SINGULARIS V DAIWA: BANKS BEWARE!

In *Singularis Holdings Ltd (in Official Liquidation) v Daiwa Capital Markets Europe Ltd*, the Court of Appeal considered a bank's duty, commonly known as a Quincecare duty, to protect companies from fraud by authorised officers.

KEY POINTS

→ Banks (and other financial institutions) have a duty to protect companies from fraud by authorised officers although the extent of the duty will depend upon the services being provided.

→ An objective test needs to be satisfied as to whether there were reasonable grounds for the bank to believe that the payments were attempts at misappropriation.

→ Fraud by a sole director/shareholder is not automatically attributed to the company, so creditors can be protected in an insolvency situation.

INTRODUCTION

The Court of Appeal's judgment in Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd [2018] EWCA Civ 84 was handed down on 1 February 2018, upholding the 2017 first instance decision Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd [2017] EWHC 257 (Ch) in which Singularis, a Cayman-registered insolvent company, was awarded judgment against Daiwa for in excess of US$150m in respect of Daiwa's failure to prevent misappropriations out of Singularis' account ordered by its authorised representatives.

The case confirms that claims against banks and other financial institutions are worth pursuing in the right circumstances. These claims can prove to be some of the most viable (and sometimes only) means to recover significant sums into an estate given the deep pockets of financial institutions.

THE PARTIES

Singularis Holdings Ltd ('Singularis') is a company wholly owned by Mr Maan Al-Sanea ('MAS'), a wealthy Saudi Arabian businessman who also owned and controlled a substantial Saudi group of companies, known as the Saad Group ('Saad Group'). The insolvencies of various companies in the Saad Group will be familiar to many readers and have been some of the most significant in the market since their commencement in 2009. Singularis sat separate from the Saad Group but was set up to hold MAS' personal assets. It had a number of directors in addition to MAS, although it is fair to say that in the time period concerned, those other directors exercised little oversight or control over the company.

Daiwa Capital Markets Europe Ltd ('Daiwa') is a London-based subsidiary of the Japanese investment bank and brokerage company. Principally an equity and bond brokerage business, importantly Daiwa was not licensed to and could not operate ordinary bank accounts.

In 2007 Daiwa and Singularis entered into a global master securities lending agreement ('GMSLA') pursuant to which Daiwa financed purchases by Singularis in shares, including significant positions in HSBC, which were then pledged to Daiwa as security for the loan. Singularis was a unique customer to Daiwa in that it was the only significant private company owned by a high net worth individual rather than a financial institution. Given its private ownership, Singularis was closely monitored by the credit risk function within Daiwa. Daiwa was somewhat inexperienced in dealing with HNW clients and its culture promoted significant deference to important customers. The significant credit extended to MAS was a form of 'name lending' based on his status as a billionaire and a member by marriage of the established Algosaibi family in Saudi Arabia. Between 2007 and 2009 Singularis was the single most profitable customer relationship for Daiwa.

THE PAYMENTS

Following numerous financial defaults by the Saad Group, on 31 May 2009, MAS' assets in Saudi Arabia were frozen by the Saudi Arabian Markets Authority ('SAMA'). Daiwa heard about this and alarm bells began to ring that Singularis would also not be able to discharge its liabilities. An email was circulated internally warning certain Daiwa compliance staff to ensure that caution was exercised in processing any payments on the account.

Daiwa proceeded to close out Singularis' share positions with its consent, which left a surplus of some US$200m in the account. This surplus was then syphoned off to companies within the Saad Group in a series of payments in June and July 2009 which the court ultimately held Daiwa should not have processed. The payment requests (all to other entities rather than to Singularis' own main bank account) included a single payment for US$180m to Saad Specialist Hospital, purportedly in part discharge of a debt owed by Singularis to a different Saad Group company. When Daiwa questioned the corporate benefit to Singularis of this transaction, it was provided with two conflicting explanations and supporting documentation for the liability which post-dated the payment request. In spite of this, Daiwa agreed to make this and all of the other payments until Singularis' account was empty.

In August 2009 Singularis was placed into liquidation and Steven Akers, Mark Byers and Hugh Dickson of Grant Thornton were subsequently appointed as liquidators.

A QUINCECARE DUTY

The most interesting part of the case is whether a 'Quincecare' duty was breached by Daiwa. This is a duty owed by a bank to its customers and third parties to protect from fraudulent activity of instructing officers. That is, in circumstances where a bank has reasonable grounds for believing that an instruction to make a payment is an attempt to misappropriate the funds of a corporate customer, that bank has a duty to protect against the fraud and will be liable to its customer in negligence if it does not.

This duty is derived from the principles set out in *Barclays Bank Plc v Quincecare [1992] 4 All ER 363*, a case in which Barclays Bank extended a loan to Quincecare for an amount of £400,000, the vast majority of which was subsequently fraudulently misapplied by the company's chairman. In resisting a claim by the bank for recovery of the loan amount, Quincecare argued that Barclays owed a duty of care to it to observe reasonable skill and care in executing the company's orders and, by allowing the payments, the bank had breached that duty.

On the fundamental questions of whether a bank did in fact owe any duty of care to its corporate customers and when that duty will arise, Steyn J stated that:

'In my judgment the sensible compromise, which strikes a fair balance between competing considerations, is simply to say that a banker must refrain from executing an order if and for as long as the bank 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… And, the external standard of the likely perception of an ordinary prudent banker is the governing one. That in my judgment is not too high a standard.'

The conclusion of Steyn J was cited with approval by the Court of Appeal in *Lipkin Gorman v Karpnale Ltd [1989] 1 WLR 1340*. In that case, the Court found that where a bank manager was aware that a partner in a law firm had a gambling problem, the bank had a duty to protect the firm's bank account from withdrawal of funds by that partner despite his being an authorised signatory on the relevant bank account.

CLAIMS AGAINST DAIWA

The liquidators at first instance argued dishonest assistance in breach of fiduciary duty by Daiwa's employees, and in the alternative breach of duty by Daiwa to exercise reasonable skill and care. No dishonesty was made out and the first limb of the claim failed. In resisting the second limb, Daiwa argued (amongst other things) that:

1. Singularis was for all intents and purposes a 'one man' company and therefore had knowledge of the misappropriation through MAS, meaning that either Daiwa could not protect Singularis from activity which it knew about and/or that the associated Quincecare duty could not arise, or that Singularis was complicit in the fraudulent activity and could not then bring a claim arising from its own illegal activity; and
2. liquidators could not bring a claim for breach of a Quincecare duty as such a duty was limited to the company and did not extend to creditors.

Rose J determined not only that Daiwa had breached its duty but that many of the factors as to why it may be impractical to impose too heavy a duty on a bank, such as the administration of hundreds of bank accounts or thousands of payment instructions received per week, did not apply in this case, and went on to state that:

'*Any reasonable banker would have realised that there were many obvious, even glaring, signs that Mr Al Sanea was perpetrating a fraud on the company when he instructed that the money be paid to other parts of his business operations. He was clearly using the funds for his own purposes and not for the purpose of benefiting Singularis. In making the disputed payments without proper or any inquiry, Daiwa were negligent and are liable to repay the money to Singularis.'*

According to Rose J, 'glaring signs' of MAS' fraud included unusual activity within Singularis' account (such as the unexpected appearance of US$80m in early June 2009), the processing of the relevant payments as compared with previous payments made from this account as well as the fact that that senior management of Daiwa were aware not only of financial problems faced by MAS and the Saad Group but that Singularis was dependent upon them for funding.

On the question of attribution, on the basis that Singularis was not created for the purpose of perpetrating a fraud and that the other directors were not complicit in it, Rose J did not accept that Daiwa could rely on Singularis' alleged own illegality in order to escape liability or that MAS' fraud should be wholly attributed to the company, pointing out that if a bank could escape liability on the basis of knowledge attributed to the defrauding officer (who would necessarily be someone senior), there would effectively be no need for a Quincecare duty at all because there would be a claim for lack of authority. The court did, however, reduce the quantum of damages payable to Singularis on account of Singularis' contributory negligence.

The court also rejected Daiwa's argument that the claim could not be brought on behalf of creditors: the claim was the company's and it was irrelevant what it did with the proceeds.

On appeal, Daiwa sought to re-run the same key arguments as set out above, however Sir Geoffrey Vos, giving the leading judgment, upheld the findings of Rose J and dismissed the appeal on all grounds.

IMPLICATIONS

The Singularis decisions together raise a number of key considerations for banks and liquidators alike.

They serve as a reminder that banks are under a duty to protect against fraud and can be held liable for not doing so in circumstances where they have been put on notice (or should be on notice) of fraudulent activity. The extent of this duty will depend upon the nature and circumstances of the services being performed by the bank and will be less stringent where the bank is responsible for high volumes of payment instructions. Banks need to have effective systems and controls in place to assess client instructions to an appropriate extent in the circumstances, and Daiwa had clearly fallen short on this front.

The decisions also serve as a reminder to liquidators that claims against banks can and do succeed, and should not be considered too difficult to pursue. Such claims can result in recoveries where the money in an estate has disappeared and cannot be recovered elsewhere.

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