THE CUSTOMER'S DUTY OF CARE TO HIS BANKER

Tai Hing Cotton Mill Ltd. v. *Liu Chong Hing Bank Ltd. and Ors.*[1]

IN situations where a court must decide which of two innocent persons is to suffer for the fraud of another, it might be natural to expect that the burden be placed on the one who has, by his conduct, enabled a fraudulent third party to cause the loss.[2] Such is apparently not the case, however, where the two innocents are a banker and his customer, and the third party is an employee of the customer who has been able, due to the employer's lax internal accounting procedures, to steal from him over an extended period by drawing forged cheques on the employer's account.

At first blush, the concept of innocence has no application to a bank's liability for paying on a forged cheque. The risk of forgery *prima facie* rests with the bank, since in such cases the bank may not debit the customer's account as it has no mandate to do so.[3] This applies even where the forgery is so skilful that the bank is not negligent in paying on any given cheque and so might rightly be called "innocent".

However, the concepts of "innocence" and "fault" have become relevant. In two situations, the courts have acknowledged that a customer owes a duty to his banker, the breach of which will allow the bank to shift the risk of loss by forgery to the customer:

1) In *London Joint Stock Bank Ltd.* v. *Macmillan and Arthur*,[4] the House of Lords recognized a duty on the customer to exercise reasonable care in drawing his cheques, the breach of which would result in his own responsibility for loss sustained as a natural and direct consequence of the breach. This duty was firmly restricted to the manner in which the cheque was drawn and hence appears only to cover situations, such as *Macmillan* itself, where the cheque was drawn in such a manner so as easily to permit an increase in its apparent value.[5]

2) In *Greenwood* v. *Martins Bank Ltd.*[6] the customer was held to owe a duty to inform the bank of any forged cheques which he discovers have been drawn on his account. If he fails to inform the bank of known forgeries, the bank can raise estoppel as a defence in the event the customer attempts to claim lack of mandate for the debit of the forged cheques.

1 [1985] 2 All E.R. 947 (P.C.).

2 At least in some instances, this is true in law. See the comments of Lord de Villiers in the appeal to the Privy Council from a decision of the Supreme Court of the Straits Settlements in Singapore in *Meyer & Co., Limited* v. *The Sze Hai Tong Banking and Insurance Company, Limited* [1913] A.C. 847, at 852.

3 This might well be regarded as trite law, based on the formulation of contractual relationship between banker and customer in such cases as *Foley* v. *Hill* (1848), 2 H.L. Cas. 28, and *Joachimsom* v. *Swiss Bank Corporation* [1921] 3 K.B. 110 (H.L.). For a very clear presentation of the proposition, see *National Westminister Bank Ltd.* v. *Barclays Bank International Ltd.* [1975] Q.B. 654 at 666.

4 [1918] A.C. 777.

5 *Slingsby* v. *District Bank Ltd.* [1932] 1 K.B. 544 (C.A.).

6 [1933] A.C. 51.

In both these instances, the customer is innocent in the sense that he has been the victim of fraud by another, but is clearly seen to be at fault in the sense of having contributed to the loss by breach of a duty owed to the bank, and therefore justly bears the risk.

With the decision of the House of Lords in *Donoghue* v. *Stevenson*[7] and the subsequent expansion of a general duty of care to many fields, it is perhaps not surprising that bankers have argued for an extension of the scope of the duty owed by customers in an effort to throw the fault onto the customer, and shift the risk of forgery to him.[8] From the banker's perspective, this approach might seem reasonable in light of the ever expanding duty of care placed on banks — including a duty to use reasonable care in the preparation of bank statements[9] and a general duty to exercise reasonable care and skill over the whole range of services it undertakes for its customers.[10]

The extended duty of care which might be owed by a customer in relation to current accounts can be seen as his reciprocal obligation to the last two duties imposed on banks, and can be expressed thus:

> 1) a "narrow" duty of care to take such steps to check his monthly bank statements as a reasonable customer in his position would take to enable him to notify the bank of any items debited therefrom which were not or may not have been authorized by him;
>
> 2) a "wide" duty to take such precautions in the management of his business as a reasonable customer in his position would take to prevent forged cheques being presented to his bank for payment.

The existence of either the narrow or the wide duty as an express or implied contractual incident of the bank-customer relationship was the central question in *Tai Hing Cotton Mill Ltd.* v. *Liu Chong Hing Bank Ltd. and others*.[11] In addressing this issue the Privy Council also made some sweeping comments touching on the inter-relationship of tort and contract and the question of the binding nature of House of Lords decisions on the Privy Council when it is deciding issues governed by English law. All three issues have general importance throughout the English common law world and deserve careful analysis.

The Facts

The plaintiff company, Tai Hing, was a textile manufacturer which conducted its business in Hong Kong in divisions. Three of those

7 [1932] A.C. 562 (H.L.).

8 See, for example, *Wealdon Woodlands (Kent) Ltd.* v. *National Westminister Bank Ltd.* (1983) Times, 12 March; *Commonwealth Trading Bank of Australia* v. *Sydney Wide Stores Pty. Ltd.* (1981), 55 **A.L.J.R.** 574 (H.C.); *National Bank of New Zealand Ltd.* v. *Walpole & Patterson Ltd.* [1975] 2 **N.Z.L.R.** 7 (C.A.); *Arrow Transfer Co. Ltd.* v. *Royal Bank of Canada et al* (1972) D.L.R. (3d) 81 (S.C.C.).

9 *Lloyd's Bank Ltd.* v. *Brooks* [1950] 6 L.D.B. 161.

10 *Selangor United Rubber Estates Ltd.* v. *Cradock (No. 3)* [1968] 1 W.L.R. 1555 (Ch. D.); *Karak Rubber Co. Ltd.* v. *Burden (No. 2)* [1972] 1 W.L.R. 602 (Ch. D.).

11 *Supra,* note 1.

divisions maintained separate current accounts, one at each of the three defendant banks. Cheques could be drawn on each account by the sole signature of a Mr. Chen, the managing director of the company.

In 1972, the plaintiff took into its employ a Mr. Leung, who shortly thereafter began perpetrating a series of frauds on the company. These included the frauds which were the subject of this action, whereby Leung forged the signature of Mr. Chen to cheques and obtained cash for them. From 1972 until he was discovered in 1978 when a newly appointed accountant began reconciling bank statements, Leung forged some three hundred cheques on the accounts of the three divisions for a total of HK$5.5 million, which sums were paid by the three banks. Leung, upon discovery, disappeared and only a small recovery was obtained through settlement with his wife.

The reasons for Leung's long period of successful forgery, as found by the trial judge were summarized in the judgement of Lord Scarman in the Privy Council:

> Leung was trusted. He was in a position to manipulate the accounts for which he was responsible; and the company's system of internal control was ill-adapted either to prevent fraud or to find out about it afterwards. There was no division of function, Leung being responsible for, and in almost sole control of, the receipts and payments made through the accounts for which he was responsible and there was substantially no supervision. Specifically, the judge found that there was a failure to check or supervise Leung's reconciliation of the monthly bank statements with the cash books of the company.... The judge summed up his view of the company's system of internal financial control as unsound and, from the point of view of preventing or detecting fraud, inadequate.[12]

On these facts, the trial judge concluded that if a duty of care were found to exist, there had been a breach, or lack of requisite care, on the part of the customer. By contrast, there is no suggestion in the judgments that any of the banks were in any respect careless in not spotting the fact that the series of cheques in question were forged.

The plaintiff company brought this action against the banks to obtain repayment of the money paid on the forged cheques. The banks, in defending the claim, based their case on three main submissions:

1) That either the wide or narrow duty of care was an implied term of the contract for the operation or a current account between the bank and its customer, breach of which would result in risk of loss being thrown on the customer (the "implied term" issue);

2) That similar duties were imposed on the customer by the law of tort, with the same effect (the "tort" issue);

3) That the express terms of the contract between the banks and Tai Hing created a binding obligation on the customer to examine and query his bank statement, failing which he accepted it as accurate (the "express term" issue).

[12] *Ibid*, at 951.

Each of these issues was examined in full by the judges at the various levels of litigation, and different conclusions were reached.[13] Little would be gained by setting out the result of each issue at each level, and so far as the reasons and results are of relevance, they will be highlighted in the discussion of the decision of the Privy Council. In dealing with these three issues, Lord Scarman went on to make a brief reference concerning the binding nature of decisions of the House of Lords vis-a-vis the Privy Council, where the issue in question before the Privy Council is governed by English law. These comments will be of general interest to all jurisdictions, including Singapore, which maintain appeals to the Privy Council, as by extension, that which is binding on the Privy Council is also binding on courts subject to its jurisdction. The comments of the Judcial Committee will be analyzed below under the heading 'the *"stare decisis"* issue'.

The Implied Term Issue

The primary contention of the banks was that either the narrow or the wide duty of care was imposed on the company as an implied term of the contract between a bank and its customer. While the narrow duty was presented as a fall-back argument in the event the wide duty was found not to apply, the Privy Council did not consider the two suggested duties of care separately. Lord Scarman lumped the two together and approached the problem by asking whether the law implied into the contract any wider duty on the customer than that formulated in the *Macmillan* and *Greenwood* cases,[14] which his Lordship obviously accepted as the leading authorities.[15] Indeed, if a duty wider than that established by those two cases is to be implied, there might be little rationale for stopping at the narrow as opposed to the wide duty of care. In the Court of Appeal, the judges did differentiate the two duties somewhat, but unanimously agreed that the wide duty of care was indeed part of the contract between the parties.

The leading authorities concerning implied contractual terms are *Lister* v. *Romford Ice and Cold Storage Co. Ltd.*[16] and *Liverpool City Council* v. *Irwin.*[17] These cases establish that there are two ways in which a term may be implied into a contract. The first is

[13] This judgment of the Court of Appeal is reported in [1984] Lloyd's L.R. 555. The judgment of the trial judge, Mantell, J., does not appear to have been reported, but his findings of fact and holdings of law are well set out in both the judgments at the Court of Appeal and Privy Council level.

[14] *Supra,* note 1, at 955*j.*

[15] For example, at 952-53 and 955; of the judgment (note 1 *supra*). With respect to the MacMillan duty, there is a contrary Privy Council decision on appeal from Australia, namely *Colonial Bank of Australasia* v. *Marshall* [1906] A.C. 559, followed in the later case of *Varker* v. *Commercial Banking Co. of Sydney Ltd.* [1972] 2 N.S.W.L.R. 967 (S.C.). However, *Marshall* was heavily criticized in *MacMillan,* and it is generally accepted that *MacMillan* is the correct and relevant authority on the point. (See Megrah & Ryder, *Paget's Law of Banking,* 8th Ed. (Butterworths, London, 1972) at pp. 290-93). In addition, the High Court of Australia has chosen to follow *MacMillan* rather than *Marshall* in *Commonwealth Trading Bank of Australia* v. *Sydney Wide Stores Pty. Ltd. supra,* footnote 8. See also the comment on that case by Penelope Watson, "Banks: Cheques and Fraudulent Alternation", [1981] Aus. Current Law AT21.

[16] [1957] A.C. 555 (H.L.).

[17] [1977] A.C. 239 (H.L.).

based on the presumed intent of the parties, in which the courts will imply terms in cases "if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in the agreement, they would testily suppress him with a common 'oh, of course' ",[18] In other instances, independently of any presumed intention, and as a legal incident of particular kinds of contracts, the courts will imply terms where, due to the nature of the contract itself, such a term is necessary, one without which the contract would become "futile, inefficacious or absurd".[19]

Trietel classifies the first type of implied term as 'terms implied in fact' and the latter as 'terms implied in law'.[20] Of terms implied by law, he says "[they] are, in truth, simply duties *prima facie* imposed by law on the parties to particular kinds of contracts... Whether such terms should be implied is not a question of intention, but one of policy".[21]

As to the banks' contention that either the narrow or wide duty of care could be implied in fact, there was little judicial disagreement.[22] As Mr. Justice Cons indicated "I do not think that the average customer would testily suppress the officious by-stander who proposed either or both terms. I think he would at least say 'I shall have to think about that'."[28]

The question then became one of whether the term was to be implied by law. Mr. Justice Hunter, in the Hong Kong Court of Appeal, preferred to call these implied terms 'imposed terms': "There is a real difference concealed in this use of the word implied, between a term implied for reasons personal or peculiar to the contract in question and to a term implied — I prefer to use the word 'imposed' — by law".[24] He went on to say that a term imposed by law does not cease to be contractual merely because it is a legal rather than a consensual incident of the contract.[25] Lord Scarman, however, firmly rejected any attempt to label the process as being one of imposition of terms:

> Their Lordships accept as correct the approach adopted by Cons JA. Their Lordships prefer it to that suggested by Hunter J., which was to ask the question: does the law impose the term? Implication is the way in which necessary incidents come to be recognized in the absence of express agreement in a contractual relationship. Imposition is apt to describe a duty arising in tort,

18 *Shirlaw* v. *Southern Foundries (1926) Ltd.* [1939] 2 K.B. 206, at p. 227 (affirmed [1940] A.C. 701).

19 *Liverpool City Council* v. *Irwin supra,* note 17, at 254 *(per* Lord Wilberforce), and at 262, 263 *(per* Lord Salmon).

20 See Treitel, *The Law of Contracts,* 6th Ed., Stevens & Sons, London, 1983, at pp. 158-165.

21 *Ibid,* p. 162.

22 Mr. Justice Hunter clearly proceeded on the basis of an imposed rather than implied term (see *infra,* note 24 and accompanying text, and Lord Scarman clearly indicated (*supra,* note 1 at 955) that the relevant test here was of necessity, the test applicable to Treitel's 'terms implied by law'.

23 *Supra,* note 13, at 557.

24 *Ibid,* at 572.

26 *Ibid,* at 573.

> but inept to describe the necessary incident arising from a contractual relationship.[26]

With all due respect, the rejection of the label "imposed terms" can only lead to confusion. The cases, and authors such as Treitel, make it clear that implication of such terms is based on their being a legal incident of the contractual relationship in question, and not on any presumed intent of the parties. As such, much depends on underlying policy factors present in the given situation before the court. The court implies terms into a particular type of contract because it is willing to impose them upon all parties in similar types of relationship. Reluctance by the Privy Council to use the label which would find wide recognition in common parlance barkens back to the days when decisions were made for unstated policy reasons, and can do little to achieve clear understanding of the law.

Whether one calls the process 'implication' or 'imposition', the authorities make clear the test is one of necessity. Both Cons JA and Lord Scarman agreed on this point.[27] They disagreed as to the necessity of the proposed duties as a legal incident in the contract between the customer and bank. Cons JA felt the terms were necessary:

> It cannot be said that the imposition of a duty of care on the customer is absolutely essential to the relationship. The banks could I think manage to service current accounts without that assistance. So could, I think, the tenant of the high rise flats [in *Irwin*] have managed to live there without the benefit of lifts, lights on the staircase or garbage chutes. But that did not deter their Lordships. They took a more practical view of necessity. They inquired if the transaction would become 'futile, inefficacious, or absurd' if these amenities were not maintained. For my part 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 even 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.... Thus, after a great deal of hesitation, I find myself finally led to the conclusion that, in the world in which we live today, it *is* a necessary condition of the relation of banker and customer that the customer should take reasonable care to see that in the operation of the account the bank is not injured.[28]

His Lordship took a much less practical, or liberal, view of the concept of necessity. He was content to point out that the judgments in *Macmillan* (as reiterated by Atkin L.J. in his overview of implied terms in the banking contract in *Joachimson's* case[29]) and *Greenwood* indicated that no further duties beyond that which were there formulated were necessary to the contract. A bank must seek any

[26] *Supra,* note 1 at 955.
[27] *Supra,* note 13, at 558, 560, and *supra,* note 1, at 955.
[28] *Supra,* note 13, at 560.

additional protection it felt was necessary by express terms of business or by asking for statutory protection.

In response to the rhetorical question why, once a duty of care is recognized, it should stop at the limits of *Macmillan* and *Greenwood,* his Lordship was content to refer to the comments of Bray J. in *Kepitiqalla Rubber Estate Ltd.* v. *National Bank of India Ltd.*[30] In the quote cited by Lord Scarman, Bray J. indicates that a wider duty could not be seen as having been in the mind of the customer at the time he entered into the banking contract. He goes on to express concern over the difficulty of formulating the standard of care required of a customer if a general duty were to be imposed. Bray J. also pointed out that the number of cases where a bank might sustain such losses is small having regard to their volume of business, and in light of their profits, the extent of the loss to a bank may be small but to an individual customer would be very serious.

The comments of Bray J., in light of legal developments since that case was decided, and having regard to the circumstances of the case at hand, appear less than convincing. The portion of his comments concerning the presumed intent of the customer is not relevant, as that is not the means by which this term is sought to be implied here. Approval of Bray's concern over the difficulty of formulating with precision the standard of care and extent of precautions required is reminiscent of the *pre-Donoghue* v. *Stevenson* days, when such arguments might well have led a hesitant judge to refuse to acknowledge a general duty of care. While *Donoghue* v. *Stevenson* is a case in tort, and we are concerned here with a case in contract, the ease and vigour with which judges formulate and apply effective standards of care for diverse situations in tort should indicate they would be able to do the same for a general duty of care implied as a necessary incident of contract. While it is understandable that Bray J. might make such comments some twenty years before Lord Atkin's judgment in *Donoghue,* it is difficult to understand such comments finding favour with the Privy Council in 1985, when the standard of the reasonable man has become universally and routinely applied.

Finally, while it may well be true that a bank may be better able to absorb the loss than the particular customer, this case shows that the bank's loss can be quite high. The fact remains that the ability to control the person responsible for the loss lies solely with the customer. Many might be excused for being more convinced by the comments of Hunter JA when he spoke of the consequence of there not being a wider duty of care imposed on the customer:

> What immediately stands out from these [recent English decisions] is the peculiar, if not unique, position of a customer if his duty of care is limited to the drawing of the cheque. Beyond that he can be as careless as he likes. If he operates his account through others he need take no step to control or check their work or their integrity. If he operates his account himself he can ignore obvious wrong entries in his pass-sheets and throw them away unread. The consequences of either course may

[29] *Supra,* note 3, at 127.
[30] [1909] 2 K.B. 1010 at 1025-26.

> be as damaging to his bank as a carelessly drawn cheque. But the risk is exclusively their's. In respect of one particular field of dishonest conduct on the part of a servant, he enjoys free fidelity insurance.[31]

If the comments of Bray J. are not a convincing statement of the difficulties involved in expanding the customer's duty of care, the question remains whether an expanded duty of care is a necessary incident of the banking contract. It is submitted that the Privy Council's approach to the concept of being a "necessary" term is much too strict, and that the practical and slightly more liberal approach of Cons JA is to be preferred, and would seem to be more in line with the judgments and result in *Irwin.* A less strict approach is even more necessary in contracts, such as that of the banker-customer relation, where most of the essential terms have been implied by the courts, either on the presumed intent of the parties or on the basis that they were necessary to the relationship.[32]

Furthermore, *Lord* Scarman did agree that a customer was subject to the *Macmillan* and *Greenwood* duties. If one examines the judgments in those cases, however, it appears that the concept of reciprocity of obligation between bank and customer played a significant role in the decision to imply these particular duties. In *Macmillan,* the duty imposed on the customer to use reasonable care to draw cheques in such a way so as not to facilitate forgery was reciprocal to the bank's obligation on the mandate to honour the customer's cheques without delay, at least to the extent of an available credit balance.[33] In *Greenwood,* the customer's duty can be seen as the duty reciprocal or corresponding to the bank's duty to report a discovered forgery and inquire into and protect itself against the circumstances of that forgery.[34]

If reciprocity of obligation was relevant to the implication of the *Macmillan* and *Greenwood* duties, why should not the narrow and the wide duty contended for in *Tai Hing* also be found to be necessary implied terms in the contract? The bank's obligation to use reasonable care in the preparation of bank statements[35] would be matched by the customer owing the bank the narrow duty, and the bank's duty to use reasonable care in the whole range of services offered[36] would be mirrored by the customer's wide duty of care. This type of argument formed the nucleus of the decision on this issue by Cons JA,[37] and provides support for finding the wider duties to be a necessary incident of the contract.

31 *Supra,* note 13, at 576. Indeed, Hunter JA gives a convincing rebuttal (at 578-79) of all the comments in the relevant quotation of Bray J. cited by Lord Scarman.

32 See *Foley* v. *Hill* and *Joachimson's* case, *supra* note 3.

33 See *supra,* note 4, at 814 *(per* Viscount Haldan), at 824 *(per* Lord Shaw) and at 829-30 (*per* Lord Parmoor).

34 See the comments of Lord Justice Scrutton to this effect in the Court of Appeal decision, reported [1932] 1 K.B. 371, at 381.

35 *Supra,* note 9.

36 *Supra,* note 10.

37 *Supra,* note 13, at 558-560.

Cons JA supported his conclusion by referring to the authorities in North America. The United States has long recognized the existence of the narrow duty of care,[38] and a similar approach appears to be developing in Canada,[39] with the most recent authority seeming to favour the wide duty.[40] Unfortunately, the Privy Council made no reference to these authorities and hence made no attempt to distinguish them or explain why the common law might develop differently in the various jurisdictions. Instead, Lord Scarman preferred to rely on the narrow rulings in *Macmillan* and *Greenwood,* and the even older authority of *Kepitigalla,* all of which predate the significant developments in the law concerning duties of care, both in contract and in tort, as a result of the decision in *Donoghue* v. *Stevenson.*

Having rejected the possibility of a wide or a narrow duty of care arising from implied contract, their Lordships next had to consider whether any such duties could be imposed on the customer as an incident of the law of tort.

The Tort Issue

Mr. Justice Cons, in the Court of Appeal, having found the wide duty to be an implied term of the contract, went on and found a co-extensive duty of care in tort, relying primarily on *Anns* v. *Merton London Borough Council*,[41] and Lord Diplock's rules for tortious liability for acts of third persons under one's control in *Home Office* v. *Dorset Yacht Co. Ltd*.[42] Mr. Justice Hunter took a very different approach. He referred to Lord Roskill's comment in *Junior Books Ltd.* v. *Veitchi Co. Ltd*.[43] to the effect that the question is not 'whether the proper remedy should lie in contract or in tort' and determined the existence of the duty by asking the questions posed by Lord Willberforce in *Anns*,[44] finding that there was a special relationship of proximity between the bank and the company and finding no valid policy reasons or considerations which would negative the duty of care contended for.

[38] The narrow duty was acknowledged in the United States as far back as the decision in *Leather Manufacturers National Bank* v. *Morgan* (1886), 117 U.S. 96, and currently finds itself in almost universal application by being incorporated in s. 4 - 406 of the Uniform Commercial Code.

[39] In *Arrow Transfer Co. Ltd.* v. *Royal Bank of Canada supra,* note 8, Laskin J., as he then was, said at 101 "I do not think it is too late to fasten upon bank customers in this country a duty to examine bank statements with reasonable care and to report account discrepancies within a reasonable time." Laskin, who dissented on the main point of the appeal concerning the interpretation of language in a verification agreement, was the only judge who considered this point. Laskin's approach is followed in *Canadian Pacific Hotels Ltd.* v. *The Bank of Montreal* (1981) 122 D.L.R. (3d) 519 (Ont. H.C.), upheld on appeal in (1982), 139 D.L.R. (3d) 575 (C.A.). Leave to appeal to the Supreme Court of Canada was granted on Nov. 1, 1982, and according to Hunter JA. (*supra,* note 13, at 578), was at the time of the Court of Appeal decision in *Tai Hing,* shortly to be considered by that Court.

[40] Montgomery, J. in the High Court of Ontario in *Canadian Pacific Hotels op. cit.* at 533, said "The customer owes a duty to the bank to operate an acceptable internal control system so that both the bank and its customer are jointly engaged in prevention and minimization of losses occurring through forgeries."

[41] [1978] A.C. 728 (H.L.).

[42] [1970] A.C. 1004 (H.L.).

[43] [1983] A.C. 520 (H.L.). For the specific comment of Lord Roskill, see 545.

[44] *Supra,* note 42, at 751-52.

Lord Scarman disagreed in sweeping terms. He did "not believe that there was anything to the advantage of the law's development in searching for a liability in tort where the parties are in a contractual relationship".[45] He preferred to stay with a contractual, not a tortious, analysis, concluding thus:

> Their lordships do not, however, accept that the parties' mutual obligations in tort can be any greater than those to be found expressly or by necessary implication in their contract. If, therefore, as their Lordships have concluded, no duty wider than that recognized in *Macmillan* and *Greenwood* can be implied into the banking contract in the absence of express terms to that effect, the respondent banks cannot rely on the law of tort to provide them with greater protection than that for which they have contracted.[46]

At their broadest, these words would severely restrict any overlap between tort and contract. Indeed, they vaguely resemble comments made by Pigeon J. in *Nunes Diamonds Ltd.* v. *Dominion Electric Protection Co.*[47] to the effect that liability in tort can only arise if the tort is independent of contract. This principle of 'if contract, no tort' has been subject to strong criticism.[48] Taken in context, however, Lord Scarman may not be going quite that far.

A necessary incident of the broad reading would be that where there is a contractual relationship with co-extensive duties of care in contract and tort, the only legal remedy would be an action in contract. However, most recent trends would indicate that an individual in such situations may choose between a contractual or tortious remedy.[49] Lord Scarman, in the citation above, speaks himself of 'mutual' obligations in tort and contract. As well, to support his 'contractual analysis' position, Lord Scarman cites from Lord Radcliffe's judgment in *Lister.* The sentence in that judgment, immediately following, but omitted from the passage cited by the Privy Council, recognizes the overlap:

> It is a familiar position in our law that the same wrongful act may be made the subject of an action either in contract or in tort at the election of the claimant, and, although the course chosen may produce certain incidental consequences which would not have followed had the other course been adopted, it is a mistake to regard the two kinds of liability as themselves necessarily exclusive of each other.[50]

[45] *Supra*, note 1, at 957 *d.* Significantly, Lord Roskill, whose comments in *Junior Books* (*supra* note 43) were relied on by Hunter JA for a contrary conclusion, was a member of the Privy Council bench in this case.

[46] *Ibid.*

[47] (1972), 26 D.L.R. (3d) 699 (S.C.C.).

[48] See, for example, G.H.L. Fridman, "The Interaction of Tort and Contract" (1977), 93 *L.Q.R.* 422; C.R. Symmons, "The Problem of the Applicability of Tort Liability to Negligent Misstatements in Contractual Situations: A Critique on the Nunes Diamonds and Sealand Cases" (1975), 21 *McGill L.J.* 79.

[49] Compare W.D.C. Poulton, "Tort or Contract" (1966) 82 L.Q.R. 346 and Fridman, *ibid.* See also Symmons, *ibid;* Street, *The Law of Torts,* 7th Ed., Butterworths, London, 1983, at p. 205; Linden, *Canadian Tort Law,* Butterworths, Toronto, 1977, at pp. 396-401; and the various case authorities cited therein.

[50] *Supra,* note 16, at 587.

Therefore, by implication, Lord Scarman's comments may be restricted to situations where a duty wider than an existing contractual duty is contended for in tort. Even in such situations, however, as Mr. Justice Cons pointed out, there would not appear to be "any reason why there should in principle be any restriction upon liability for conduct which, although it would or might not have occurred without the existence of the contract, is otherwise independent of it".[51] A good example of a situation where wider tortious liability might exist in a contractual setting is liability for negligent misstatements made by one contractual party to another. There are strong arguments that in such situations the existence of a contract should not preclude wide tortious recovery.[52]

Furthermore, while Lord Scarman's words are capable of wide interpretation, perhaps they should be restricted to the factual situation before the court. It must be remembered that the duties contended for could not exist outside the contractual arrangement between banker and customer — there could be no independent duty of that nature. The existence of such duties depended entirely on the contract, and on the mutual, reciprocal, obligations of the parties thereto. Taken in this context, Lord Scarman's comments appear logical and reasonable. In such commercial relationships, where the applicable duties are so dependent upon the contract, they should be found in the agreement of the parties, through the express terms used, or presumed as having been intended, or implied by the court as necessary to the particular type of contract involved.

It is submitted, however, that even if one accepts the claim that any duty in this case would have to be contractual, the development and universal acceptance of a general and wide duty of care in one area of the law should impact upon the ability of a court to find that a particular form of that duty should be implied as a necessary incident of particular types of contract. Such an approach was indeed recognized in the judgment of Hunter JA:

> Secondly, and possibly of greater significance, is the question why is the duty imposed? One possible answer is that it results from the conscious or unconscious application of what can now be called tortious principles of proximity to those who have entered into a special or proximate relationship by reason of their banking contract, and by reason of the reciprocal obligation undertaken by each.[53]

However, in their stated preference for the approach of Cons JA, and their comments on the applicability of tortious principles to contractual situations, their Lordships seem firmly to have rejected this concept.

The Express Term Issue

Having rejected an implied contractual duty and an 'imposed' tortious duty, the Privy Council was left to consider the impact of certain express terms contained in the rules and regulations for account

[51] *Supra,* note 13, at 561.
[52] See Symmons, *supra,* note 48.
[53] *Supra,* note 13, at 573.

operation. These terms, accepted by the company when each account was opened, varied in wording, but indicated that monthly statements would be given to the customer and that the balances shown would be deemed to be correct within specified periods, unless the customer objected to the information contained therein.[54] The argument appears to have been that the express contractual terms ousted the limited common law duties reflected in *Macmillan* and *Greenwood* and substituted therefor the 'narrow' extended duty of care.[55]

Clauses relating to bank passbooks and statements can either impose a duty on a customer to examine the statement, breach of which would give rise to negligence on his part, and deny recovery in cases such as these, or attempt to create a settled account between bank and customer upon receipt of the statement and failure to object to the balance shown.[56] In the latter situation, the most that could be expected of a clause in the context of the bank customer relationship is that acceptance of the statement creates an admitted statement of account having evidential effect only (as opposed to there being a substantive account settlement for vauable consideration),[57] and the Privy Council and the majority in the Court of Appeal clearly examined the clauses as if this was the most that they could be.[58] All three clauses before the court obviously attempted to create evidential settlement, and one, the Liu Chong King clause, purported to impose a duty of examination.

[54] With respect to the third respondent, the Chekiang First Bank Ltd., the relevant rule provided:

> "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...".
>
> For the Bank of Tokyo Ltd. the relevant clause read:
>
> "The Bank's statement of my/our account will be confirmed by me/us without delay. In case of absence of such confirmation within a fortnight, the bank may take the said statement as approved by me/us."
>
> And, the Liu Chong King Bank Ltd. clause stated:
>
> "A statement of the customer's account will be rendered once a month. Customers are desired: (1) to examine all entries in the statement of account and to report at once to the bank any error found therein. (2) to return the confirmation slip duly signed. In the absence of any objection to the statement within seven days after its receipt by the customer, the account shall be deemed to have been confirmed."

[55] The exact form of argument on this issue is not set out clearly in either the Privy Council or Court of Appeal judgments. That this was indeed the form in which the argument was framed may be gathered from Lord Scarman's remarks *(supra* note 1, at 952, *a-b).*

[56] That there is indeed a dual approach on this issue is clearly set out in J. Milnes Holden, "Bank Pass Books and Statements" (1954), 17 *Mod. L. Rev.* 41.

[57] As explained by Hunter JA, it is difficult in the bank customer relationship to find the mutual discussion and acceptance of the statement of account by the bank and customer which is necessary to find a strict settlement of an account having substantive effect. See *supra,* note 13, at 580. For a discussion of the account settlement issue in general, see Holden, *ibid,* and *Camilla Tank Steamship Co.* v. *Alexandria Engineering Works* (1921), 38 T.L.R. 134 (H.L.).

[58] Justice Hunter makes this express conclusion *supra,* note 13, at 580, and on this issue, Justice Faud agreed (at 569). The analytical approach adopted by Justice Cons did not really necessitate a consideration of this account settlement issue. Lord Scarman, in his comments, speaks in terms of 'conclusive evidence' effect, and therefore adopts a similar approach: *infra* note 63 and accompanying text.

In interpreting the clauses in the three contracts, Lord Scarman adopted a strict construction approach, construing the words *contra proferentem* the banks, following a similar approach to that adopted by the trial judge[59] and favoured by Laskin J. in the *Arrow Transfer* case.[60] His Lordship suggests that strict construction principles will apply to words which attempt either to impose a duty of care or create an evidentiary, or admitted, statement of account:

> ... in no case do they constitute what has come to be called 'conclusive evidence clauses'. Their terms are not such as to bring home to the customer either 'the intended importance of the inspection he is being expressly or impliedly invited to make' or that they are intended to have conclusive effect against him if he makes no query, or fails to make a query in time, on his bank statement. If banks wish to impose on their customers an express obligation to examine their monthly statements and to make those statements, in the absence of query, unchallengeable by the customer after expiry of time, the burden of the obligation and the sanction imposed must be brought home to the customer .... Clear and unambiguous provision is needed if the banks are to introduce into the contract a binding obligation on the customer who does not query his statement to accept the statement as accurately setting out the debit items in the accounts.[61]

The wording of the clauses before the court left much to be desired from the point of view of such a strict test.[62] For the future, if a bank intends to rely on an admitted statement of account argument, its express clause should clearly indicate the account as reflected in the statement is to be taken as 'conclusive' if not queried within the stipulated time frame, bringing the gravity of the sanction home to the customer. This might well require a clear statement that the customer bears the risk of loss for forgeries in the face of failure to dispute the statement. If the bank intends to rely on an imposed duty argument, it may not be enough to rely on a bare statement in the express terms that the customer accepts such a duty, for Lord Scarman indicates that the customer must be made aware of the importance of the duty to inspect (or by extension, duty to conduct operations with due care) before it would meet the rigid interpretation test. Once again, this may require an express statement of transferred risk of loss in the case of forgery to the customer.

The Stare Decisis Issue

During the course of the argument, it was suggested that even if the English courts were bound to follow the strict decisions in *Macmillan* and *Greenwood,* the Privy Council was not in the same position. However, it was agreed in this case that the applicable law was English law, in which case, said Lord Scarman, the Judicial Committee will follow a House of Lords decision which covers the point in issue. While the House of Lords, as a result of the 1966 practice statement, may depart from its own decisions, the Privy Council will not depart

[59] The comments of the trial judge on this issue can be seen in the judgment of Justice Cons in the Court of Appeal, *supra,* note 13, at 565-66.
[60] *Supra,* note 8, at 97-98.
[61] *Supra,* note 1, at 959.
[62] The clauses are set out *supra,* note 54.

from a decision of the House where it is accepted or decided that the point is governed by English law. The only qualification to this general principle is outlined by Lord Scarman:

> It is, of course, open to the Judicial Committee to depart from a House of Lords decision in a case where, by reason of custom or statute or for other reasons peculiar to the jurisdiction where the matter in dispute arose, the Judicial Committee is required to determine whether English law should or should not apply.[63]

If this is indeed the approach which will be taken by the Judicial Committee, it has important implications for counsel in Singapore when faced with a decision of the House of Lords which stands in the way of success. Clearly, in such cases, counsel should not readily admit the matter is governed by English law. However, this might be a difficult admission to avoid in situations where the issue is governed by the common law, or is an issue subject to statutory provisions such as s. 5 of the Civil Law Act.[64] In the former situation, the argument should be made that by reason of custom, or reasons peculiar to Singapore, the common law has developed differently here[65] In the latter case, attempts might be made to argue that the law of England to be administered here needs modification and adaptation due to local circumstances.[66] If either case cannot be strongly and substantively made out, the local courts, subject to Privy Council jurisdiction, would be themselves bound to apply the English decision, as, according to Lord Scarman, the Privy Council itself would take that stance.

Conclusion

In Hong Kong, and in all jurisdictions subject to Privy Council jurisdiction where this point is governed by English common law, a customer's duty of care to a bank is no wider than has been recognized by the *Macmillan* and *Greenwood* cases. Only a decision by the House of Lords departing from the limits of those cases, and disagreeing with the Privy Council on the main issues here, can alter this position. Barring statutory intervention, banks wishing to extend the duty of care owed by customers will have to rely upon precisely worded clauses[67] in express terms of business contained in the rules

63 The complete comment of Lord Scarman on this point, can be found in the case report, *supra,* note 1, at 958, *b-e.*

64 Singapore Statutes (Rev. Ed. 1970) Cap. 30.

65 This is, in essence, an argument that the common law has developed differently in Singapore than it has in England. The concept of divergent development of the common law has itself been accepted by the Privy Council in *Australian Consolidated Press Ltd.* v. *Uren* [1969] 1 A.C. 590. In theory, of course, due to the fact that there is a cut-off date in most jurisdictions for the reception of English law, counsel should not have to establish affirmatively that the common law has developed differently here. However, in practice, English common law is treated as being continually received, and therefore, convincing affirmative arguments for divergent development may well have to be presented to a court.

66 This argument would rely on s. 5(3) (a) of the Civil Law Act, *supra,* note 64, which was introduced into the Act by the Civil Law (Amendment No. 2) Act 1979, No. 24 of 1979.

67 Of course, depending upon the type of clause inserted into the agreement, in jurisdictions where the Unfair Contracts Terms Act 1977 applies, consideration should be given to whether or not the provisions of that Act would be applicable. The applicability of the provisions of the Act to a particular clause will depend upon the facts of any given case, the nature

and regulations of account operation or in other documents, such as account verification agreements.[68]

Due to the strict interpretion approach adopted by the Privy Council for such express terms, banks seeking to draft appropriate terms might find it difficult to formulate with sufficient certainty provisions which will impose a duty of reasonable care to cover all eventualities which might arise. One alternative would be to draft a clause placing all risk of loss for forgery on the customer. However, as this would run counter to the very foundation of the bank-customer mandate, banks might well opt for simple but clear clauses which provide that the statement of account is to become conclusive evidence of the account balance.

The effect of such a clause is that the risk of loss on forgery rests with the bank, but only until the time period for notifying the bank of wrongful debits on any given statement expires. After such time, the account is taken as conclusive and the loss becomes that of the customer. This has the advantage of making the bank liable for paying without a mandate (at least until such time as the statement becomes conclusive evidence of the balance) while placing an onus on the customer to help the bank by checking the monthly statement. The disadvantage of such clauses is that they pass the risk of loss to the customer after the expiry of time allowed for checking the statement, whether or not the customer has been negligent either in its internal management procedures or failing to notice the inaccuracies in the statement.

There can be no doubt, due to the reliance on the comments of Bray J. and the use of a *contra proferentem* approach to contractual interpretation, that the Privy Council was motivated by a desire to protect a customer where a bank pays on a forged cheque, especially since a bank may be better able to bear the loss. The question which should have been asked is whether greater protection will be provided a customer by subjecting him to express clauses which may make him liable regardless of negligence or by imposing, as an implied term of a contract, a duty of reasonable care in his management operations and in inspecting his statements, a duty which could adjust itself to actual fact situations, type of customer and his conduct in any given case. In the long run, depending on the response of banks in terms of express provisions adopted, the latter may have provided greater customer protection.

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of the Bank's customer, the nature of the clause used, etc. In many instances, the situation may not come within the technical provisions of the Act, and even if such were the case, many such clauses could arguably satisfy the test of reasonableness laid down in the statute. As so much depends upon the nature of the clause, and upon the particular facts involved, and as the matter has not been considered by the case authorities dealt with here, further consideration of the point is outside the scope of this comment.

[68] Such agreements are common in some jurisdictions. In Canada, they have been given effect by the majority decision in the *Arrow Transfer* case, *supra,* note 8.

* Lecturer, Faculty of Law, National University of Singapore.

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