

Customers Duties to Banks

Identifying the Customer

- Relationship commences at time that the bank accepts customers' instructions.
- *Great Western Railway v London and Country Banking Co. (1901)*
 - "I cannot think that Huggins was in any sense a customer of the bank; no doubt he was known at the bank as a person accustomed to come and get cheques cashed, but he had no account of any sort with the bank".

Woods v Martins Bank Ltd (1958)

- Although plaintiff did not have account with defendant bank at the relevant date, it was held that he was a customer of the bank. The court decided that a special relationship was created when manager of Defendant agreed to provide financial advice to Plaintiff
- Justice Salmon:
"No doubt the defendant could have refused to advise the Plaintiff, but, as he chose to advise him, the law in these circumstances imposes an obligation on him to advise with reasonable care and skill"
- Note that manager had acted in his capacity as manager of the bank when advising Woods, and that the bank advertised itself as an institution which would engage in such activities.

Customer's Mandate

- Customer's mandate is the authority of the customer given to the bank, for example, to pay cheques drawn on the customers account. This is a term and condition of the account to create and operate the account.
- Where the signature of a customer is forged, the forged instruction or order (eg cheque) is a nullity and the customer is not liable for payment: *Cheques Act s 32(1)*
 - A bank that pays a cheque bearing a forged signature breaches the customer's mandate
- Customer may be subject to an estoppel if she has knowledge of the forged signature prior to payment on the cheque

Customer Duties

Duties owed by customer to the bank:

→ Macmillan duty: London Joint Stock Bank Ltd v Macmillan [1918]

→ Greenwood duty: Greenwood v Martin's Bank [1933]

London Joint Stock Bank Ltd v Macmillan

- A clerk prepared a cheque for signature for one of the partners of the firm of stockbrokers. The cheque as presented to the partner was made out in name of firm for a sum of £ 2 , with a large gap between the sterling symbol and the actual figures, and left the space for the words in blank. The clerk then altered the cheque to £120.00 & wrote the words "One hundred and twenty pounds" in the blank space. The clerk cashed the cheque at the bank and took the money for his own purposes.
- The brokers sued the bank for breach of contract on the basis that it had only ordered the payment of £2, whereas the bank had paid out £120.

Macmillan Duty

- A customer must exercise reasonable care when drawing cheques so that the bank is not misled.
- The customer had breached its duty of care – the alteration of the cheque and loss was a direct result of the customer's breach – so that the bank was entitled to debit the account for £120.
- The drawer of a cheque (the customer) was responsible for any loss caused by her drawing of a cheque in such a manner as to facilitate a fraudulent alteration of the cheque.
- Scope of duty is confined to the mode of drawing and signing of cheques:
 - "The negligence must be in the transaction itself, that is in the manner in which the cheque is drawn".

Slingsby v Distric Bank Ltd [1932]

- The executor of an estate signed a cheque for £5,000 in favour of "Pay J P & Co or order", a firm of brokers. There was a large gap between the payee's name and the printed words "or order". The cheque was altered by a third party who wrote in the gap "per C & P " , indorsed the cheque with the names C & P and paid it so altered into the W Bank to the credit of a company in which he was interested and which had an account at that bank.
- Executors sued the bank for conversion, negligence and breach of duty
- Executor did not breach duty of care to bank by leaving a gap after the name of the payee. It was not normal practice for a customer to draw a line through a space after the payee's name

Commonwealth Trading Bank v Sydney Wide Stores (1981)

- High Court found that the banker and customer contract implied "a duty upon the customer to take usual and reasonable precautions in drawing a cheque to prevent a fraudulent alteration which might occasion loss to the banker".
- There was a fraudulent alteration of the payee's name on the cheque after the cheque had been duly signed
- Approved Macmillan but did not decide in the instant case whether customer had breached its duty of care to the bank.

Greenwood duty (1933)

- Customer had a duty to promptly inform the bank that his cheques have been forged.
- Customer must have actual and not constructive knowledge of forgery.
- Duty extends to notifying bank of any unauthorized operations on the account.

Greenwood vs Martins Bank Ltd

- A husband discovered that his wife had been drawing monies from his bank account by forging his signature on a series of cheques. His wife claimed that she had forged his signature to help her sister in a legal suit. To avoid publicity he did not tell his bank. Later he discovered that his wife's explanation of her forgeries was untrue and he threatened to reveal what she had done to the bank. His wife committed suicide. He then sued the bank to prevent it from maintaining the debit to his accounts for the amount of the forged cheques.

Greenwood duty

- HELD: The customer had a duty to notify the bank of the forgeries as soon as he discovered them. The customer had breached his duty to the bank with the result that the bank was entitled to maintain the debit on the account.
- Bank was adversely affected by the husband's silence- the bank believed that the payments were authorised by its customer, and so it did not during the lifetime of the wife, sue the husband, then being vicariously liable for his wife's tort, or the wife herself.
- Customer's duty is based on an estoppel
- Requirements for estoppel are:
 - i. representation or conduct amounting to a representation intended to induce a course of conduct by the representee;
 - ii. an act/omission resulting from the representation, by the representee; and
 - iii. detriment to such person as a consequence of the act/omission.

Actual or Constructive Knowledge

- In considering the *Greenwood* duty, is actual or constructive knowledge required? Should the same standard of knowledge apply to a business customer with the ability to detect fraud and a personal customer of limited financial means?

Patel v Standard Chartered Bank [2001]

- The bank argued that the customer owed the bank a duty to report fraud of which a "putative reasonable person" would be aware. Toulson J rejected this claim, finding the duty to be limited to actual knowledge and with what he described as "wilful blindness", ie, "deliberately refraining from making enquiries from unwillingness to know the results".
- In rejecting the applicability of the reasonable person test, Toulson J drew strong support from *Tai-Hing Cotton Mill Ltd. v Liu Chong Hing Bank Ltd.* [1986] AC 80 (PC) and observed that the test, in the banking context, would be "imprecise in definition and uncertain in application". Moreover, if a term is to be implied into a banking contract to give it commercial efficacy, it must be, Toulson J stated, "clear in its meaning and capable of reasonably certain application".

No Expansion of Customer Duties

- “There is **no duty** recognized in English (and Australian) case law, even towards the drawee bank, to exercise reasonable care:
 - (a) in the safekeeping of cheque books or corporate seals
 - (b) in the general course of carrying on business, including the selection of employees, so as to detect or prevent forgeries, as well
 - (c) in relation to the examination of periodic bank statements, so as to discover and report forgeries and prevent their repetition

In all such cases, a customer is neither liable in negligence nor estopped by his negligence from asserting the forgeries” (Geva)

Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd (1986) [Macmillan Duty]

- The company’s accounts clerk forged managing directors’ signatures on 300 company cheques over 3 1/2 year period on a sum totalling more than HK\$5.5 million. Clerk disappeared. Company sued bank on basis that it was not entitled to debit the company’s accounts with amount of the forged cheques (ie no mandate to pay). Bank’s defence - company should have examined bank statements which would have revealed the fraud. Bank had an express agreement with company that, unless errors notified to bank within a specified period, statements would be deemed to be correct.
- HELD Company could not have expected this agreement to cover forged cheques and the specific term had not been made clear to the company.
- Where the bank seeks to vary the terms of the implied contract by adding expressly stated conditions, these conditions will only override the implied contract if “the burden of the obligation and of the sanction imposed is brought home to the customer”.
- Privy Council refused to extend the Macmillan duty. It rejected the existence of a duty to exercise precautions to prevent forged cheques being presented to the bank, and of a lesser duty to check periodical bank statements so as to be able to notify the bank of any unauthorised transactions. It was held that neither duty was to be implied as a necessary incident of the banker-customer relationship or imposed by the general law of tort.

National Australia Bank Ltd v Hokit Pty Ltd (1996)

- The C family ran a hairdressing business through a series of companies including H Company, which kept cheque accounts with NAB. A new bookkeeper forged signature of authorised signatories on H Company’s cheques both to (i) pay H Company’s expenses, and (ii) for herself. Signatory aware of (i) but not (ii). The latter was covered up by bookkeeper altering H Company’s records. When H discovered the forgery, H Company sued the bookkeeper and NAB. The bank alleged breach of a duty on the part of H Company to take care to prevent the irregular transactions.
- Bank’s defence was that H owed the Bank the following implied duties arising from the banker-customer relationship:
 - “ (a) to exercise reasonable precautions to prevent forged cheques being presented to the Bank
 - (b) to have in place, and implement, systems by which senior management of the plaintiffs could ascertain within a reasonable time whether their accounts were being debited with amounts not authorised by the plaintiffs;
 - (c) if the plaintiffs’ accounts were not audited by external accountants, to carry out audits or checks by appropriately qualified officers of the plaintiffs; and
 - (d) if the directors of the plaintiffs were not sufficiently qualified or experienced to carry out an audit or check of the accounts, to engage external accountants to carry out audits”.
- Court of Appeal rejected all attempts by the NAB to widen the duty of care owed by customers to banks. Duty (a) was the only relevant duty. It was irrelevant to H’s duty of care to NAB as to the state of its accounting procedures and controls.
- Negligence of customer does not per se give rise to a tortious liability to the banker; however, negligence of customer may be taken into account in establishing estoppel against the customer.

Canadian Pacific Hotels v Bank of Montreal

- The joint signature of the manager (Saunders) & accountant (Hird) were required on the bank account. The accountant delegated the bank reconciliation responsibilities to an assistant accountant (Sands). Sands forged signatures, making cheques payable to companies controlled by him. The accountant received a summary report on bank reconciliation but did not examine the underlying documentation.
- The Supreme Court of Canada held that the company was under no duty to “examine bank statements and vouchers with reasonable care and to report any discrepancies within a reasonable time”.
- “Whether a duty of care exists is a question of law that requires a court to determine whether a party is under a legal obligation to exercise reasonable care in favour of another party. Two elements are essential to establishing a duty of care: proximity and foreseeability. A duty of care will be found to exist where there is a close and direct relationship between the parties and where it is reasonably foreseeable that carelessness by one party could cause damage to the other party. Consideration, however, must also be given to public policy and whether the recognition of a legal obligation to exercise reasonable care is in the best interest of society. Even if the elements of proximity and foreseeability are found to exist, public policy concerns could persuade a court to hold that a duty of care is not a good idea. Where a court establishes that a duty of care exists, the court then looks to the defendant’s conduct and determines whether the manner in which the duty was exercised was reasonable.”

How Do Businesses Protect their Interests?

- Check background of employees
- Segregation of duties between employees
- Insert financial controls, for example, bank reconciliation – check that bank statements are reconciled with disbursements records (eg requisitions, cheque butts etc)
- Banks incorporate exemption or restriction of liability (eg verification clauses) in their contract with businesses, but will these be effective?

Uniform Commercial Code Article 4

- The **US law** is different than Australia- article 4 reverses the onus of proof by imposing a duty on a customer to discover unauthorised signature or alteration of cheques.
- The rule in the US is that where the “bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries... the customer must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof”.