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**Ponzi Schemes and Bank Duties:
So v HSBC Bank Plc [2009] EWCA Civ. 296**

Andrew Bowen, Advocate

Introduction

As the economic bubble has burst a number of “high yield” investment frauds, so-called Ponzi schemes have come to light in which investors were lured by the prospect of high returns but the reported returns and the trades on which they were based were fictitious. In *So v HSBC Bank Plc* the Court of Appeal (Etherton, L.J. gave the judgment with which Sir Anthony Clarke M.R. and L.J. Keene agreed) considered claims by investors that, in the context of fraudulent inducement of them to pay money into an account opened by one of the fraudster’s companies with HSBC Bank Plc, the bank owed a duty of care to those investors when they were not customers and whether the bank’s breach of duty had been the effective cause of the loss.

Background

In 2004 the fraudster, (“B”), opened sterling, dollar and euro accounts with HSBC Bank Plc in London in the name of a company, 5th Avenue Ltd, having told HSBC that he was a “bonds and options trader”. The fraudulent scheme he operated was based on two documents which were executed before any funds were transferred by an investor into the scheme. The first, described as a “private enterprise assets administration benefit participation agreement” was between the investor and LB, a company registered in Nevada, and provided that in return for payment by the investor LB would purchase and trade in highly rated “fixed income instruments” with equal sharing of profits between the investor and LB. The second document was on 5th Avenue Ltd’s letterhead and had the title “Irrevocable Bank Instruction”. The text set out instructions from 5th Avenue to HSBC naming the investor, directing the purchase and sale of “fixed income instruments” and limiting the circumstances in which the funds could be paid out of the account. Critically for the purposes of the action, each letter of instruction had been dated, stamped and signed in the name of HSBC by an HSBC manager with the words “Receipt Acknowledgment (Bank)”. Walker J. at first instance found that the letter was written in obscure language which made little practical or commercial sense and that this would have been apparent had an investor taken proper advice. B had told the manager that the purpose of the date and signature by HSBC was purely administrative so that the bank would have a copy of the letter of instruction on file. An important aspect of this arrangement was that the investor was not a customer of HSBC, which in turn led to the central issue of whether the bank owed the investor a duty of care.

The claimant investor, (“S”), had met B to discuss the investment but had not been content for the funds to be transferred into an account solely in the name of 5th

Avenue and wanted a joint account. During further negotiations the HSBC manager, at B's request, provided a reference letter which confirmed that B was a client "in good standing" and that the bank had a copy of the letter of instruction in respect of S. S was given the reference letter and the scheme documents, which included an additional page containing instructions for transfer to a "joint account" in the name of S and 5th Avenue and which had not been stamped or even seen by the bank; in fact the account was not joint but was 5th Avenue's euro account. S tried to get verification from HSBC's manager of the joint account's validity but, without that verification, was persuaded by B that all was in order and so gave instructions for the transfer of the \$30 million to 5th Avenue's euro account, believing that as it was a joint account no withdrawals could be made without their consent. The sums were removed from the euro account and shortly afterwards B was arrested in connection with his dealings with investors' money. S lost a majority of the sum invested.

Six months later HSBC became concerned that B had acted fraudulently and started proceedings against B and 5th Avenue. They amended their claim to include declarations against investors, including S, stating that the bank had no liability to them. S counterclaimed that HSBC was liable to him for his losses on the grounds of breach of contract, dishonest assistance in breach of trust and negligence. At first instance ([2007] EWHC 2819 (Comm.)) Walker J. concluded that S, along with the other investors, had been foolish and greedy and had been taken in by B's "remarkable charm". While expressing sympathy for their loss he concluded that HSBC's involvement had not been such as to give rise to legal liability to S. HE dismissed the counterclaim and granted the declaration sought by the bank. S was given leave to appeal on the claim in negligence.

The law

In *Customs and Excise Commissioners v Barclays Bank Plc* [2007] 1 A.C. 181 (which concerned the issue of whether the bank owed a duty of care to Customs and Excise in respect of a freezing order), at para.4 Lord Bingham summarised the legal principles to be applied for establishing whether a defender, sued as causing pure economic loss, owed the pursuer a duty of care in tort or not:

"The first is whether the defendant assumed responsibility for what he said and did vis-à-vis the claimant, or is to be treated by the law as having done so. The second is commonly known as the threefold test: whether loss to the claimant was a reasonably foreseeable consequence of what the defendant did or failed to do; whether the relationship between the parties was one of sufficient proximity; and whether in all the circumstances it is fair, just and reasonable to impose a duty of care on the defendant towards the claimant (what Kirby J. in *Perre v Apand Pty Ltd* (1999) 198 C.L.R. 180, para.259, succinctly labelled "policy"). Third is the incremental test, based on the observation of Brennan J. in *Sutherland Shire Council v Heyman* (1985) 157 C.L.R. 424, 481, approved by Lord Bridge of Harwich in *Caparo Industries Plc v Dickman* (1990) 2 A.C. 605, 618, that: 'It is preferable, in my view, that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care restrained only by indefinable considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed'."

The scope of the duty of care will largely determine the extent of the losses that can be claimed when the duty has been breached. In other circumstances the recoverable losses depend on the victim establishing causation. It is sufficient for liability in delict that a negligent statement was an effective cause of loss, even if it was not the effective cause or the proximate cause; it is sufficient that it was one of several causes, provided it was real and effective (*JEB Fasteners Ltd v Marks Bloom & Co* (1983) 1 All E.R. 587 Hobhouse L.J. 857 (e)–(g)).

Court of Appeal

The judge at first instance had rejected the claim made by S that by signing and stamping the letter of instruction and then sending the reference letter HSBC's manager had represented to S that the bank would carry out the instructions in the letter. Etherton L.J. found that the judge was wrong and said that the fact that S might seek advice on the substance of the arrangement and how it would operate in practice did not impinge on the existence of the representations (at [40]). At [50], after considering *Customs and Excise Commissioners v Barclays Bank Plc*, he held that HSBC was under a duty of care to S in respect of the representations relied on by them arising from the stamping and signing of the letter of instruction and the reference letter. He said that, even if a reasonably prudent investor would have sought advice, there was no reason to seek advice on the reliability of the bank's own representation that it would comply with the terms of the letter of instruction. At [52] he then held that the bank was in breach of its duty by stamping the letter of instruction without making any attempt to understand its contents or making it clear to S that the letter of instruction had not been accepted by the bank.

Walker J. had rejected the claim made by S that the representations made by HSBC had been an effective cause of the transfer of the money. Etherton L.J. held that it was essentially a matter of fact whether a breach of duty was an effective cause of the loss. He said that the duty of care was not to prevent S suffering losses as a result of the fraud carried out by B but was rather to avoid making misleading representations to S that it had accepted the letter of instruction and intended to carry out its terms. As the judge had found that S had not in fact relied on the letter of instruction because he had sought assurances that the account into which the money would be transferred was a joint account (he had been critical of the evidence given by S who he found had been selective in his recollection of events), Etherton L.J. agreed that the judge was entitled to hold that it was B's fraud in relation to the "joint account" rather than the bank's representations that was the effective cause of S deciding to transfer the funds which were subsequently lost. The appeal was dismissed.

Conclusion

Although the most obvious moral of the story is never to act on or be associated with a potentially binding document that you don't understand, the case was another example of the court examining whether a duty of care was owed in relation to economic loss and the precise scope of that duty that would in turn determine the scope of the recoverable loss, as well as whether a breach of the duty has been proven to be the effective cause of the loss. Banks would be well advised to review their procedures in respect of providing information about their clients or their accounts which they know will be shown to third

parties because of the potential duty of care which may arise in the event that the customers are not all that they seem.