EW Barker Centre for Law & Business
Faculty of Law

NUS EW Barker Centre for Law & Business Working Paper 23/04

NUS Law Working Paper 2023/015

Preventing Fraud on Bank Customers and Creditors

Hans Tjio

Professor, EW Barker Centre for Law and Business,

Faculty of Law, National University of Singapore

[Uploaded May 2023]

© Copyright is held by the author or authors of each working paper. No part of this paper may be republished, reprinted, or reproduced in any format without the permission of the paper's author or authors.

Note: The views expressed in each paper are those of the author or authors of the paper. They do not necessarily represent or reflect the views of the National University of Singapore.

Preventing Fraud on Bank Customers and Creditors (Hans Tjio) (to be presented at Conference on Fraud and Risk in Commercial Law, NUS, June 2023)
May 2023

Modern day fraud looks different, partly due to technological change and the use of financialized entities in a changed regulatory environment which has removed many frictions that used to exist in business. Sometimes the victim is the direct author of its own loss, as with authorized push payment fraud. Often, this comes about because some form of deception has been practiced on the victim and so the issue is with gatekeeper liability, often for an omission. We now see the rediscovery of a common law duty based on failure to prevent fraud on the part of banks in the UK. This may partly be due to courts' increasing willingness to accept regulatory standards in deciding on facilitator liability, even if that may not have been the case in the past with respect to the more direct liability of financial institutions. Negligence may have to be understood in context, however, if liability is linked to external regulatory codes. But facilitators are not just entities themselves; often senior individuals (as opposed to those whose wrongs are attributable to the firm) in those entities can and must be incentivized to set up systems to prevent external wrongdoing or regulatory breaches. While they are usually insulated from liability to third parties, their duties to their company or entity must also be understood in context so that a proper chain of responsibility can be created.

There are important recent decisions on areas like transactions (such as large dividend payments) to defraud creditors where it has not followed that directors are liable simply because the company has breached an external rule. It will be suggested that both fraudulent conveyance laws and directors' duties had and have to respond to the changed regulatory space. Many of the permitted powers in today's financial context were once prohibited, with regulatory competition removing or diluting capital maintenance rules like, for example, the prohibition against a company giving financial assistance for the acquisition of its own shares. Such a rule once provided a checkpoint to prevent egregious management behavior which in turn founded cases on knowing assistance and receipt by third parties but often no longer exist. Regulatory changes provided new powers to decision makers but may have imposed duties on facilitators and we need to find the right framework to ensure that they are exercised properly and judged accordingly.

Keywords: Banking Law, *Quincecare*, Negligence, Individual Liability, *Sequana*, Directors' Duties, Capital Maintenance

Modern day fraud

Fraud today is different for a number of reasons. First, much of it is linked to technology. This has facilitated greater anonymity and automation in facilitating fraud. At the same time, the enhanced security of systems today, whether financial or proprietary, even if not absolute, means that fraud will be at the end-user level as Low has pointed out[1] and which will be the focus of the first part of this chapter. One example of this in Singapore is with the bank "phishing" scam in December 2021 where 790 people were convinced by fake emails purportedly from a Singapore bank to provide their details to fraudsters who emptied their bank accounts of almost S$14 million (£8 million). While an independent review showed that there was no cyberattack on the bank's IT systems, the regulators found the relevant bank to have been slow in reacting to the "phishing" attacks and it was required to make goodwill payments to its account holders and increase its regulatory capital.[2] We will see that it may be that private law could have provided the possible causes of action to justify the imposition of such ad-hoc measures against banks.

But regulatory changes have also meant that what may not have been seen as fraudulent once is now so, and vice versa. Money laundering and terrorism financing are the clearest examples of the former. Know-your-client rules are expected not just of banks but also solicitors and even real estate agents who are in a difficult position as facilitators given their lower level involvement. Conversely, what may have been seen once as financial fraud is no longer so and this will form another focal point for this chapter. This is because many Commonwealth corporate law rules have been liberalised before the altar of shareholder primacy since the 1980s[3], and this has impacted not just the corporation and its directors but also private law, especially in its effects on shareholders and third parties dealing with corporations. But the factual matrices are not that different in that the parties are the same: there is a victim, primary wrongdoer and facilitator. What has changed, however, is the *roles* that the parties play in the fraud: whilst in the past, the victim and primary wrongdoer were often connected and there would have been a relational breach that a facilitator assisted in, today, it is more likely that the victim and facilitator are linked, and we may thus expect the latter to do more to protect the former.

Selangor Rubber Estates: Financial and Dishonest Assistance

The case that evidences these temporal changes most clearly is *Selangor United Rubber Estates Ltd v Craddock (No 3)*[4] ('*Selangor*'). Here, District Bank was found to have knowingly assisted

---

[1] KFK Low, 'Confronting Cryptomania: Can Equity Tame the Blockchain?' (2020) 14 *Journal of Equity* 240, 256.

[2] 'MAS Imposes Additional Capital Requirements on OCBC Bank for Deficiencies in Response to Spoofed SMS Phishing Scams' (26 May 2022) at https://www.mas.gov.sg/news/media-releases/2022/mas-imposes-additional-capital-requirement-on-ocbc-bank-for-deficiencies-in-response-to-spoofed-sms-phishing-scams (accessed 7 May 2023).

[3] RJ Rhee, 'The Neoliberal Corporate Purpose of Dodge v. Ford and Shareholder Primacy: A Historical Context 1919-2019' (2023) 28 *Stanford Journal of Law, Business, and Finance* 202.

[4] *Selangor United Rubber Estates Ltd v Craddock (No 3)* [1968] 1 WLR 1555 (Ch).

a breach of trust by the directors of the plaintiff company, who had used the company's funds to provide financial assistance to Craddock to purchase 79% of the plaintiff company's shares in a takeover. In a roundabout way, company money was paid by cheques drawn on the bank to WT Ltd who borrowed the money at 8% and then lent the money to Craddock at a 1% premium. Craddock having disappeared with the loan outstanding, successful claims were brought against the directors of the plaintiff company for breach of fiduciary duty, as well as against WT Ltd and the bank for dishonest assistance of those breaches, with the latter also said to be negligent in handling the plaintiff company's accounts by paying the money to WT Ltd without inquiry.

The concerns with fraudulent takeovers of cash rich companies in the 60s and 70s[5] gave way to LBOs and MBOs in the 1980s with the belief that the market for corporate control would improve corporate governance.[6] There was growing faith in shareholder primacy which led to regulatory changes to permit takeovers where the bidder did not have its own resources. While the requirements of dishonest assistance have evolved,[7] more important for present purposes is the fact that the foundational prohibition against a company giving financial assistance to a share purchaser – the contravention of which was what District Bank was held to have assisted in the *Selangor* case – no longer applies to private limited companies in the UK. This is the case in many countries now, with some relaxation intruding even into the sphere of public companies, who, in Singapore for example, are now merely subject to a material prejudice test that is also of general application in Australia.[8] As such, if the facts of *Selangor* were repeated today, there would be no breach of trust, fiduciary or any other duty on the part of directors for the bank to assist in.

But private law always finds a way, and the other aspect of the bank's liability in *Selangor*, based on a duty of care on the part of the bank to its corporate customer in relation to the latter's bank account, has found a new lease of life. It was largely overlooked until recently, as the focus was on restitutionary and third party claims in equity.[9] Steyn J (as he then was) in *Barclays Bank plc v Quincecare Ltd*[10] ('*Quincecare*') reformulated the relevant principle as follows:

> In my judgment the sensible compromise, which strikes a fair balance between competing considerations, is simply to say that a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has

[5] A Hudson, *The Law and Regulation of Finance*, 2nd edn (London, Sweet & Maxwell, 2013) [30-35].

[6] PL Davies, *Introduction to Company Law*, 3rd edn (Oxford, Clarendon Press, 2020) 107.

[7] In particular, the mental element, which has shifted over time from a form of notice to knowledge, then dishonesty, and now possibly back to knowledge again: *Group Seven Ltd v Nasir* [2019] 3 WLR 1011; see generally, PS Davies, 'The Mental Element of Accessory Liability in Equity' (2022) 138 *LQR* 32.

[8] Companies Act 1967 (Singapore), s 76(9)(BA); Corporations Act 2001 (Cth), s 260A.

[9] See, eg, C Hewetson and G Mitchell QC, *Banking Litigation*, 4th edn (London, Sweet & Maxwell, 2017) Ch 1 (Deposit-Taking Liability).

[10] *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363 (Comm), 376-7.

> reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company … And, the external standard of the likely perception of an ordinary prudent banker is the governing one.

Even so, the now termed *Quincecare* duty of care remained dormant for almost 30 years until 2017 when Rose J (as she then was) applied it in *Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd*[11] ('*Singularis*'). It was then quickly applied in *Federal Republic of Nigeria v JP Morgan Chase Bank, NA*[12] ('*Nigeria*') (where the bank was refused reverse summary judgment) and then *Roberts v Royal Bank of Scotland plc*[13] (where the action was time barred and the bank resultingly awarded reverse summary judgment, although the court thought it was not difficult for bank customers to plead a *prima facie* case in this context). However, these were still orthodox cases involving the bank being in substance an accessory to a breach of duty owed by the wrongdoer to the victim. This subsequently set the stage for the argument in *Philipp v Barclays Bank*[14] ('*Philipp*') that the duty could be extended to cases where the wrongdoer is independent from or unknown to the victim, but has set up a scheme which has led to the victim's will being slightly overborne. This is important as the Court of Appeal in *Philipp* noted that authorised push payment fraud had been identified as the second most prevalent financial fraud after credit card fraud.[15]

***Philipp* and return to negligence**

In *Philipp*, a couple lost their life savings after instructing Barclays Bank to transfer money in their account to accounts of a petroleum company in the UAE. They were advised to do this by fraudsters who convinced them that they had to transfer the funds to safe accounts to avoid fraud and were in fact assisting FCA investigations by doing so. While the actual facts were in dispute, particularly as to whether the bank had warned the claimants about possible risks, the Court of Appeal reversed the decision of the first instance judge[16] who had struck out the plaintiffs' claim on the basis that the claimants were individuals who were victims of external fraud that they authorised and not corporate customers defrauded by their own agents. The

---

[11] *Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd* [2017] EWHC 257 (Ch), [2017] Bus LR 1386 whose decision was upheld on first appeal in *Singularis Holdings Ltd (in Liquidation) v Daiwa Capital Markets Europe Ltd* [2018] EWCA Civ 84, [2018] 1 WLR 2777, and then on final appeal in *Singularis Holdings Ltd (in Liquidation) v Daiwa Capital Markets Europe Ltd* [2019] UKSC 50, [2020] AC 1189.

[12] *Federal Republic of Nigeria v JP Morgan Chase Bank, NA* [2019] EWHC 347 (Comm), affirmed in *JPMorgan Chase Bank, NA v Federal Republic of Nigeria* [2019] EWCA Civ 1641.

[13] [2020] EWHC 3141 (Comm).

[14] [2022] EWCA Civ 318, [2022] QB 578; noted S Booysen 'Authorised Payment Scams and The Bank's Duty of Care' [2022] *LMCLQ* 349; P Watts 'Playing the Quincecare Card' (2022) 138 *LQR* 530; RY Chua, 'The Quincecare Duty: An Unnecessary Gloss?' [2023] *JBL* 161.

[15] ibid [15].

[16] [2021] EWHC 10 (Comm), [2021] EWHC 10 (Comm). Cf Chua (n 18), who points out that a duty of care to ignore the customer's instructions directly contradicts the bank mandate. It is better dealt with by agency and fiduciary principles in cases of internal fraud and external fraud respectively.

Court of Appeal traced the line of cases from *Selangor* to *Singularis* and acknowledged that they had lowered expected standards of care but felt that the duty was to protect the customer and not the bank. Consequently, there was no limitation of the duty to corporate claimants only, and the bank possibly owed a duty of care to the individual claimants here. We will see that the issue is perhaps not who the plaintiff is but the fact that the defendant is a financial institution.

The Court of Appeal recognised, however, that the duty of care was likely co-extensive with an implied term in the banker-customer contract[17] which required the bank to observe the customer's mandate. As Hudson has long advocated,[18] however, the Court of Appeal looked also at the fact that banks are required to have anti-money laundering procedures in place in finding that a duty could exist, although it also thought that the matter had to go to trial given the link between duty and standard in such cases.[19] This clearly demonstrates that the duty of care may be inversely correlated with the expected standards of care. Courts are more prepared to find the existence of a duty if it does not impose intolerable burdens on the relevant parties. But there are deeper philosophical questions if the two are linked as Amirthalingam has pointed out that there is then "little maneuverability"[20] with respect to the duty of care. There will invariably then have to be a trial to in effect examine whether there was a breach of the expected standards of care. But if the standards are low, the bank usually wins.

In the UK, in the trial of the *Nigeria* case,[21] it was held that the *Quincecare* duty required a bank to be put on inquiry that a specific payment instruction that had been impugned might be vitiated by fraud, and not merely "fraud in broad terms" based on historical allegations of corruption and financial crime.[22] Thus, simply because there might have been "plainly high-risk features for the purposes of AML and financial crime and corruption generally" was "plainly not enough" for the bank to be put on notice of a "serious and obvious risk of a fraud" on a particular occasion.[23] It was also held that the terms and conditions there required gross negligence as they had modified the *Quincecare* duty. Hence, while Burrows QC (as he then was) had earlier recognised at the striking out stage[24] that the duty of inquiry aspect of the *Quincecare* duty would be in line with sound policy because "in the fight to combat fraud, banks with the relevant reasonable grounds for belief should not sit back and do nothing", it is clear now that the duty is carefully calibrated and narrowly circumscribed,[25] as demonstrated

[17] *Philipp* (CA) (n 14) [37]-[38].

[18] Hudson (n 5) [26-24].

[19] *Philipp* (CA) (n 14) [77]-[78].

[20] K Amirthalingam, 'Duty? It's Just Not Cricket' (2002) 10(3) *Tort Law Review* 163, 165.

[21] [2022] EWHC 1447 (Comm).

[22] ibid [346]-[347].

[23] ibid [350].

[24] *Nigeria* (HC) (n 12) [30].

[25] Booysen (n 14) 354.

by the requirement of specificity that the red flags alleged must relate to the particular transaction at hand. Consequently, we have seen pushbacks since *Phillip* in an attempt to keep open the existence or applicability of the duty as a question of law that provides a filter at an earlier stage.

Pushback

A recent Malaysian case shows that the *Quincecare* duty does not apply to moneys borrowed from the bank but only where the bank is "custodian" even though in *Selangor* it was seen more as the liability of a paying bank.[26] In Singapore, without referencing *Quincecare*, it was held that a bank which refused to accept its customer's deposit could not be seen to owe a duty of care as negligence just did not fit the factual matrix.[27] That may in fact be a problem in these cases – how to frame the action such that it is intuitive and does not lead to too much unnecessary litigation given that banks have so many different relationships with their clients, many of which are not "custodial" in nature. Even where the *Quincecare* duty exists, the majority in the UK Supreme Court in *Stanford International Bank v HSBC plc*[28] ('*Stanford'*) rejected an appeal against the striking out of a claim on the basis that the bank's customer was already insolvent by the time its account was depleted and so did not suffer an actionable loss.

Just prior to *Stanford*, in *Royal Bank of Scotland International Ltd v JP SPC 4*[29] *('RBS')*, the Privy Council found that the duty did not extend to third party beneficiaries of a customer's account who were defrauded by the customer unless the purpose of the bank's service was to protect the third party. Here the bank customer was a company run by two fraudulent individuals who misapplied monies beneficially owned by fund investors. The moneys were to be lent to a law firm but much of it went to accounts of the two fraudsters. In upholding the decision of the court below to strike out the claim against the bank, the Privy Council said that it would only be in highly exceptional situations that there would be a duty of care as it would otherwise undermine extant dishonest assistance rules.[30] It disapproved of cases suggesting a duty of care to third party non-account holders such as *Baden v Société Générale pour Favoriser le Développement du Commerce et de I'Industrie en France SA*[31] ('*Baden*') (like *Selangor* better known for accessory liability and states of knowledge) which had relied on the

[26] *Alliance Bank Malaysia Bhd v Khee San Food Industries Sdn Bhd* [2021] 12 MLJ 78.

[27] *AL Shams Global Ltd v BNP Paribas* [2018] SGHC 143, [2019] 3 SLR 1189.

[28] [2022] UKSC 34, Lord Sales dissenting on the basis that *Sequana* sees the company representing creditor interests in insolvency; see RY Chua, 'The Aftermath of a Ponzi Scheme' [2023] LMCLQ 218.

[29] *Royal Bank of Scotland International Ltd v JP SPC 4* [2022] UKPC 18, [2022] 3 WLR 261, noted A Bellas 'Royal Bank of Scotland International Ltd v JP SPC 4: Assumption of Responsibility and the Quincecare Duty' (2023) 139 *LQR* 215; KP Soh and R Tan 'The Quincecare Duty and Third-Party Beneficial Owners' [2023] *LMCLQ* 6.

[30] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC).

[31] *Baden v Société Générale pour Favoriser le Développement du Commerce et de I'Industrie en France SA* [1993] 1 WLR 509.

discredited two-stage *Anns*[32] test. It also thought[33] that Peter Gibson J in *Baden* had not identified the case as one involving economic loss and omission, where there is a duty only in more restricted circumstances. The PC ultimately used the incremental approach of *Caparo Industries plc v Dickman*[34] and the more modern doctrine of assumption of responsibility contained in the judgment of *N v Poole Borough Council*,[35] and finding none in relation to the third-party beneficiaries of the account, held that the protection offered by the *Quincecare* duty did not extend to them.

These are understandable attempts at retaining some form of control at the duty of care level. This examines the scope of duty not as a test of causation or remoteness but more of a threshold inquiry.[36] But it does show that using the general rubric of negligence may not always be the best fit here. The question is how to translate a duty of inquiry from a relationship with a bank customer into negligence if inquiries are not made by the bank. This suggests some form of gatekeeper or oversight liability at a time when fraud is omnipresent but while there is some intuitive link between the duty to inquire and negligence, there are also difficulties implementing it. First, there is the overlay between contract and tort. Second, courts are generally reticent to impose negligence liability in respect of omissions,[37] and with pure economic losses.[38] Third, it seems to apply to entities only, possibly because there are external rules applicable to them. Fourth, even if it is negligence liability, can it be better categorised given that banks have insulated themselves from liability in much of their other dealings with their customers. Finally, the liability here is direct in that the bank assumes responsibility to the customer and is not vicarious liability derived from employee wrongdoing. Should there, however, be a senior person within the bank that should be personally liable, not to the customer, but the bank, for not setting up systems that would have ensured that the bank made the necessary inquiries?

Oversight liability and contextual negligence

---

[32] *Anns v Merton London Borough Council* [1978] AC 728 (HL).

[33] *RBS* (n 29) [53].

[34] *Caparo Industries plc v Dickman* [1990] 2 AC 605 (HL).

[35] *N v Poole Borough Council* [2019] UKSC 25, [2020] AC 780.

[36] *Manchester Building Society v Grant Thornton UK LLP* [2021] UKSC 20, [2022] AC 783 and *Meadows v Khan* [2021] UKSC 21, [2022] AC 852, noted AC Walton "Negligence and Scope of Duty Post *SAAMCO*: Old Ideas, New Look" [2022] *LMCLQ* 33, 38 who sees the assumption of responsibility in *South Australia Asset Management Corpn v York Montague Ltd* [1997] AC 191 as more about remoteness.

[37] *Smith v Littlewoods Organisation Ltd* [1987] AC 241 (HL), 271C. "The most troublesome question in negligence today remains omissions liability": J Morgan 'A Riddle Wrapped in An Enigma: Assumption of Responsibility, Again' (2022) 81 *CLJ* 449, 449.

[38] *Caparo* (n 34) 621.

Recently, Loth has said that private law is a "discourse on other discourses".[39] While there is always an impetus to rationalise the law with heuristics[40], such as a generalised single test of negligence, the reality is that we should still be aware of the particularised context in which liability arises. Weir has always maintained that there are different harms recognised by the tort of negligence with, in decreasing order of importance: personal injury, property damage, and economic losses.[41] It is not that the language of negligence is inappropriate but that in the case of a bank's oversight liability for economic losses it has to be properly understood or the number of cases brought to court will not subside even if they continue to be unsuccessful.

What are the important facts here that are categorizable even if they do not lead to the need for a new conceptual framework? There used to be a reluctance to find a duty of care in tort overlapping or concurrent with contractual liability.[42] This is no longer the case although Gardner and Murphy have pointed out that we still have to be careful about the tort/contract interface given remaining contextual issues.[43] Exceptionally, though, there may be a contractual framework which is incompatible with any assumption of responsibility by the defendant.[44] Specifically, the contract may exclude or limit the scope of tortious duties and obligations owed by one party to the other.[45] Further, incompatibility would be more so with economic losses in, for example, the bank mis-selling cases where parties deal at arms-length from inception and the interests of one party are in conflict with the other party's interests. More likely, however, the bank mandate here to look after the customers' accounts delineates the scope of duty as Booysen has pointed out,[46] which suggests that this is a form of negligence

---

[39] M Loth, *Private Law in Context: Enriching Legal Doctrine* (Cheltenham, Edward Elgar Publishing, 2022) 136 paraphrasing JB White, *Justice as Translation, An Essay in Cultural and Legal Criticism* (Chicago, IL, University of Chicago Press, 1990) 261-2.

[40] K Amirthalingam 'Clinical Negligence and Relational Psychiatric Injury' (2022) 138 *LQR* 370, 370 states that "Lord Atkin used the neighbour principle as a metaphor to explain existing case law; it was not intended as a heuristic device for judicial expansion of the law of negligence".

[41] T Weir, *Tort Law* (Oxford, Clarendon Press, 2002) 20.

[42] *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80 (PC), 107, where Lord Scarman doubted whether "there is anything to the advantage of the law's development in searching for a liability in tort where the parties are in a contractual relationship".

[43] J Gardner and J Murphy, 'Concurrent Liability in Contract and Tort: A Separation Thesis' (2021) 137 *LQR* 77.

[44] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 (HL),196; *White* v *Jones* [1995] 2 AC 207 (HL), 257. Or if there are private international law considerations although strong arguments have been made against this in S Peari and M Teo, 'Justifying Concurrent Claims in Private International Law' (2023) 82 *CLJ* 138.

[45] *JP Morgan Chase Bank v Federal Republic of Nigeria* [2019] EWCA Civ 1641 at [40]; Soh and Tan (n 29) 9.

[46] Booysen (n 14) 355. Cf Watts (n 14) and Chua (n 14), who both consider the tension between the bank's obligation to obey the mandate and its Quincecare duty, as essentially a duty not to follow instructions, to be much harder to reconcile, and suggest that the negligence standard is inapposite and that the obligation to disobey should be imposed and enforced on a different juridical basis.

circumscribed by contract like that observed in *Henderson v Merrett Syndicates Ltd*.[47] There is a customer mandate for the bank to act in accordance with her instructions, and yet take reasonable care to protect her at the same time which as *Nigeria* itself shows can be modified such that it is only breached with gross negligence.

At the same time, there is often no liability in the tort of negligence for omitting to do something especially where individuals are concerned. But here there is an omission in a contractual and regulatory setting where a bank was tasked with protecting its customer's interest.[48] Lord Bridge in *Curran v Northern Ireland Co-ownership Housing Association*,[49] who was bound by but did not like *Anns*, thought that there was a distinction between misfeasance and nonfeasance.[50] However, Tofaris and Steel see negligence liability for omissions apposite for certain institutions like the police given their extant purposes and position, and a victim's dependence on them[51]. Some form of categorisation exists, but more is required given the width of 'assumption of responsibility'. What is it about banks that warrants opening them up to greater possible liability for omissions like the police?

Entities and Regulation - failure to prevent duty

The late Lynn Stout[52] pointed out that entities have less of a conscience compared to humans who are prosocial creatures and are already incentivised to act well regardless of liability rules. Traditional negligence liability generally undercompensates but that has not resulted in suboptimal societal behaviour as humans take more care than legally required than, say, corporations.[53]

While Lord Templeman in *Winkworth v Edward Baron Development Co Ltd*[54] ('*Winkworth*') referred to the "conscience of the company"[55] that was "confided in its directors", that was to take into account the interest of creditors and not just shareholders/directors themselves when acting in a company's best interest. Micheler has argued that there is the corporate culture[56] to

---

[47] *Henderson* (n 44) 181 per Lord Goff, citing Lord Shaw in *Nocton v. Lord Ashburton* [1914] AC 932 (HL), 972.

[48] Cf Watts (n 14) who does not see any particular undertaking. It is argued in the next part that the special position of banks today puts them in this position.

[49] *Curran v Northern Ireland Co-ownership Housing Association* [1987] AC 718 (HL).

[50] ibid 728.

[51] S Tofaris and S Steel, 'Negligence Liability for Omissions and the Police' (2016) 75 *CLJ* 128.

[52] L Stout, *Cultivating Conscience* (Princeton, Princeton University Press, 2011).

[53] ibid 174.

[54] *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512 (HL).

[55] ibid 1516.

[56] E Micheler, *Company Law – A Real Entity Theory* (Oxford, Oxford University Press, 2021). In Singapore and Australia, "corporate culture" is formally used in legislation to determine whether the

consider which allows an entity to do things that no person could do for herself (there may be more individual guilt there) and becomes a "corporation man".[57] In any case, we shall see when examining *BTI 2014 LLC v Sequana SA* ('*Sequana*'),[58] where Lord Briggs referred to the *Winkworth* quote that, even if a company were liable, the directors that act on its behalf may not be, without something extra that suggests that the directors are assuming personal responsibility to the third party,[59] or if the directors have breached their duty to their own company. Given that personal shield, entities (and their organs) may take less care than human individuals would when acting for themselves in the same matter, which may explain why corporate purposes are struggling to find a concrete foothold to latch onto.

Banks also can last in perpetuity and are more likely to be viable gatekeepers. Aside from being incorporated, given bail-in rules now, a bank cannot really be insolvent given that its debt will be swapped for equity – or even wiped clean – whenever it defaults.[60] As Jacinda Arden has pointed out, banks are public bodies exercising public functions with a social licence.[61] Given the advantages banks have, there are usually external constraints on banks imposed by statutes, codes and guidelines that need to be internalised. While negligence as a reasonable person standard can accommodate external requirements more easily than, say, the duty of loyalty owed by a director,[62] it is something that should be signalled to both bank employees and persons dealing with them.

The reality though is that, in the past, courts have been ambivalent about using external codes, and even when they are used, they have been used just as often to shield banks from liability, especially if they have their own dispute resolution mechanisms and are not amenable to private claims. Hudson has lamented that courts have not been consistent in using codes,[63] even though he feels that "[t]he regulatory context of money laundering is what is actually informing

---

corporation should be liable for an employee's misdeeds: Securities and Futures Act 2001 (Singapore), s 236B(8)(*c*); Criminal Code Act 1995 (Australia), s 12(2)(c).

[57] Stout (n 52) 168 *et seq*.

[58] *BTI 2014 LLC v Sequana SA* [2022] UKSC 25, [2022] 3 WLR 709 [140].

[59] See, eg, *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830 (HL), 835 holding that directors need to separately assume responsibility which should be based on objective exchanges between plaintiff and defendant. Cf FMB Reynolds, 'Personal Liability of Company Directors in Tort' (2003) 33 *HKLJ* 51.

[60] T Hale, 'Additional tier 1 bonds: the wiped-out debt at centre of Credit Suisse takeover', *Financial Times* (20 March 2023).

[61] 'Jacinda Ardern says banks 'wrong' to take huge profits as cost of living crisis deepens' *The Guardian*, (9 November 2022) at https://www.theguardian.com/world/2022/nov/08/jacinda-ardern-says-banks-wrong-to-take-huge-profits-as-cost-of-living-crisis-deepens (accessed 7 May 2023).

[62] A Gold, 'The Internal Limits on Fiduciary Loyalty' (2020) 65(1) *American Journal of Jurisprudence* 65.

[63] Hudson (n 5) [26-23].

banking practice in any event".[64] We are seeing this played out again with these bank cases, with the willingness to look cursorily at them at the summary stage to prevent a striking out action. But, at trial, when scrutinised more carefully, the codes are usually not seen as sufficient support for a duty of care or, more likely, any high-level standard of care. So, they were used to prevent a striking out action in *Philipp* and *Nigeria*. But at the trial stages in *Nigeria* it was said that the codes had to be focused on something more specific to the transaction and not general scrutiny based on know-your-client requirements where the concern is more with a customer's possible money-laundering than third party fraud.

The thing is that we only want an institution to do slightly more, and not to become an insurer. The idea is for someone, even while working in an entity and not likely subject to personal liability (these are not cases where first the employee is liable and the entity only vicariously so – the entity is directly liable for an omission[65]), or even a well written algorithm, to prevent the holes in the cheese from lining up in these banking cases . Stout has suggested slightly more onerous negligence rules perhaps for corporations.[66] We are at the moment in time where this is a possibility, with numerous instances where the UK Supreme Court has expressed willingness to hear cases of holding companies being liable in negligence for damage to persons affected by its subsidiaries, although again any duty of care must be seen in context.[67] Even there, the relevance of extrinsic things like codes and public documents are being fought over with some leading to a possible assumption of responsibility and duty of care on the part of the parent, and others not.[68] In this regard, Europe may be leading the way as evidenced by Royal Dutch Shell's recent experience before the Dutch courts, which suggests that

---

[64] Hudson (n 5) [30-2].

[65] Weir (n 41) 21 that tort has these two devices to make a company liable as "non-existent bodies are very good at *not* doing things, since in fact they can't do anything".

[66] Stout (n 52) 172.

[67] See PL Davies, 'Corporate Liability for Wrongdoing within (Foreign) Subsidiaries: Mechanisms from Corporate Law, Tort and Regulation' in *Festschrift for Sarah Worthington* (forthcoming) who argues that:

> To perform that second-stage task, the courts needed to move beyond the generalities of *Caparo* and focus directly on the characteristics of the parent/subsidiary relationships which would lead the courts to regard the imposition of a duty of care on the parent towards third parties as appropriate.

In *Lungowe v Vedanta Resources plc* [2019] UKSC 25, [2020] AC 1045 [56], which was not a case about pure economic loss, Lord Briggs thought that the principles in *Caparo*, namely, its three ingredients of foreseeability, proximity and reasonableness, ought not to be the starting point.

[68] Compare the first instance decision in *Okpabi v Royal Dutch Shell plc* [2017] EWHC 89 (TCC), [2017] Bus LR 1335 [95]-[96] where compliance with extrinsic material was not seen to found a duty of care with that in the Court of Appeal in *Okpabi v Royal Dutch Shell plc* [2018] EWCA Civ 191, [2018] Bus LR 1022 which placed weight on those documents whilst affirming, although both were then reversed by the Supreme Court in *HRH Emere Godwin Bebe Okpabi v Royal Dutch Shell plc* [2021] UKSC 3, [2021] 1 WLR 1294.

environmental concerns may be a different form of public negligence involving a duty not owed to a neighbour but more generally.[69]

While authorised push payment fraud is about economic loss, a less protected value, it is also about a duty of inquiry on the part of banks (which could flag suspicious transactions quite easily both by and against a customer) that do not have internal moral barometers and need to be incentivised to do more given that negligence liability undercompensates.[70] One way is to shift the burden of proof so that it is for a bank to display a due diligence defence. Thus, under the UK Bribery Act, section 7 provides that a company may be guilty of the offence of failing to prevent bribery benefitting the company subject to a defence which requires them to prove that they did all they reasonably could to prevent the offending. While that is in relation to wrongdoing by its own employees, which would require the setting up of internal controls, the kind of oversight liability here is about a bank failing to prevent a third party from causing harm to its customers. This might only require the bank to clearly warn the customer, whose reliance on the bank is presumed, and refer her to an independent lawyer.

But what is anomalous is that banks have traditionally been able to protect themselves from liability in many similar and arguably more egregious situations. There has traditionally been no duty to warn customers against improvident transactions. The bank mis-selling cases have also seen low level duties of care at best imposed, and protection from non-reliance clauses, despite the fact that banks were proximate causes of the Global Financial Crisis. But this also shows the contractual limitations of the negligence standard, which in *Nigeria*, was even reduced to gross negligence. It is, however, harder to craft something like non-reliance clauses in a "custodial" relationship than in an antagonistic transactional one. Perhaps *Barclays Bank plc v O'Brien*[71] ('*O'Brien*') situations provide a closer analogy. That was seen as a priority fight that may also have had some kind of quasi-property or restitutionary basis, or even an equitable duty of care.[72]

If the goal is just to get the bank to warn the customer, reversing the burden of proof may be too much. Given bank mandates, we cannot expect the bank to stop the transaction altogether as it may open itself up to countervailing contractual liability. But if it is just about notice and

---

[69] *Milieudefensie v Royal Dutch Shell plc* ECLI:NL:RBDHA:2021:5337 where Shell was ordered to reduce its emissions by 45% by 2030: B Mayer, "*Milieudefensie v Shell:* Do Oil Corporations Hold a Duty to Mitigate Climate Change?" in Engert, Enriques, Ringe, Varottil and Wetzer (eds), *Business Law and the Transition to a New Zero Economy* (Beck, Hart, Nomos, 2022) . This led to Shell dropping the 'Royal Dutch' prefix and moving to London, and the derivative action led by Clientearth against its directors.

[70] Stout (n 52) 172 arguing for special damages "based entirely on concern for economic efficiency, and particularly the need to ensure that conscienceless corporations fully "internalize" the otherwise-external costs they impose on others".

[71] *Barclays Bank plc v O'Brien* [1994] 1 AC 180 (HL).

[72] C Rickett and D McLauchlan, 'Undue Influence, Financiers and Third Parties: A Doctrine in Transition or the Emergence of a New Doctrine?' [1995] *NZ Law Review* 328. See also H Tjio, 'O'Brien and Unconscionability' (1996) 113 *LQR* 10. Strict liability would lead to too much restitution: P Birks and NY Chin, 'On the Nature of Undue Influence' in Beatson and Friedman ed., *Good Faith and Fault in Contract* (Oxford, Clarendon Press, 1995) 80-81.

a precautionary warning, we need to understand how the duty of inquiry fits into negligence liability as, like with *O'Brien,* it is likely to lead to a set of procedures that banks will have to follow. This will likely be along the lines of what the UK House of Lords did in *Royal Bank of Scotland plc v Etridge (No 2)*[73] in setting out what is expected of a bank and independent solicitor in ensuring that a surety is free of undue influence from the borrower. This has worked out even though it has never been totally clear what the source of the *O'Brien* duty is.

It may be that the bank can be seen as a quasi-fiduciary in its "custodial" relationships even if it is debtor/creditor rather than trustee/beneficiary.[74] It may be akin to an occupier, bailee or employer in specific tortious settings.[75] While the courts have invariably said that the bank is not a fiduciary, particularly in the traditional banker-customer relationship,[76] McMeel has argued that this should not be the zeitgeist in light of the many roles played by banks today.[77] He regrets the fact that lower standards were used by judges even against the wishes of policy makers. But even if we call them fiduciaries, that does not mean that any duty of care they owe is fiduciary in nature. While it is in the US, we shall see that that still has not been enough in creating oversight liability (albeit there on the part of boards and ESG).

Again, we are not looking at legal but factual categorisation to better understand negligence liability here and to make it work more intuitively. This will then coerce the inquiries we want the bank to make and the warnings it should give. Loth states that "what matters here is that if we see private law as a kind of regulation, it is essentially a two-tier regulation; general in advance, tailor-made afterwards."[78] Formal regulation is clearly better when it provides what the parties have to do in detail and the consequences if they do not. But often codes do not provide remedial action and are a hybrid mixture of private ordering and public regulation, the latter of which often lags practice.[79] If so, we have to understand bank negligence with respect to customer accounts in the context of these external guidelines in order to create an *Etridge*-like private law code.

With corporate attribution, there is a wrong by an individual within the entity that is then attributed to the entity, either because there has been the necessary delegation and proper

---

[73] [2001] UKHL 44, [2002] 2 AC 773 [120].

[74] This is illustrated by *In re Osterlund*, 17 Bankr. 853 (Bankr. N.D. Ga. 1982) where the court stated that "banks have been recognized as having a fiduciary duty to their customers in certain circumstances, particularly where the bank acts in a 'custodial' capacity."

[75] Weir (n 41) 21.

[76] *Bank of Scotland v A Ltd* [2001] EWCA Civ 52, [2001] 1 WLR 751 at [25]; *cf Stanford* (n 28) at [137]. where Lord Sales saw no distinction between the *Quincecare* duty and a director's fiduciary *Sequana* duty but compare Lady Rose at [34].

[77] G McMeel, 'Banks, Financial Intermediaries and Fiduciary Duties' in Sandra Booysen (ed), *Financial Advice and Investor Protection: Comparative Law and Practice* (Cheltenham, Edward Elgar Publishing, 2021) 107.

[78] Loth (n 39) 169.

[79] R Brownsword, RAJ Van Gestel and H–W Micklitz (eds), *Contract and Regulation – A Handbook on New Methods of Law Making in Private Law* (Cheltenham, Edward Elgar Publishing, 2017).

exercise of power or because of "system intentionality".[80] But this may not be what is happening in these bank negligence cases as it does not arise because an employee, even if senior, has carried out a negligent act which is then attributed via *eg* vicarious liability. Liability here is not derivative but direct and comes from the bank mandate with the customer which requires that the former take reasonable care to protect the latter from fraud. The entity may not have done enough given its public functions and privileged position. It is about negligence in the context of a contractual relationship, public charters and codes. That triggers a duty of inquiry to see that the bank customer is aware of the risks involved in the transaction involving her account before executing her order.

The need for individual liability

What may be needed in these cases where entities have direct duties of care (as opposed to derivative liability) to third parties is for individuals within them to also be exposed to the risk of liability to incentivise them to go against a corporate culture that to various degrees requires them to focus on profits and to cut costs. The parallel in criminal or public law with failure to prevent offences[81] imposed on corporations is the senior management liability for poor supervision that we see in the UK. There is a Financial Conduct Authority and Prudential Regulatory Authority (PRA) Senior Managers and Certification Regime which sets out a responsibilities map for senior managers to assess the fitness and propriety of certain employees carrying out a "significant harm" function. If there is a breach of responsibility within a senior manager's remit the regulator can take action against the senior manager for failing to take "reasonable steps" to avoid a breach occurring. This regime became applicable to banks from March 2016 and other PRA firms from 2018 although doubts have been expressed whether it is working to change bank culture.[82] This is not the first time that the UK has struggled with the boundaries of corporate and individual liability to prevent moral hazard. The UK Corporate Manslaughter and Corporate Homicide Act 2007 was introduced to remove the directing mind requirement even for manslaughter to one where more generalised management failure could make the company liable. But Gower and Davies recount how 'the wheel thus came full circle'[83] when, during passing of the Act, there was debate on imposing liability not just on the company but on senior individuals within it, but this was eventually

---

[80] R Leow, *Corporate Attribution in Private Law* (Oxford, Hart Publishing, 2022); E Bant, 'Catching the Corporate Conscience: A New Model' [2022] *LMCLQ* 468; see now, E Bant, 'Systems Intentionality: Theory and Practice' in E Bant (ed), *The Culpable Corporate Mind* (Oxford, Hart Publishing, 2023).

[81] It presently applies to bribery and tax evasion. See UK Law Commission's potential reform of corporate criminal liability for failure to prevent more generally with respect to employees and agents of company though not fraud in general at https://www.lawcom.gov.uk/law-commission-sets-out-options-to-government-for-reforming-how-companies-are-convicted-of-criminal-offences/ (accessed 7 May 2023).

[82] E Hickman, 'Is the Senior Managers and Certification Regime Changing Banking for Good?' (2022) 85(6) *MLR* 1440.

[83] PL Davies, *Gower and Davies, Principles of Modern Company Law*, 8th edn (London, Sweet & Maxwell, 2008) [7-32].

resisted by the legislature. In contrast, the MAS in Singapore has consistently stated that it prefers to punish the individuals behind corporate action.[84]

Within private law, however, directors and senior management will not be liable in negligence to third parties given that the interposition of a separate entity which they represent insulates them from any assumption of responsibility to those third parties – they have to themselves be fraudulent.[85] Their duties are to the company itself, and the struggle today is to craft something which can make management take account of external rules applicable to the company. At one level it seems to work until we actually delve into its mechanics. Individual liability is important if the goal is to incentivise senior people in the bank who set the corporate culture and can also counter it. What we seek to do is to make the decision-maker behave like a pro-social individual again so that this in turn feeds into corporate action.

A company could sue its directors if the company suffers a loss or is criminally liable in a way that is "attributable" to the director. "Stepping stone" liability in Australia has helped in having directors made liable, usually for breaches of the duty of care and to act in the best interests of the company in relation to the breach or non-compliance with other statutes by the company, often involving securities disclosure. But Langford[86] has highlighted that derivative stepping stone liability was seen in *Cassimatis v Australian Securities and Investments Commission*[87] as merely an application of a direct statutory duty. A Singapore judge also expressed "surprise" that defendants pleaded guilty to a breach of s 157 of the Singapore Companies Act, an earlier version of Australian legislation, that required directors to act "honestly and use reasonable diligence", for failing to get their company to comply with the continuous disclosure rules of the exchange.[88] The fit of these more traditional directors' duties with omissions and external requirements is not always a comfortable one, especially since s 157C of the Singapore Act provides that directors can delegate and are only liable if they failed to act in good faith or to make proper inquiry where the need for inquiry is indicated by the circumstances.

It is more complex if the company suffers no clear loss as it is then about compliance and faithfulness to rules. In the US, it has been said that oversight compliance duties were created by the recognition of directorial good faith and its use in *In re Caremark International*

---

[84] Y Yahya, 'Huge 1MDB-related fines "hurt shareholders, not those liable"' *Straits Times* 30 June 2017, quoting Ravi Menon, MD of MAS. See further RA Guttman, 'Effective Compliance Means Imposing Individual Liability', (2018) 5 *Emory Corp. Governance & Accountability* Rev 77.

[85] See also *Standard Chartered Bank v Pakistan National Shipping Corpn (Nos 2 and 4)* [2002] UKHL 43, [2003] 1 AC 959 [22]; and now *Sim Tee Meng v Haw Wan Sin David* [2019] SCGA 71, [2020] 1 SLR 82, *Barclay-Watt v Alpha Panareti Public Ltd* [2022] EWCA Civ 1169, [2023] 1 BCLC 240.

[86] RT Langford, 'Dystopian Accessorial Liability of the End of "Stepping Stones" As We Know It?' (2020) 37(5) *Company and Securities Law Journal* 262.

[87] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52, (2020) 376 ALR 261, where directors were found liable in negligence to their financial advisory firm when their investment strategy led to losses to their clients and caused the firm to lose its licence.

[88] *Public Prosecutor v Ngiam Zee Moey* [2022] SGDC 115 on rule 703 of the SGX Listing Manual which has statutory backing under section 203 of the Securities and Futures Act 2001 (Singapore).

('*Caremark*').[89] However, the duty of loyalty is usually used in the context of reducing agency costs, whereas here we may have to increase them in order to detect misconduct even at the expense of profits, which is the main reason why it is said that *Caremark* has not worked in providing a foundational duty (as opposed to what the court wanted directors to do in that specific case, which was to be better informed about food safety).[90] Instead *Marchand v Barnhill*[91] is said to be the first example of *Caremark* 2.0 where Leo Strine CJ in the Delaware Supreme Court said that:

> If *Caremark* means anything, it is that a corporate board must make a good faith effort to exercise its duty of care. A failure to make that effort constitutes a breach of duty of loyalty.

Loth (and later Wittgenstein[92]) have pointed out the limits of language, but juxtaposing good faith, care and loyalty together like this does not make it any easier to digest into something that tells directors how to balance their duties to the company, which is still mainly concerned with maximizing shareholder value, and regulatory requirements on them which may come at a cost not through breach but compliance. It has been argued by Hill and McDonnell that developing the good faith duty in the US helped deal with problems of structural bias, where directors are in a position where they are likely to act against the corporate interest and in favour of another constituency,[93] which could be the major shareholder. This could then allow directors to argue that something must be done for the benefit of the company even at the expense of the shareholders.

While good faith has perhaps been translated into a duty to comply with external rules in the US, this requires some investment in knowing the law and the context behind the words which is not obviously captured by saying that directors have a duty of good faith (which is on its face subjective) to the corporation, when in the US directors can be directly accountable to shareholders.[94] In his chapter, Weiming Tan argues that the UK can learn from *Caremark*. Gold, however, asks in this context "if the Delaware courts haven't stretched fiduciary loyalty concepts to the breaking point, even in corporate contexts where charters are a component of

---

[89] *In re Caremark International*, 698 A.2d 959 (Del Ch 1996). Gold (n 62) fn 24, discussing *In re Walt Disney Co Derivative Litigation* 907 A 2d 693 (Del Ch 2005).

[90] J Arlen, 'Evolution of Director Oversight Duties and Liability under Caremark: Using Enhanced Information-Acquisition Duties in the Public Interest' (August 28, 2022) at https://ssrn.com/abstract=4202830 (accessed 7 May 2023).

[91] *Marchand v Barnhill* 212 A.3d 805 (Del 2019) 824.

[92] Loth (n 39) 88 said that Wittgenstein was a "philosopher born twice" and legal concepts need to be understood in context of the particular language game.

[93] C Hill and B McDonnell, 'Disney, Good Faith, and Structural Bias' (2007) 32 *Journal of Corporation Law* 833.

[94] R Flannigan, "The Academic Contribution to the Shaping of American Director Fiduciary Duty" (2022) 66 *Canadian Business Law Journal* 58.

the parties' relation."[95] We will see if Commonwealth law can in fact do better given its experiences with the duty to act bona fide in the company's interest.

Directors duties and external purposes

The quote from *Marchand* shows the continued difficulties in weaving in external regulatory oversight duties into the relationship between a director and company, which has a major shareholder constituency to consider. In the Commonwealth, the US good faith duty finds its closest analogue in the duty to act bona fide in the company's best interest.[96] In the UK, however, s 172 of the Companies Act 2006 translates that into the duty to promote the company's success for the benefit of shareholders which has to balance the interests of the various corporate constituencies such as employees, customers and even "the community and the environment."[97] This may be a nominate duty[98] according to Flannigan, not fiduciary. This explains why it can apply to non-fiduciary managers too as historically fiduciary duties were only about controlling opportunism in limited access arrangements, and the good faith duty was seen as an agency add-on which applies to many other employees.[99]

With bank negligence, the duty is to the customer and we just need to understand what it has to do in light of external fraud which damages the customer, and it may be that not much is required given the contradictions with the bank mandate. With what we see, however, with directors' duties to comply with ESG and corporate purposes, Paul L Davies has said that we need to find:[100]

> ways of using corporate law to secure better levels of compliance with external regulation. These look like fruitful lines of enquiry, but, unfortunately, not simple ones.

Certainly, we can internalise some rules into the director-company relationship as Gold explained.[101] However, it is invariably the case that some regulations cannot fit the internal rule of law box, particularly when the cost to the company comes from compliance and not breach.

---

[95] Gold (n 62) 72.

[96] D Kershaw, *The Foundations of Anglo-American Corporate Fiduciary Law* (Cambridge, Cambridge University Press, 2018) believes that there is really a great deal of convergence in Anglo-American fiduciary law even if the language used is different.

[97] Companies Act 2006 (UK), s 172(1)(d).

[98] R Flannigan, 'The Adulteration of Fiduciary Doctrine in Corporate Law' (2006) 122 *LQR* 449.

[99] ibid 457-8. The distinction between the duties of fidelity and fiduciary duties were set out by the Singapore Court of Appeal in *Smile Inc Dental Surgeons Pte Ltd v Lui Andrew Stewart* [2012] SGCA 39, [2012] 4 SLR 308 [49]-[55].

[100] PL Davies, "The role of corporate law in corporate purpose: the British Academy Report" *ECGI Blog* at https://www.ecgi.global/blog/role-corporate-law-corporate-purpose-british-academy-report (accessed 7 May 2023).

[101] Gold (n 62) 69.

More firm specific corporate law rules are needed[102] but these are hard to back with hard sanctions. Corporate law could mandate the specification of purposes in corporate constitutions, but Davies has further argued against them on the basis that they would be watered down in the same way company objects were in the past to avoid ultra vires transactions. Where voluntary, they have not led to the widespread use of such constitutional purposes in jurisdictions like France that introduced regulations in that regard.[103] It would be ideal if these purposes were inserted into constitutions, for s 171(a) of the Companies Act 2006 requires that directors must "act in accordance with the company's constitution", and s 172(2) modifies the duty to promote the success of the company for its shareholders in cases where 'purposes of the company consist of or include purposes other than the benefit of its members' where the goal is on 'achieving those purposes'. But it will be argued in the last part that, even if not, the other half of the proper purpose rule in s 171(b) still has a part to play in coordinating the various directors' duties into something that can accommodate ESG more intuitively. However, we will first examine the difficulties of using the general s 172 company success/good faith/best interest test even in the case where the company has suffered a clear loss. This may be because on the face of it is a subjective test but may need to be understood from an objective angle to work.[104]

***Sequana* and the proper purpose rule**

We have seen that capital maintenance rules have been pushed back for 40 years now in the case of financial assistance rules that buttressed the private law actions in *Selangor*. Those who cannot adjust suffer the most, usually employees or involuntary creditors. What remains a thorn to those desiring the frictionless movement of assets in the corporate/financial world is s 423 of the Insolvency Act 1986, which despite the statute it is part of, is not dependent on bankruptcy, and applies in the context of undervalued transactions made with the purpose of prejudicing persons with claims against the transferor. This was observed by Lord Neuberger in *Prest v Petrodel Resources Ltd*[105] as a "specified and limited" application of the principle that "fraud unravels everything". US fraudulent conveyance cases in practice see a necessary purpose to defraud creditors only if it leaves the company 'insolvent or with unreasonably small capital' as that then puts assets beyond the reach of creditors.[106] Intent may otherwise be hard

[102] L Anidjar, 'Corporate Law and Governance Pluralism' (2022) 35(2) *Canadian Journal of Law and Jurisprudence* 283.

[103] This is illustrated in recent amendments to Article 1835 of the French Civil Code which merely "*allows*" rather than mandate a Corporation to specify its "*raison d'être*" in its articles of association.

[104] RT Langford and IM Ramsay, 'Directors' Duty to Act in the Interests of the Company: Subjective or Objective?' [2015] 2 *JBL* 173. Compare Lady Arden (at [180]) and the majority (at [232]) in *Children's Investment Fund Foundation (UK) v Attorney General* [2020] UKSC 33, [2022] AC 155. See further WM Tan, Negotiating New Curves Along Chancery Lane: Four More Questions on Fiduciaries' (2022) 35 TLI 197, 214-216.

[105] *Prest v Petrodel Resources Ltd* [2013] UKSC 34, [2013] 2 AC 415 [83], noted E Lim 'Salomon Reigns' (2013) 129 *LQR* 480, H Tjio 'Lifting the Veil on Piercing the Veil' [2014] *LMCLQ* 19.

[106] M Kahan, 'Legal Capital Rules and the Structure of Corporate Law: Some Observations on the Differences Between European and US Approaches' in Hopt and Wymeersch (eds), *Capital Markets*

to prove as this is rarely "susceptible to direct case".[107] But that is not the position in the UK where in *Sequana* the judges continued to apply it without the need to prove insolvency,[108] which is itself a difficult matter to show in practice even if not conceptually.[109]

In *Sequana*, section 423 was used to set aside a lawful dividend paid by a company from distributable reserves to its holding company Sequana whilst having one material contingent liability. That was some ten years before the company, which was set up to meet the liability, became insolvent. However, the estimate of that liability which involved costs arising from the clean-up of a polluted river was too low and so the dividend payment was challenged as a conveyance intended to defraud creditors, including here BAT, which was to be indemnified for the clean-up costs. The dividend was ultimately set aside by the court on the basis that it was given for no consideration (clearly a transaction at an undervalue) to Sequana to set off against debts owed by it to the company and to put those assets out of the reach of the company's creditors. Unfortunately, Sequana was also bankrupt and so the appeals which ultimately reached the Supreme Court, focussed only on whether the directors of the company, which assigned its claims to BTI and been sold by Sequana, had breached their duties to the company.

This was held not to be so at every level as directors' duties, while owed to the company (to promote its success for the benefit of its members as a whole) under section 172(1), did not shift its focus to creditors under subsection (3) as insolvency was not "probable"[110] or "imminent"[111] when the dividend was paid. While much academic ink will be spilled over this, the concern with this paper is not with that *West Mercia*[112] duty but why some form of "stepping stone" argument based on a breach of directors' duties to comply with s 423 (without asking the insolvency question) failed to launch. As Lord Briggs, with whom Lord Kitchin agreed, said:[113]

and Company Law (Oxford, Oxford University Press, 2003) 147. See US Bankruptcy Code, s 548(a)(1); *In re Semcrude LP* 526 BR 556 (Dist Del 2014).

[107] This is illustrated by *In re Kaiser*, 722 F 2d 1574 (2d Cir 1983).

[108] *Sequana* (SC) (n 58) Lord Reed at [61] appeared to see s 423 as an insolvency rule but compare eg Lady Arden at [368]. Cf J Armour, 'Transactions Defrauding Creditors' in J Armour and H Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Oxford, Hart Publishing, 2003) [3.1].

[109] *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3*BL plc [2013] UKSC 28.

[110] *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112, [2019] 1 BCLC 347 [220] per David Richards LJ.

[111] *Sequana* (SC) (n 58) [86] (Lord Reed), [186] (Lord Briggs), [243] (Lord Hodge).

[112] *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250.

[113] *Sequana* (SC) (n 58) [182]. J Armour, 'Avoidance of Transactions Fraud on Creditors at Common Law' in Armour and Bennett (eds) (n 108) [7.59-60] thought that directors could be liable in negligence (although he also discussed a breach of terms of the constitution).

> It is, in passing, an irony of the present case that the May dividend has been found to have offended section 423 but no claim that it involved for that reason alone a breach of duty by the respondent directors has ever been pursued

In the Court of Appeal,[114] David Richards LJ (as he then was), was even more pointed in stating that section 171 Companies Act 2006 had not been sufficiently advanced before the judge even though it had been pleaded that it was an improper use of directors' power to pay dividends to Sequana to put Sequana's debts beyond the reach of the company's creditors. Rose J (as she then was) at first instance explained that this was because:[115]

> The main provision relied on is section 172 and in particular the proviso in section 172(3). BTI also referred to the duty in section 174 (to exercise reasonable care, skill and diligence), that in section 171 (to exercise powers for the purpose for which they were conferred) and that in section 173 (duty to exercise independent judgment). But it was not suggested that the result of the case could be any different depending on which duty was breached. I will therefore focus on section 172.

We have seen that the focus with s 172 was on when the duty to take creditor interests into account arises and all the courts rejected a lesser "real risk of insolvency" test. In the Supreme Court, however, Lady Arden disagreed that this "creditor duty" came about only through s 172(3) but that s 172(1) itself required directors when considering the company's success to also consider creditor interests alongside those specifically mentioned, which included employees and the environment. While not disagreeing with the shareholder-centric approach of the others, she said:[116]

> It is inherent in shareholder primacy that other interests such as those of creditors will necessarily diminish the interests of shareholders. They are only ever residual claimants.

The other judges saw less in s 172(1) in terms of a strong form of enlightened shareholder value, and so s 172(3) was needed to recognise and further develop the "creditor duty". This approach may, however, conflict with the fact that s 423 of the Insolvency Act operates outside insolvency. However, Lord Briggs discerned the general need for some impartiality as:[117]

> There is nothing inconsistent with the fiduciary nature of the directors' duty that it calls for a balancing of potentially competing interests. Much of the development of fiduciary duty arose in connection with family settlements, where trustees charged with investment powers faced the constant challenge of balancing the interests of life tenants and remaindermen, the former being interested in maximising income, and the latter in preserving and enhancing capital.

---

[114] *Sequana* (CA) (n 110) [231]-[234].

[115] *BTI 2014 LLC v Sequana SA* [2016] EWHC 1686 (Ch), [2017] 1 BCLC 453 [457].

[116] *Sequana* (SC) (n 58) [376].

[117] ibid [177].

Maintaining fairness amongst the shareholders is in fact expressly mentioned in s 172(1)(f) but it appears that too much is expected of the duty to promote the success of the company which, like the US good faith duty, may not be able to operate on its own in allowing directors to take into account external concerns when it may actually damage certain shareholder interests. As with the *Quincecare* duty, we are expecting contradictory action. The chance was missed in *Sequana* to make a proper purpose argument (or even directorial negligence given the clear loss suffered by the company). But there was enough there to suggest that it could be foundational towards getting directors to act in accordance with external requirements. First, it was pointed out that s 171(a) could be used if purposes were inserted into the constitution. While this is highly unlikely, the proper purpose rule has enough in it that it could still provide the key to the incorporation of outside values. We have seen Lord Briggs in *Sequana* speak of the duty of impartiality in the context of s 172. In a similar vein, in *Eclairs Group Ltd v JKX Oil and Gas plc* ('*Eclairs*'),[118] in what Lord Sumption saw as a "formidable dissent" in the Court of Appeal,[119] Briggs LJ (as he then was) said:[120]

> I consider it important that the court should uphold the proper purpose principle in relation to the exercise of fiduciary powers by directors, all the more so where the power is capable of affecting, or interfering with, the constitutional balance between shareholders and directors, and between particular groups of shareholders.

Maintaining a fair balance could be the additional understanding that illuminates s 171(b) which otherwise states that directors have to "only exercise powers for the purposes for which they are conferred." There is enough there to accommodate external codes given that it is about constitutionality, fairness and faithfulness to powers that are given to the power-holder.[121] And enforcing the duty is less about obtaining damages but seeing that the power is exercised properly. Thus, in *Eclairs*, for example, an action was successfully brought by shareholders to enjoin the company from suspending their votes in an AGM as the board had done so not to compel disclosure (as the relevant power was intended to) but to improperly prevent a hostile takeover.[122] But it may be that even if s 171 does not do so on its own, it can in tandem with the other duties set out in the Companies Act 2006 do enough to accommodate external purposes. It adds another dimension to fiduciary duties as its role is to "regulate the exercise of authority"[123] rather than prevent opportunism or promote loyalty.

---

[118] *Eclairs Group Ltd v JKX Oil and Gas plc* [2015] UKSC 71, [2016] 1 BCLC 1, noted H Tjio, 'The Proper Purpose Rule' [2016] *LMCLQ* 176.

[119] *Eclairs* (SC), ibid [29].

[120] *Eclairs Group Ltd v JKX Oil and Gas plc* [2014] EWCA Civ 640, [2014] 2 BCLC 164 [122].

[121] Cf Leow (n 80) 72 that "for other powers, the proper purpose is likely to be what the power-holder believes to be the company's interest".

[122] The other thing to note was that the shareholders could bring the actions personally and not derivatively through the company.

[123] R Flannigan, 'Fraud on a Power, Improper Purpose and Fiduciary Accountability' (2019) 62 *Canadian Business Law Journal* 133.

Since we started with *Selangor*, it is apposite to end with it. The strange anomaly as highlighted above in cases like *Selangor* was that third-party liability in those cases was premised on there being a primary breach of duties by directors misapplying corporate assets by providing financial assistance to a purchaser for the acquisition of its shares regardless of insolvency (or perhaps loss). That capital maintenance leak seems less egregious than the breach of the fraudulent conveyance rule which directly claws back undervalued transactions with third parties. It could be because the prohibition against financial assistance is a manifestation of the proper purpose rule.[124] But that itself is linked to the concept of fraud on a power[125] which underpins the fraudulent conveyance rule in s 423.

Conclusion

There has been deregulation in commercial/corporate law for the past 40 years now. This has removed certain frictions that provided protection against fraud and risk, such as rules maintaining capital in a company.[126] Private law has had to respond to these changes and while it has held the fort there are clearly still difficulties that need to be resolved. We believe that the right language regarding liability must be attached to the wrongs that are seen today. Negligence law and the best interest duty may have been overworked and we should explore whether other duties, such as one to act for proper purposes, can provide a better understanding of why a bank may have to protect its bank customer against external fraud affecting her accounts or why directors cannot deal with company assets in a way that harms its creditors or damages the environment. It has been argued that negligence is better at incorporating external requirements or purposes but should still be understood in context. However, the best interest director duty of loyalty which may translate to one promoting the success of the company for the shareholders finds it more difficult to do so. It could do with a nudge from the proper purpose rule in a more coherent way than good faith in the US has arguably required regulatory compliance oversight on the part of boards.

[124] *Selangor* (n 4) 1575 – "clear and not disputed that they owe a fiduciary duty to the company to apply its assets only for the purposes of the company and are therefore liable for breach of that duty". See Davies (n 83) [10-024] and RP Austin and IM Ramsay, *Ford's Principles of Corporations Law* (17th ed, Australia: LexisNexis Butterworths, 2018) 24.670.

[125] Flannigan (n 123) 148; *Eclairs* (SC) (n 118) [15].

[126] See T Dudycz and P Mielcarz, 'The Capital Maintenance Regime Matters for Creditors' (September 15, 2021) at https://ssrn.com/abstract=3924627 (accessed 7 May 2023), for empirical evidence showing that capital maintenance rules affects a company's ability to raise debt due to the perception of its credit risk,