records, as at the 31st March of the relevant year. Chekiang complied with, in particular, the 1975, 1976 and 1977 requests. 40

(12) Between the 4th March 1974 and the 30th December 1975 Leung and/or his wife converted to their own use 85 genuine cheques drawn by Tai Hing on Chekiang and having a face value of H.K.\$593,500.35. The debits in respect of the said cheques were shown in the relevant monthly statements of account.

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p.9 11.18-33
p.27 1.16-
p.30 1.44
p.571 11.44-47
p.572 11.10-11

10 (13) The Judge found that between the 30th November 1974 and the 28th January 1978 Leung forged the signature of Chen on 132 cheques drawn on Chekiang. This finding was upheld in the Court of Appeal and is not disputed in the present appeal. Again the debits in respect of the forged cheques were shown in the monthly statements of account.

p.572 1.31-
p.573 1.40
p.637 11.21-26
p.660 11.12-14
Pt.II pp.192-312

20 (14) Despite the fact that throughout the periods mentioned in (12) and (13) above (amounting together to nearly four years) Tai Hing had received monthly statements from Chekiang and, in acknowledging those statements, had indicated that they had "been examined and found correct", Tai Hing did not draw the attention of Chekiang to any of the cheques mentioned in (12) and (13) above until May 1978.

p.572 1.7

Issues

30 4. The issues in the Third Respondent's appeal are the same, mutatis mutandis, as those in the First Respondent's appeal that is to say :-

(A) whether the terms of the banking contract made between Tai Hing and Chekiang provide a complete defence to Chekiang;

40 (B) whether the wider or narrower duty referred to in the Case of the First Respondent should be implied into the contract between Tai Hing and Chekiang;

(C) whether Tai Hing owed to Chekiang the wider or narrower duty in tort;

(D) whether Tai Hing is estopped by its negligence and/or its representations from asserting that its account has been wrongly debited with the amounts of

the forged cheques.

Issue (A) (the terms of the banking contract)

- (1934) 50 T.L.R.
465 pp.468-469
P.C
p.629 11.32-35
5. As a matter of law "there can be a settled or stated account between banker and customer: what has been questioned is whether the acceptance by the customer without protest of a balance struck in the pass book constitutes a settled account, but the question has had reference merely to the issue whether such a settlement can be inferred as a matter of fact from the passing backward and forward of the pass-book. The legal competence of such a settlement, if made, is not questioned": per Lord Wright in Firm Bishun Chand v. Seth Girdhari Lal and Another. Chekiang submits that, contrary to the custom in England and of some of the major banks in Hong Kong, the banking contract between Tai Hing and Chekiang expressly provided for a settled account by virtue of Rule 7 of the Rules governing the account, so that the issue whether "such a settlement can be inferred as a matter of fact" does not arise in this case and the authorities in which that issue arose are not directly relevant. This submission is enlarged below. 10 20
- p.570 11.44-45
p.587 11.17-19
p.630 11.15-19
p.638 11.33-36
p.659 11.14-15
6. The Judge found that Tai Hing was aware of the Rules of Chekiang when it opened its account and that they were "intended to govern a commercial relationship" between Tai Hing and Chekiang. The Court of Appeal unanimously affirmed that, taking into account the commercial nature of the relationship between the parties, Tai Hing was bound by the Rules so far as they could be given contractual effect. Chekiang submits that the decisions of the Judge and the Court of Appeal were plainly correct on this point and should be upheld. 30 40
7. For the purpose of construing the banking contract between Tai Hing and Chekiang, the Rules should be read in the context of the banking procedure operated by Chekiang (and accepted and implemented by Tai Hing over a period of 20 years) whereby monthly statements setting out the relevant words of Rule 7 were sent to the customer together with an acknowledgment 50

form to be signed and returned by the customer confirming that the balance shown had "been examined and found correct". Read in this context, it is clear that the purpose of Rule 7 was to give commercial efficacy to Chekiang's procedure of submitting monthly accounts and having them verified, by entitling Chekiang to treat each monthly statement as constituting a settled account and as conclusive evidence of the state of the account, if no "error" therein was notified by the customer within 10 days. Further, Cons V-P was right in holding -

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(a) that Rule 7 should be interpreted as it would "be read by an ordinary person looking for no subtle distinctions, seeking no refined shades of meaning"; p.634 11.19-23

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(b) that "errors" in Rule 7 should accordingly be construed as meaning "anything wrong, whatever happened to be the cause"; and

(c) that "correct" in Rule 7 (and, as Chekiang submits, in the form of acknowledgment) should not be construed as "correct but not conclusive".

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8. Accordingly the Judge was wrong in holding that Rule 7 provided no defence to Tai Hing's claim. In particular the Judge was wrong insofar as he based that decision on the grounds - p.590 11.26-27

(a) that no express reference was made to "fraud or forgery" in Rule 7; p.590 11.19-27

(b) that the word "correct" rather than the words "conclusive evidence" were used in Rule 7; and

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(c) that no reference was made in Rule 7 to the items to be included in the monthly account.

As regards (a) above, the word "error" does (as Cons V-P held) in its ordinary and natural meaning, and in the context of a verified statement of account, include an error arising out of forgery or fraud, and any attempt to particularise the cause of "error" in Rule 7 would not only have

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been unnecessary, but might have had the effect of introducing an unintended restriction on the natural meaning of the word. As regards (b) above, the words "deemed to be correct" cannot be naturally construed otherwise than as referring to "conclusive evidence" in the context of a commercial agreement having contractual force (it being the unanimous view of the Judge and the Court of Appeal that the Rules had such force). As regards (c) above, the essential contents of a monthly bank statement in respect of a current account are well established by convention and, in the case of Chekiang, there was an established procedure in relation to monthly statements which Tai Hing accepted and implemented over a period of 20 years. 10

9. Generally, in reaching the conclusion that Rule 7 did not provide a defence to Tai Hing's claim against Chekiang the Judge - 20

(1980) A.C.827
(1983) 1 W.L.R. 964
(1983) 2 A.C.803

(1) gave undue weight to the principle that the Rule should be construed contra proferentem, particularly having regard to recent decisions on the construction of similar contractual provisions (see Photo Production Ltd. v. Securicor Transport Ltd., Ailsa Craig Fishing Co.Ltd. v. Malvern Fishing Co.Ltd. and Another and George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd.); 30

(2) gave insufficient weight -

(a) to the existence of the formal procedure operated by Chekiang and its customers for the monthly verification of accounts by the customer;

(b) to the fact that, whereas the customer would be in a position to detect fraud or forgery in the course of such verification, Chekiang would be unlikely to be in that position; 40

(c) to the fact that Chekiang was in a position of disproportionate risk by comparison with its customer, since Chekiang was

obliged to pay out on all cheques apparently signed in accordance with the customer's mandate;

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(d) to the fact that the customer, unlike Chekiang, was in a position to guard against fraud or forgery in the issue of its cheques;

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(e) to the fact that the customer, if it found the verification procedure onerous, could at any time terminate its banking arrangements with Chekiang;

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(f) to the fact that, under modern conditions, a bank has been held to have extensive duties to its customers (as e.g. in Selangor United Rubber Estates Ltd. v. Cradock and Karak Rubber Co. Ltd. v. Burden) which render it reasonable and necessary that the customer should accept the principle of a settled account after verification;

(1968) 1
W.L.R. 1555
(1972) 1
W.L.R. 602

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(g) to the fact that the customer would be entitled to re-open the account if there were circumstances which made it inequitable for Chekiang to rely on the settled account (Re Webb and Camillo Tank Steamship Company Ltd. v. Alexandria Engineering Works).

(1894) 1 Ch.71
p.84
(1921) 38
T.L.R. 134
pp.137 and
145

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10. For similar reasons Hunter J. was wrong in deciding (and Fuad J.A. in agreeing) that, although Rule 7 had contractual effect, the procedure for acknowledgment of monthly statements as having "been examined and found correct" did not constitute conclusive evidence of the state of the account. In particular Chekiang submits that the printing of the relevant words of Rule 7 on the statements of account and the form of the acknowledgment were, in the words of Hunter J., sufficient "to bring home to the customer the intended importance of the inspection" he was being invited to make and its conclusiveness.

p.659 11.14-15

p.659 11.15-19

11. The Third Defendant accordingly submits that Rule 7 coupled with the acknowledgments of monthly statements afford a complete defence against Tai Hing's claim as giving rise to a settled account which cannot be

're-opened in the absence of circumstances which would make it inequitable for Chekiang to rely on the settled account (Re Webb and Camillo Tank Steamship Company Ltd. v. Alexandria Engineering Works, supra). Alternatively, the monthly statements having been acknowledged to have been "examined" and to be "correct", and in the absence of any such circumstances as aforesaid, constitute under Rule 7 conclusive evidence of the state of the account between Chekiang and Tai Hing so as to afford a complete defence as aforesaid. No circumstances such as are mentioned above have been found or alleged. 10

Issue (B) (implication of the wider or narrower duty into the contract)

12. In relation to this issue the Third Respondent adopts, mutatis mutandis, the submissions of the First Defendant set out in paragraphs 29 to 39 and 49 to 53 inclusive of the First Respondent's case. 20

13. The Third Respondent further submits that, in relation to Chekiang, the established procedure for obtaining regular confirmation that monthly statements had been "examined and found correct" renders the implication of at least the narrower duty absolutely unavoidable. In the absence of at least the narrower duty, this procedure (which was clearly intended to give effect to Rule 7) would, as indicated by Cons V-P, have been "futile, inefficacious and absurd" (per Lord Salmon in Liverpool City Council v. Irwin). 30

p.622 11.20-40
(1977) A.C.239
at p.263

Issue (C) (the wider or narrower duty in tort)

14. In relation to this issue the Third Respondent adopts, mutatis mutandis, the submissions of the First Respondent set out in paragraphs 40 to 53 inclusive of the First Respondent's case. 40

15. The Third Respondent further submits that, in relation to Chekiang, the established procedure obtaining between Chekiang and Tai Hing for obtaining regular confirmation that monthly statements had been "examined and found correct" constitute a situation in which a duty of care can readily be established under the principles

discussed by Lord Wilberforce in Anns v. Merton London Borough Council. First, the established procedure mentioned above clearly indicates a relationship of proximity or neighbourhood between Tai Hing and Chekiang (by creating the machinery for the discharge of a mutual responsibility for the proper conduct of the account) such that it must have been in the reasonable contemplation of Tai Hing that carelessness on its part might be likely to cause damage to Chekiang, so as to give rise to a duty of care. Secondly, the existence of this procedure (and its acceptance and implementation by Tai Hing over a period of 20 years) leaves no reasonable scope for limiting the extent of this duty of care to anything less than the narrower duty.

20 Issue (D) (Estoppel)

16. If Tai Hing owed to Chekiang the wider or the narrower duty of care then, as the Judge found on the facts, Tai Hing was in breach of such duty and is thereby estopped from asserting that its account was wrongly debited with the amounts of the forged cheques. All three members of the Court of Appeal held (and were correct in holding) that such breach of duty constituted grounds on which Chekiang could base an estoppel so as to defeat Tai Hing's claim.

p.577 11.7-8
p.584 11.13-16
p.634 11.29-32
p.638 11.30-36
p.659 11.38-39

17. Even if Tai Hing did not owe any duty to Chekiang, by signing the acknowledgment forms in respect of the monthly statements Tai Hing represented in the plainest possible terms that the balance shown on the statements had been "examined" and found "correct". Since Rule 7 of Chekiang's Rules expressly provided for the monthly statements to be deemed by Chekiang to be correct if no error was notified within 10 days and since the monthly statements themselves contained the relevant words from Rule 7, Tai Hing must have contemplated and intended that Chekiang should act upon the representations made by Tai Hing in the acknowledgment forms. Further it is an inescapable inference that Chekiang in fact acted in reliance on Tai Hing's acknowledgments, since -

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(a) Chekiang had (by Rule 7) made it a term of its contract with Tai Hing that it should be entitled to deem a monthly statement to be correct if no error was notified within 10 days;

(b) if Tai Hing had failed or refused to sign and return an acknowledgment, Chekiang would immediately have been put on notice of the possibility of error; and

(c) having no notice of such possible error, Chekiang in fact continued to operate the account without further enquiry of Tai Hing.

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18. In continuing to operate the account without further enquiry of Tai Hing Chekiang acted to its detriment, in that it was thereby deprived of the opportunity to uncover the fraud and forgery of Leung and to take action against him before it was too late. Accordingly Tai Hing is estopped from asserting that its account was wrongly debited with the amounts of the forged cheques.

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19. The annual requests by Tai Hing that Chekiang should certify the balances stated in those requests for the purposes of Tai Hing's audit constituted a further representation by Tai Hing that Tai Hing accepted the balances as being correct, which representations likewise were intended to be acted upon by Chekiang, and were acted upon by Chekiang to its detriment, so as to give rise to an estoppel.

p.594 1.27 -
p.595 1.8

20. The Judge held that, on the evidence before him and on such inferences from the proven or admitted facts as he thought it right to make the elements necessary to an estoppel had been made out in favour of Chekiang. Similarly Cons V-P held that, by reason of the monthly "confirmations" of statements (but not the annual audit requests), Tai Hing was estopped from going behind Chekiang's monthly statements and that estoppel was a complete answer to Tai Hing's claim against Chekiang. Hunter J. reached the same conclusion as Cons V-P and Fuad J.A. agreed.

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p.635 11.32 and
33.36
p.659 11.39-42
p.638 11.30-36

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21. Chekiang submits that the Judge and all three members of the Court of Appeal were correct in holding that the acknowledgements of the monthly statements gave rise to an estoppel, but that the members of the Court of Appeal were wrong in holding that the annual audit requests did not likewise give rise to an estoppel.

22. Chekiang submits that this appeal should be dismissed with costs for the following reasons among others:-

R E A S O N S

1. BECAUSE, Chekiang's contractual terms in relation to the account provide a complete defence to Chekiang.
- 10 2. BECAUSE, the wider and/or narrower duty should be implied into the contract between Tai Hing and Chekiang.
3. BECAUSE, Tai Hing owed to Chekiang the wider and/or narrower duty.
4. BECAUSE, Tai Hing is estopped by its negligence and/or its representations from asserting that its account has been wrongly debited with the amounts of the forged cheques.
5. BECAUSE, the Judgment of the Judge on estoppel by representation was right.
- 20 6. BECAUSE, the Judgments of the Court of Appeal save in the respects expressly referred to above were right.

PETER HORSFIELD

DOREEN LE PICHON

IN THE PRIVY COUNCIL

ON APPEAL

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- and -

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