

Insights

RECENT HONG KONG COURT DECISION ON A BANK'S LIABILITY ON ITS EMPLOYEE'S FRAUDULENT CONDUCTS

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Introduction

What happens when a Bank's customer loses money due to a fraud perpetrated by an employee of the Bank? What, if any, remedies does the defrauded customer have against the Bank?

The Hong Kong Court of First Instance *Luk Wing Yan v CMB Wing Lung Bank Ltd (previously known as Wing Lung Bank Ltd)* [2021] HKCFI 279 considered these issues.

Background

The plaintiff (the "**Plaintiff**") was the victim of a fraud perpetrated by the security manager (the "**Employee**") of the defendant bank (the "**Bank**").

The Employee led the Plaintiff to believe that her money was being invested in "internal" investment opportunities that the Bank made available only to the Bank's employees, which opportunities allegedly would result in extremely attractive returns (around 100 times the amount banks pay on deposits). These internal investments did not exist. Between 2010 and 2013, the Plaintiff transferred a net of HK\$23.8 million from the Plaintiff's bank account into the Employee's bank account. Both the Plaintiff's and the Employee's accounts were held at the Bank.

The Plaintiff was not the only victim of the Employee's fraud scheme. After the fraud came to light, the Employee pleaded guilty to and was convicted of three counts of fraud. She was sentenced to imprisonment for nine years and four months.

The Plaintiff sought to hold the Bank liable for the losses sustained by the Plaintiff as a result of the fraud perpetrated by the Employee. The Plaintiff's key causes of action against the Bank were (1) vicarious liability for the Employee's fraud and (2) the Bank's negligence in handling transfers of funds from the Plaintiff's account to the Employee's account.

The Hong Kong Court of First Instance dismissed the Plaintiff's claims.

Vicarious liability

The doctrine of vicarious liability, by which employers in certain circumstances are held liable for torts committed by their employees, was developed for the purpose of providing the victims of tort with a remedy against persons who have the means to satisfy awards and on whom it would be just to fix liability to do so.

The well-established test for vicarious liability is the “close connection” test (whether the employee’s tort was so closely connected with their employment that it would be fair and just to hold their employer vicariously liable). However, given the infinite range of circumstances where the issue arises, there is an inevitable lack of precision in the “close connection” test. The Court needs to make an evaluative judgment in each case, having regard to all the circumstances and the assistance provided by previous court decisions.

The Court in *Luk Wing Yan* was of the view that, for cases involving fraudulent misrepresentation (such as this case), the test of apparent authority should be adopted. The employer will be liable if the employee’s fraudulent misconduct falls within the scope of the employee’s authority, actual or apparent.

In general terms, apparent authority will exist where: (1) a principal has represented, by words or conduct, to a third party that the agent has authority to enter into the kind of transactions in question, (2) the third party enters into a transaction in reliance on that representation, and (3) the reliance is reasonable. It is trite that an agent cannot clothe themselves with apparent authority.

In this case, the Court held, the Employee, as a staff member of the Bank, was authorised to sell securities products to customers. However, the Court said it was illogical to extend such authority to the sale of internal products which were limited to dealings between the Bank and its employees. The Court found that there was no representation or holding out by the Bank that the Employee had authority to offer the alleged internal investments to the Plaintiff.

Further, as the Plaintiff admitted, she was overjoyed to be offered the investments with extremely high returns, and she did not care why, how or what was the logic of the investments. The Court was of the view, therefore, that despite harbouring obvious suspicions, the Plaintiff was blinded by her greed to commit to take part in the fraudulent investments. The Court found no actual reliance by the Plaintiff on any such apparent authority of the Employee, and held that any such reliance by the Plaintiff on any apparent authority would not have been reasonable.

In the absence of apparent authority, the Court rejected the Plaintiff’s claim against the Bank on the basis of vicarious liability.

Negligence – *Quincecare* duty

The Plaintiff’s claim in negligence was based upon the “*Quincecare* duty”, which is the duty imposed on a bank to refrain from executing a customer’s order when the bank is put on inquiry that the order is an attempt to defraud the customer.

The *Quincecare* duty comes into play where the bank has received an order or instruction on behalf of its customer (i.e. from an authorised agent), rather than directly from its customers. The *Quincecare* duty arises only in circumstances of attempted misappropriation of the customer's funds by an agent of the customer, i.e. the order or instruction given on behalf of the customer is not one genuinely made for the benefit of, or properly authorised by, the customer.

The Court pointed out that the *Quincecare* duty has no resonance where the cause of the customer's loss is their own desire to make the payments to their intended recipient. In this case, the payment instructions were made directly by the Plaintiff and, therefore, the *Quincecare* duty was not triggered. The Court held that the Plaintiff was "a victim of her own greed and gullibility" and her losses were not caused by any negligence or breach of duty on the part of the Bank.

The Court refused to expand the scope of a bank's *Quincecare* duty to detection or enquiry of transfers which were authorised by its customer and may have been made in furtherance of a fraud.

First, the *Quincecare* duty is ancillary and subordinate to a bank's ordinary primary duty to comply with and act on the customer's instructions in relation to the funds in the account. Elevating the *Quincecare* duty to a duty to detect whether any instructed payment is part of a fraud scheme would cast a shadow over the effectiveness of the customer's instructions and emasculate the primary duty of the bank. The Court reasoned that there was no clear framework of rules by reference to which the extended *Quincecare* duty might operate in a sensible way.

Secondly, the Court made reference to the point that the *Quincecare* duty is a common law duty which rests upon the general concept of a bank adhering to standards of honest and reasonable conduct in being alive to suspected fraud. Accordingly, the benchmark is expressed in quite general terms by reference to a not-too-high standard of the ordinary prudent banker.

Comments

This judgment will be welcomed by banking and financial institutions for the confirmation of the limited scope of the *Quincecare* duty. However, in the closing obiter remark, the Court considered the potential future development of a bank's duty in an era of increasing sophistication in and the use of artificial intelligence. The Court said banks may be placed in a position to monitor the operation of bank accounts held by their employees at their banks, in order to protect its customers from fraud committed by its employees. For this to come to fruition, however, industry-wide consultation and implementation and careful consideration will be required.

Even if that were to happen, employees still may circumvent the banks' supervision by carrying out the fraud at accounts held at banks which are not their employers. The Court emphasised that, at the end of the day, customers must remain vigilant and be careful of suspicious banking activities and raise their concerns as necessary. The Court reminded bank customers: "if something seems too good to be true, it probably is".

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