Banks' liability for fraud on customers by third parties

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Earlier this year the UK High Court considered the extent of a bank's duty of care to its customer to prevent fraud on the customer. The case of The Federal Republic of Nigeria v JP Morgan Chase Bank, N.A. [2019] EWHC 3476 (Comm) applied the principle established in the case of Barclays Bank plc v Quincecare Ltd [1992] 4 All ER 363.

The facts

In April 2011 the Federal Republic of Nigeria (**Customer**) settled a long-running dispute in respect of an offshore Nigerian oilfield known as OPL 245. In accordance with the terms of the settlement, the Customer set up a depository account with JP Morgan Chase Bank (**Bank**). The sole purpose of the account, which was a type of escrow account, was to hold the settlement funds that would eventually be paid by the Customer to those entitled under the settlement.

In August 2011, the Bank made three transfers from the Customer's account on instructions by its authorised signatories totalling in excess of US$875 million to accounts at two separate banks. It was alleged that the money was used to pay off corrupt former and contemporary Nigerian government officials.

The Customer's claim against the Bank rested on a breach of the '*Quincecare* duty of care'.

> ***'Quincecare duty of care'***
> *The case that gave its name to this duty involved a loan from Barclays Bank to Quincecare for the sole purpose of purchasing four chemist shops. The chairman of Quincecare withdrew a substantial amount of it and misapplied it for dishonest purposes, causing the loss of almost the entire sum. Barclays then sued Quincecare as principal debtor. Quincecare put forward counterclaims that a bank owed a duty of care to both its customer and third parties to protect against fraud. The Court held that a bank will be liable if it has reasonable grounds for believing that a payment it makes will be defrauding the customer.*
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> *The 'Quincecare duty of care' is therefore a bank's duty of care to refrain from withdrawing funds from a customer's bank account if there are reasonable grounds for believing that the payment is part of a scheme to defraud the customer. The duty is part of a bank's overall duty of reasonable skill and care in executing customers' orders. It arises by reason of an implied term of the contract between a bank and its customer or under a coextensive duty of care in negligence.*

In the current case the Judge had to determine:

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1. if a *Quincecare* duty of care was owed by the Bank to the Customer or if it had been excluded by the terms of the depository agreement between the two parties; and
2. if there was such a duty, whether the Bank could rely on the indemnity from the Customer in the depository agreement in its defence.

Additionally, the Bank claimed that that there was no realistic prospect of the Customer successfully showing causation of loss; the same outcome would have resulted even if the Bank had not breached its duty. The Bank had undertaken checks and complied with all authorisations and conditions and sought instruction from the Attorney General of Nigeria. As this was a hearing on an application by the Bank for a reverse summary judgment and/or for the case to be struck off, the Judge held that the Bank had failed to establish that the Customer had no realistic prospect of success which could only be determined at trial.

Application of Quincecare

The Customer claimed that the Bank was put on inquiry and had reasonable grounds for believing that the payment instructions may have been an attempt to defraud the Customer.

The Bank argued that the terms of the depository agreement, which contained narrow release conditions, did not leave any room for a *Quincecare* duty of care. The conditions were designed to preclude an additional duty to investigate compliant instructions in the interest of time.

Specifically, the Bank relied on several clauses in the depository agreement which at first glance might appear to conflict with the *Quincecare* duty or to exclude it. The clauses in question, which will be familiar to many deposit-taking banks and custodians, include:

> *"5.1 The duties and obligations of the Depository in respect of the Depository Cash shall be determined solely by the express terms of this Agreement. […]"*
>
> *"5.8 The Depositor hereby authorises the Depository to act hereunder notwithstanding that:… (ii) the Depository or any of its divisions, branches or affiliates may be in possession of information tending to show that the instructions received may not be in the best interests of the Depositor and the Depositor agrees that the Depository is not under any duty to disclose any such information."*
>
> *"7.2 The Depository shall be under no duty to enquire into or investigate the validity, accuracy or content of any instruction or other communication."*
>
> *"7.4 The Depository need not act upon instructions which it reasonably believes to be contrary to law, regulation or market practice but is under no duty to investigate whether any instructions comply with any applicable law, regulation or market practice."*
>
> *"8.2(d)[The Depository shall not be liable to the Depositor for any loss suffered by the Depositor by] the Depository acting on what it in good faith believes to be instructions…to have been given or signed by the appropriate parties."*

Despite the inclusion of these fairly standard 'entire agreement', exemption and limitation clauses, the Judge ruled that the terms of the

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depository agreement did not displace the *Quincecare* duty. In order to effectively disapply the duty, the agreement would need to include clear and direct wording expressly excluding it.

Indemnity clause

The Bank also claimed that, even if the Customer's claim for breach of duty was successful, it was protected by the indemnity in the depository agreement. This provided that the Customer -

> *"irrevocably and unconditionally agrees on demand to indemnify ... the depository ... against all costs, claims, losses, liabilities, damages, expenses, fines, penalties, tax and other matters (losses) which may be imposed"*

It was held that the indemnity only applied to claims by third parties and not claims by the Customer. So the Bank failed in its attempt to rely on the indemnity.

What must banks do (or not do, as the case may be)?

Banks have a duty to their customers to protect them from fraud when making payments. Reliance on compliance with mandates will not protect a bank if it fails to make the appropriate enquiries or to take appropriate action when put on notice of a potential fraud on its customers.

Whilst courts are not expecting banks to demonstrate Sherlock levels of deduction when it comes to potential fraud, Quincecare imposes a negative duty not to pay even where there are compliant instructions. Banks must refrain from making a payment when there is reasonable belief that the payment could be fraudulent to its customer.

This case also highlights the importance of having in place robust and clear agreements with customers which reflect the intentions of both parties. In particular, banks (and their advisers) should not assume that standard provisions intended to limit a bank's liabilities will protect the bank in all circumstances and should ensure that agreements expressly exclude any liabilities and duties not accepted by the bank.

Watch this space

The case is ongoing and is yet to proceed to trial so the Court may well have more to say about the effect of the Bank's exculpatory clauses and their interaction with the *Quincecare* duty. Any further rulings on these provisions may impact the way these types clauses are drafted by banking lawyers in the future.

We will be following the proceedings with interest and will prepare further guidance for our banking clients as appropriate.

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