TAI HING COTTON MILL LIMITED v. *LIU CHONG HING BANK & ORS: AN EXAMINATION*

A recent advice of the Privy Council[1] has reaffirmed the relationship between banker and customer as defined in *London Joint Stock Bank* v. *Macmillan*,[2] after a decision of the Hong Kong Court of Appeal which had seriously questioned it.[3]

Background

The relationship between banker and customer, and the duty which a customer owes to his banker in the course of their dealings, has been judicially examined at length over a long period of time. In *Young* v. *Grote*,[4] decided in 1827, a wife authorised the cashing of one of her husband's blank cheques which had been filled in by a clerk in their employ. The clerk had left enough space to add the words "three hundred" to the £50/2/3d which had been authorised. It was held that the banker had been misled by "want of proper caution on the part of the customer".[5] The decision was debated in 1851,[6] in 1854[7] and in 1861[8] and cited with approval in many other cases.[9]

The *scope* of the duty was also widely discussed. In *Orr & Barber* v. *Union Bank of Scotland*[10] Lord Cranworth said, "The principle is a sound one, that where the customer's neglect of due caution has caused his banker to make a payment on a forged order, he shall not set up against them the invalidity of a document which he has induced them to act on as genuine". The principle of what amounts to "customer's neglect" was held in a number of cases to be neglect in the actual drawing of the cheque itself.[11] Attempts were made to broaden the principle: in *Lewes Sanitary Steam Laundry Co.* v. *Barclay, Bevan & Co.*[12] cheques had been forged by the customer's employee. The bank raised a defence that the customer had been negligent in employing the rogue, knowing that he had previously

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[1] *Tai Hing Cotton Mill Ltd* v. *Liu Chong Hing Bank* [1985] 3 W.L.R. 333.
[2] [1918] A.C. 777.
[3] *Tai Hing Cotton Mill Ltd* v. *Liu Chong Hing Bank Ltd & Ors* [1984] 1 Lloyds Law Reports, 555.
[4] (1827) 4 Bing. 253.
[5] (1827) 4 Bing. 253, 259.
[6] *Robarts* v. *Tucker* (1851) 16 Q.B.D. 560.
[7] *Barker* v. *Sterne* (1854) 9 Ex. 684.
[8] *Orr & Barber* v. *Union Bank of Scotland* (1861) 1 Macq. 513.
[9] *Macmillan's* case, at 796.
[10] (1861) 1 Macq. 513, 523.
[11] Macmillan, op. cit., per Lord Finlay, L.C. at 789.
[12] 11 Com. Cas. 255.

been convicted of forgery, but this was rejected by Kennedy, J. In *Kepitigalla Rubber Estates Ltd* v. *National Bank of India Ltd*,[13] also a case of cheques forged by an employee, Bray, J. held that it is the duty of the customer of a bank to use reasonable care in the issuing of mandates, but drew a distinction between the act of issuing a mandate and the situation prior to that act. The bank's contention that the customer impliedly agreed to take precautions in the general course of carrying on its business to prevent forgeries by its servants could not be said to be necessary to make the contract between banker and customer effective, nor could it be said to have been in the minds of either the customer or the banker when the contractual relationship was established.[14]

This limited duty was expressed as follows in *Macmillan*:[15] "The duty . . . is to draw the cheques with reasonable care to prevent forgery, and if, owing to the neglect of this duty, forgery takes place, the customer is liable to the bank for the loss". Lord Finlay, L.C. expressly denied any extension of the principle: "Attempts have often been made to extend the principle of *Young* v. *Grote* beyond the case of negligence in the immediate transaction, but they have always failed".[16]

The duty which a customer owes to his banker was further defined in *Greenwood* v. *Martins Bank*:[17] a customer may be estopped from denying that a signature is his if he is aware of the forgery but makes no attempt to inform the bank. In this case a husband was aware of his wife's forgeries of his signature but did not notify the bank until after her suicide, thereby preventing the bank from putting an end to the forger's activities, or allowing them to prosecute for the fraud. Since situations such as this might be thought to be rare, the duty for all practical purposes was that expressed in *Macmillan's* case.[18]

In Australia

In *Colonial Bank of Australasia* v. *Marshall*,[19] the Privy Council upheld a High Court decision. In this case the amount shown on the face of the cheque had been fraudulently altered after signature by the drawers. It was held that the bank could not debit the plaintiff's account with the larger sum: the mere fact of a cheque being drawn with spaces that a forger might use was not a violation of the customer's duty towards his banker.

Both *Marshall* and *Macmillan* were concerned with the alteration of the amount of the cheque. It is suggested that there is no conflict between the cases since in *Macmillan*, the amount had not been written in words at all when the cheque was presented for signing! However, in *Commonwealth Trading Bank of Australia* v. *Sydney Wide Stores Pty Ltd*,[20] the High Court was asked to decide which of the two cases stated the law in Australia. It was held that *Macmillan's* case did so, a decision

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[13] [1909] 2 K.B. 1010.
[14] At 1025.
[15] [1918] A.C. 777, 793.
[16] At 795.
[17] [1933] A.C. 51.
[18] A duty so well known it was referred to as "The Macmillan Doctrine" in an article by E. P. Ellinger, *Lloyds Maritime & Commercial Law Quarterly*, Nov. 1984, 559.
[19] *Colonial Bank of Australasia* v. *Marshall* [1906] A.C. 559.
[20] (1981) 55 A.L.J.R. 574.

which reversed a striking out order and restored a defence of negligence against the plaintiff customer, whose cheque made out to a client with the initials CAS was altered to read CASH, thus enabling the rogue to obtain payment. The allegation of negligence rested on two grounds: negligence in the actual drawing up of the cheque so that the name of the payee might be altered; and negligence in failing to discover the fraud of the employee. It was held that *Macmillan* was to be preferred in that there was a duty arising from the contract between customer and banker "to take usual and reasonable precautions in drawing a cheque to prevent a fraudulent alteration which might occasion loss to the banker"[21] and that the decision in *Marshall* imposed a considerable burden on bankers without their having the means to protect themselves very satisfactorily,[22] but per Murphy, J. that "no high standard of care should be required".[23]

This duty of care has been recognised in Canada[24] and New Zealand.[25] It was against this background that the Hong Kong Court of Appeal reached its decision to extend the duty of the customer beyond the Macmillan Rule.

Tai Hing

The case involved a dishonest employee, Leung Wing Ling, who managed to make off with approximately HK$5.5 million over a period of six years by the simple means of forging his employer's signature on over 300 cheques. On joining the Company he had used another method of obtaining money: opening bank accounts in names similar to those of real suppliers of the Company and persuading the manager to sign cheques in their favour, but ultimately he adopted the first-mentioned method, the subject matter of the present dispute. Three separate bankers were involved.

The trial judge, Mantell, J.[26] formed a view of the internal financial control of the Company as unsound and inadequate to prevent or detect fraud. Leung was trusted and worked without supervision and it was not until the Company took on another accountant, who carried out the basic task of reconciling the monthly bank statements with the Company's cash books that anyone realised something was amiss.

Mantell, J. held that there was nothing in principle to support the bankers' contention advanced for the existence of either the *wider* duty (that of a reasonable customer to take precautions to prevent forged cheques being presented to his bank for payment) or the *narrower* duty (to check his monthly statements as a reasonable customer in his position would do in order to enable him to notify the bank of unauthorised discrepancies). However, his Lordship agreed that if there were either such duties, then on the facts of this case the plaintiff was in breach of both. He rejected also an argument by the banks that the customer's duty could arise in tort if it could not be implied into the banking contract, holding

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[21] (1981) 55 A.L.J.R. 574, 578.
[22] Per Gibbs, C.J., Stephen, Mason, Aickin, Wilson and Brennan, JJ.
[23] At 579.
[24] *Will* v. *Bank of Montreal* (1931) 3 D.L.R. 526.
[25] *National Bank of N.Z. Ltd* v. *Walpole & Patterson Ltd* [1975] 2 N.Z.L.R. 7.
[26] In the Supreme Court of Hong Kong.

that where the parties are in a contractual relationship, their rights and duties cannot be more extensive in tort than they are in contract.

The banks also raised a defence of estoppel, founded on two points: first, through the Company's mismanagement of their bank accounts; secondly, that the Company's neglecting to challenge the monthly bank statements was, by implication, a representation to each of the banks that the debits had been authorised. The bank statements received by the Tai Hing Company contained a "verification counterfoil" which was supposed to be returned to the bank within a reasonable time after receipt and checking. This followed U.S. and Canadian practice, but two Hong Kong High Court decisions had held that these clauses did not form part of the contract between banker and customer.[27] However, the trial judge held that the failure to challenge the debits *did* amount to a representation that they were correct and that two of the three banks involved thereby suffered damage by their reliance on these representations. Accordingly he gave judgment for the Company against the third bank, the Liu Chong Hing Bank, but found in favour of the Tokyo and Chekiang Banks. The Company appealed and the Liu Chong Hing Bank cross-appealed.

In the Court of Appeal the case was argued in both tort and contract. It was here that the Macmillan Rule was challenged. All three judges (Cons, J.A., Hunter, J. and Fuad, J.A.) held that it was a necessary condition of the relationship between banker and customer that the customer should take reasonable care to see that in the operation of the account the bank was not injured and that the customer was required to take reasonable care to protect the interests of the bank. The Company was in breach of its duty and must bear the loss occasioned by Leung's fraud.

The judges differed, however, as to the nature of the contract between the customer and the bank. Cons, J.A. held that there was a term implied into the banking contract to the effect that the bank statements became *final* if they were not queried by the customer, that is, they became conclusive evidence of the correctness of the debits shown in them. This is in line with American and Canadian practice, but not with English practice.[28] This was rejected by Hunter, J. (with whom Fuad, J.A. agreed): such a term could not be implied into the contract. All three judges, however, agreed that the Company was estopped from denying the correctness of the bank statements.

The Court found that the duty of the customer extended beyond the duty expressed in *Macmillan's* case to the *wider* duty. The relationship between banker and customer is a special one, in which the bank is peculiarly susceptible to injury if the customer is negligent in the way it carries on that part of its business which relates to the bank. In this case the plaintiff could have controlled the actions of Leung in its capacity as employer, while the Bank was in a position where it was liable to suffer as a result of such want of control. This damage was foreseeable[29] and there was a sufficient relationship of proximity to found a duty of care.[30]

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[27] *Asien-Pazifek Merchant Finance Ltd* v. *Shanghai Commercial Bank* [1982] H.K.L.R. 273 and *Lam* v. *Wah Shing Garment Manufacturing Co.*, ibid., 215.

[28] E. P. Ellinger, op. cit., 559.

[29] *The Wagon Mound* [1961] A.C. 388.

[30] *Junior Books* v. *Veitchi* [1983] A.C. 520.

The Privy Council

This result, which must have delighted the banking community, was to be short-lived. The advice of the Privy Council, delivered by Lord Scarman, dismissed the arguments with decisive brevity. The attempt to argue that the law of tort might be applicable to the present case was dealt with shortly:

> "[it is] a travesty of the House's reasoning in *Macmillan's* case to suggest that causation in the law of tort had anything to do with their limiting the duty of care of the customer to the transaction of drawing the cheque . . . the relationship between banker and customer is contractual and . . . its incidents, in the absence of express agreement, are such as must be implied into the contract because they can be seen to be obviously necessary."[31]

The arguments for the implication of a term into the banking contracts are dealt with more fully but dismissed in the end just as decisively. Here the Board accepted the approach of Cons, J.A. as correct: a term, in order to be implied into a contract, must be a necessary incident and one without which the whole transaction would become "futile, inefficacious and absurd".[32] Cons, J.A. went on to find that this was indeed a perfect description of the fact situation in *Tai Hing*:

> "[I] can think of little more futile than for the operator of an active bank account to throw his monthly statements in the waste paper basket without ever bothering to look at them; little more inefficacious than to leave the operation of that account to a clerk whose work is never checked; and little more absurd than to expect the bank to insure the honesty of the customer's clerk when the customer deliberately puts into the clerk's hands the weapons with which he can plunder and rob the bank."[33]

The Privy Council rejected his conclusion while accepting his approach, finding that the wider duty of care which a customer should owe to his banker is *not* a necessary incident of the banker-customer contract. In passing, it ought to be noticed that the possibility of a wider duty of care was not overlooked by the House of Lords, in both *Joachimson* v. *Swiss Bank Corporation*[34] and in *Macmillan's* case and it was rejected specifically. The Privy Council found no difficulty in accepting that there is a "rational stopping place short of the wider duty"[35] and that was the limit set to the risk in *Macmillan* and *Greenwood*. As Bray, J. said in *Kepitigalla*, "if the banks desire that their customers should make these promises they must expressly stipulate that they shall".[36]

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[31] *Macmillan*, at p. 10.
[32] *Liverpool City Cl* v. *Irwin* [1977] A.C. 239, 262.
[33] At 560.
[34] [1921] 3 K.B. 110.
[35] Court of Appeal decision.
[36] [1909] 2 K.B. 1010, 1022.

Conclusion

The banking contract is just that—a contract. However much the banks may desire it, the Privy Council has clearly shown that they are not to be given any right to enquire into their customers' private lives—for that, in effect, is what the Court of Appeal decision would allow them to do. Greater protection must come either from the terms of the contracts between bankers and customers or from legislative change. Whether it would be worth a bank's while to try and impose much stricter terms on customers is debatable. On the question of social desirability, as Murphy, J. said, "in terms of social policy there is a real question whether it would be better to let the loss continue to fall on the banking industry . . . Further, if the cumulative losses are now so slight, it would be absurd to impose a standard of care such that every drawer of cheques would have to regard employees and associates as potential forgers".[37] Perhaps more pragmatically, it would be a brave bank to be the first to try and impose terms upon its customers that would manage to avoid these problems completely. As Bray, J. said:

> "I am inclined to think that a banker who required such a stipulation would soon lose a number of his customers. The truth is that the number of cases where bankers sustain losses of this kind are infinitesimal in comparison with the business they do, and the profits of banking are sufficient to compensate them for this very small risk. To the individual customer the loss would often be very serious; to the banker it is negligible."[38]

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[37] *Sydney Wide*, at 579.
[38] *Kepitigalla*, at 1025.