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Reclaiming Moneys Paid under Fraud in Documentary Credits

Standard Chartered Bank v *Sin Chong Hua Electric & Trading Pte Ltd & Ors*[1]

A bank need not pay against the presentment of documents stipulated under a letter of credit if the documents presented prove to be fraudulent. But what happens when the moneys have already been paid over to the beneficiary? What if the moneys have been further transferred to the account of a third party? Goh Joon Seng J's decision in *Standard Chartered Bank* v *Sin Chong Hua* establishes that the bank has a proprietary claim against both the initial recipient as well as the third party as long as the moneys paid over are traceable.

In *Sin Chong Hua*, the first defendants were traders who contracted to provide generators to Indonesian buyers. The plaintiffs were instructed by the buyers to open a letter of credit in favour of the first defendants. The first defendants presented documents which *ex facie* showed that the generators had been shipped. This was not so – what were in fact shipped were bricks. When the fraud was discovered, the bank had already paid into the first defendants' account with another bank (UOB) and the first defendants had disbursed the moneys into various other accounts, including that of the second and fourth defendants kept with AMEX. The second and fourth defendants' claims that they were *bona fide* purchasers for value were rejected on the evidence. Goh J held that as the plaintiffs were entitled to recover the payments from the first defendants, they had a persistent equitable proprietary interest akin to that found in *Chase Manhattan Bank* v *Israel British Bank (London) Ltd*[2] which entitled them to trace into the accounts of the second and fourth defendants. In the result, Goh J declared that the moneys in these accounts belonged to the plaintiffs.

1 [1995] 3 SLR 863. Judgment delivered on 3 September 1991.
2 [1981] 1 Ch 105.

His Honour quoted extensively from *United City Merchants (Investments) Ltd* v *Glass Fibres and Equipments Ltd*,[3] *Edward Owen Engineering* v *Barclays Bank*[4] and Professor Ellinger's *Documentary Letters of Credit*[5] to establish the proposition that the bank has a good cause of action to recover from the payee the moneys paid over. His Honour cited *Chase Manhattan Bank* for the proposition that in circumstances of mistaken payments, the payor has a persistent equitable proprietary interest which allows him to trace the proceeds into other accounts.

Nonetheless, not every mistaken payment entitles the payor to claim that he has a persistent equitable proprietary interest in the moneys paid over. Dictum from the Privy Council in *Re Goldcorp Ltd*[6] indicates that a distinction ought to be made between (a) a transfer of property under a void basis, and (b) a transfer of property under a voidable basis. An instance of a case in the former category will be *Sinclair* v *Brougham*[7] where the transfer was void for the contract being *ultra vires* the recipient of the property. In this category, the beneficial interest remains with the transferor and it will be readily accepted that there is a persistent equitable proprietary interest leading to an equitable right to trace and thereon to a proprietary claim.

In the latter category will be cases where the transfer is *prima facie* valid but voidable at the option of the transferor because of vitiating factors like fraud and undue influence. It is by no means undisputed that there is an unfettered right to trace in this category. For a start, what may be considered as falling within the concept of "persistent equitable proprietary interest" here is different in nature from that in the first category. In such cases of voidable transfers, it is commonly assumed that the beneficial interest is transferred to the transferee.[8] Indeed, in *Re Goldcorp Ltd*, the Privy Council held that where the moneys were transferred absolutely to the use of the transferee albeit under a voidable contract, the moneys would not be impressed with a trust in favour of the transferor. To do so, "it is necessary to show either a mutual intention that the moneys should not fall within the general fund of the company's assets but should be applied for a special purpose, or that having originally paid over without restriction

[3] [1983] 1 AC 168.

[4] [1978] QB 159.

[5] EP Ellinger, *Documentary Letters of Credit: a Comparative Study* (University of Singapore Press, 1970).

[6] [1994] 2 All ER 806 at 824-25.

[7] [1914] AC 398. See also *Westdeutsche Landesbank Girozentrale* v *Islington LBC* [1994] 3 WLR 938 (property received under an *ultra vires* swap transaction entered by the local authority).

[8] *Hodgson* v *Marks* [1971] Ch 892, 929.

the recipient has later constituted himself a trustee of the money."[9] In a voidable transaction, what equity confers on the transferor is an entitlement to rescind and the mere equity to "revest the equitable title to the purchase money in themselves – at least to the extent necessary to support an equitable tracing claim."[10] It appears that in order to assert proprietary interest in the funds into which the moneys are paid, it is necessary to successfully rescind the contract.[11] Although authorities like *Stump* v *Gaby*[12] may suggest that the transferor of a voidable transaction has beneficial interest relating back to the point of transfer, the High Court of Australia in *Latec Investments Ltd* v *Hotel Terrigal Pty Ltd* has explained that the right to assert this interest is contingent on his right to enforce his equity.[13] Thus where the subsequent transferee has obtained a beneficial interest in the subject matter for value without notice, the contest would be between transferor's equity to set aside the transaction and the subsequent transferee's equitable interest; in these circumstances, the subsequent transferee's equitable interest would prevail. The maxim *qui prior est tempore potior est jure* has no application. This applies also to a case where the subject matter of transfer is money; the transferor's election to avoid the contract is a necessary pre-condition to asserting an equitable title to the moneys lent.[14]

What the *Latec* case shows is that an equitable right can be classified differently for different purposes. Goh J's judgment inclines – if impliedly – towards the position that the transferor's right to avoid the transaction may be classified as a persistent equitable proprietary interest for the purpose of tracing. This is similar to the position of Millett J in *El Ajou* v *Dollar Land Holdings*.[15] However this position is not one which has been incontrovertibly accepted. In *Westpac Corporation* v *Markovic,*[16] a bank lent money to a bankrupt fraudster who used it to purchase certain shares in a company; the Supreme Court of South Australia held that the bank was not allowed to trace the moneys into the shares which came to vest in the Official Receiver in Bankruptcy.[17] In *Re Goldcorp Ltd*, the Privy Council

9 *Supra,* note 6, 823.

10 *El Ajou* v *Dollar Land Holdings plc* [1993] BCLC 735 at 753, *per* Millett J.

11 *Supra*, note 6, at 825e-f.

12 (1851) 2 De G F & G 623, 42 ER 1015.

13 *Latec Investments Ltd* v *Hotel Terrigal Pty Ltd* [1965) 113 CLR 265, 290-91 *per* Menzies J.

14 *Daly* v *Sydney Stock Exchange* (1986) 60 ALJR 371, 378.

15 S*upra,* note 10, at 753.

16 (1985) 82 FLR 7.

17 In principle, the Official Receiver in Bankruptcy should be in no better position than the bankrupt; see *Ex p Holthausen* (1874) LR 9 Ch D 812. Therefore the result in a case where the fraudster is a bankrupt should not differ from a case where the fraudster is solvent. Nonetheless, Zelling J in *Markovic* inclined towards the view that s 58 of the Bankruptcy

seemed to deny the possibility of tracing unless the plaintiffs have effectively rescinded their contract.[18] A time may yet come for a fuller consideration of the issue of when a mere equity to rescind enables tracing to be carried out. Until then, it would make for clearer analysis to make a distinction between property passing under a voidable basis and one passing under a void basis.

Equitable tracing is useful not just for the purpose of founding a proprietary claim but also to establish a personal claim against a person who knowingly receives the trust property or knowingly assists in the breach of trust. However, Goh J did not seem to be attempting to establish whether the second and fourth defendants had knowingly received the monies in question.[19] Instead, he appeared to be using equitable tracing to establish the common law action for monies had and received. Under English law, one has to proceed under common law tracing in order to establish this cause of action. It will appear that the present case cannot satisfy the common law rules of tracing since *Agip (Africa) Ltd* v *Jackson*[20] has established that monies which pass through the clearing system – as appeared to be the facts in the present case – cannot be traced at common law. Goh J's juxtaposition of equitable tracing and his citation of *Lipkin Gorman* v *Karpnale*[21] therefore appears to indicate a desire to extend the present law to allow the common law action for money had and received to be established based on equitable tracing. Whether this is a desirable development of the law should be subject to fuller consideration since one will effectively be abolishing the restrictions attendant to establishing liability for money had and received. Alternatively, his "fusion" of equitable tracing and the action for money had and received may be viewed as abolishing the "knowledge" requirements in the equitable action for knowing receipt. Goh J's approach has wide ramifications. This liberal conception of tracing and the action for money had and received will widen the law's reach of persons against whom restitution may be sought. With the explicit adoption of the innocent change in position defence by the House of Lords,[22] as well as by the Singapore Court of Appeal,[23]

Act 1966 (Cth) which vests after-acquired property in the Official Receiver prevents the defrauded payor from tracing the money into the shares. Quaere: whether *Markovic* has ramifications beyond the insolvency context? See further, note 27.

18 *Supra*, note 6, at 825. See Hayton's comment [1994] LMCLQ 449 at 452.

19 *Bank Tejarat* v *Hong Kong and Shanghai Banking Corporation* [1995] 1 Lloyd's Rep 239 is a case on similar facts but resolved according to the orthodox equitable principles governing liability for knowing receipt and knowing assistance.

20 [1990] Ch 265 at 286, *per* Millett J. Affirmed by Court of Appeal [1991] 3 WLR 116 at 238.

21 [1991] 2 AC 548.

22 *Lipkin Gorman* v *Karpnale*, *supra,* note 21.

23 *Seagate Technology Pte Ltd* v *Goh Han Kim* [1995] 1 SLR 17.

the recipient's interest in the security of receipts may yet be adequately protected. Nonetheless, it should be a development which should be carefully considered before it is properly accepted into the legal system.

As to the nature of the proprietary interest, Goh J's conclusion that the moneys in the second and fourth defendants' accounts *belonged* to the plaintiff in the passage immediately following the citation of *Lipkin Gorman* can be a little misleading.[24] The moneys do not belong to the plaintiff by the facultative rules of property law. The proprietary claim arises only because the court of equity as a court of conscience will compel the defendants to treat the assets as trust assets given the circumstances in which the defendants have received the property in their hands.[25] It is important to recognize that equity's recognition of a plaintiff's proprietary claim is influenced by such factors as laches or his coming to equity with "unclean hands". The proprietary remedy which equity awards also varies: an equitable lien is possible[26] in addition to the constructive trust. Furthermore, in order to assert a proprietary claim over these assets, he may have to satisfy the court that there is no impediment to rescission and revesting of property in him. Thus, where the defendant has charged the assets to a *bona fide* purchaser for value without notice, the *bona fide* purchaser's interest will trump the plaintiff's. On the other hand, when the defendant is insolvent, the plaintiff's equity will probably prevail against the claims of the trustee in bankruptcy.[27] Fortunately for the plaintiffs in *Sin Chong Hua*, these complications did not afflict their case. The moneys were traceable into

24 *Supra*, note 1, at 872.

25 *El Ajou*, *supra*, note 10, at 737.

26 See *Lord Napier and Ettrick* v *Hunter* [1993] 1 All ER 385.

27 The trustee in bankruptcy as an officer of the court is obliged to act in an honourable and high-minded manner: *Ex p James; Re Condon* (1874) LR 9 Ch 609. Furthermore, it appears well established that the intervention of bankruptcy does not prevent a defrauded party from rescinding the contract and seeking the revesting of the transferred property in him: *Tilley* v *Bowman* [1910] 1 KB 745. Complications arise where the defrauded party is attempting to set aside a payment of money and trace into traceable exchange products; *Westpac Corporation* v *Markovic*, *supra,* note 16, suggests doubts to the proposition that a defrauded payor can set aside the payment and trace into property for which the moneys were exchanged. Similarly, *Daly* v *Sydney Stock Exchange* (1986) 60 ALJR 371 appears to deny the tracing remedy when a lender advances money following fraudulent misrepresentation by the borrower. Perhaps the denial of the equitable tracing can be explained on the basis that peculiar rules govern the insolvency context; while transferors of property may be allowed to reclaim title to the original property, transferors of money will generally not be able to assert title to traceable proceeds of the original property. A distinction should, however, be made in a case where the money transferred is impressed with a trust from the moment of receipt as in a Quistclose scenario where the payment induced by fraudulent misrepresentation is used to make an unauthorised investment or purchase. See *Barclays Bank Ltd* v *Quistclose Investments Ltd* [1970] AC 567 and *Carreras Rothmans Ltd* v *Freeman Mathews Treasure Ltd* [1985] Ch 207.

identifiable accounts which were not subject to any security interest. The account holders were not bankrupt either. There was therefore no impediment to the plaintiffs asserting their equity. Nonetheless, it is important to bear in mind that it is the intervention of equity which creates the plaintiffs' proprietary interest.

The simple facts of this case and the apparently obvious resolution it calls for belies the difficult issues that underlie restitution and the law of tracing. The law of restitution – and along with it, the law of tracing – is still in the process of systemisation. It is hoped that in the future, Singapore courts will rise to the challenge to rationalise the "rough edges" and perhaps to add to the development of these exciting areas of law.

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