

O N A P P E A L  
FROM THE COURT OF APPEAL OF HONG KONG

B E T W E E N :

TAI HING COTTON MILL LIMITED

Appellant

AND

LIU CHONG HING BANK LIMITED

First Respondent

THE BANK OF TOKYO LIMITED

Second Respondent

CHEKIANG FIRST BANK LIMITED

Third Respondent

CASE FOR THE FIRST RESPONDENTS

KINGSFORD DORMAN  
14 OLD SQUARE  
LINCOLN'S INN  
LONDON WC2A 3UB

CAMERON MARKBY  
MOOR HOUSE  
LONDON WALL  
LONDON EC2Y 5HE

Solicitors for the Appellants

Solicitors for the Second Respondent

LINKLATERS & PAINES  
BARRINGTON HOUSE  
59/67 GRESHAM STREET  
LONDON EC2V 7JA

MAXWELL BATLEY  
27 CHANCERY LANE  
LONDON  
WC2A 1PA

Solicitors for the First Respondent

Solicitors for the Third Respondent

IN THE PRIVY COUNCIL

ON APPEAL

FROM THE COURT OF APPEAL OF HONG KONG

BETWEEN

TAI HING COTTON MILL LIMITED           Appellant

and

LIU CHONG HING BANK LIMITED       1st Respondent

THE BANK OF TOKYO LIMITED       2nd Respondent

CHEKIANG FIRST BANK LIMITED       3rd Respondent

CASE FOR THE 1ST RESPONDENT

Record

p.614-660

1. This is an appeal from a judgment of the Court of Appeal of Hong Kong (Cons V-P, Fuad JA and Hunter J) given on 27th January 1984 whereby they dismissed with costs an appeal by the Appellant (Plaintiff) ("Tai Hing") against a judgment dated 12th July 1983 of the High Court (Mantell J) and allowed with costs the Cross-appeal of the First Respondent ("LCH"). That judgment dismissed with costs Tai Hing's claims against the 2nd and 3rd Respondent (Defendant) banks ("LCH", "Tokyo" and "Chekiang") and declared as

p.568-595

against LCH that it was not entitled to debit Tai Hing's Account with the sum of \$187,195.74.

2. Tai Hing's claims against LCH, Tokyo and Chekiang were for wrongful debiting of forged cheques in its current accounts maintained with them respectively. The cheques in question were forged by Leung Wing Ling ("Leung") a member of Tai Hing's own accounts staff. From December 1972, shortly after his employment as an accounts clerk, he began to steal from Tai Hing. His forgeries involved over 300 cheques of over HK\$5 million extending from November 1974 to March 1978; the forgeries on the LCH account were from November 1977 to March 1978. The debits for the forged cheques were shown on the monthly statements which the banks sent to Tai Hing. Had Tai Hing taken reasonable indeed elementary precautions, Leung's forgeries would have been prevented and in any event would have been discovered by Tai Hing within days from receipt of the monthly bank statement showing the debit of the first forged cheque.

p.571 1.30-49  
p.572 1.1-11  
p.572 1.22-35  
p.574 1.1-5  
p.615 1.44  
p.574 1.6-49  
p.575 1.1-12

3. Tai Hing's contention is that it owed no duty to its bankers to take such elementary precautions and that its failure to do so could not give rise to any legal consequences. Thus, Tai Hing maintains that in respect of forged cheques its bankers are under an absolute liability to it and are effectively its free insurers.

4. The basic question in this appeal is whether the Court of Appeal was right in rejecting Tai Hing's contentions that LCH was not entitled to debit Tai Hing's account with the amount of the forged cheques.

The facts

5. The relevant facts and findings can be summarised as follows. They were either undisputed or were found by the Judge and were unchallenged in the Court of Appeal.

p.90 1.15-20

6. Tai Hing was incorporated in September 1957. It was founded and controlled by Mr. Chen Yuan Chu ("Chen"), who has remained its managing director. It started business in August 1959.

p.96 1.8

p.91 1.20-30 7. Its accounting system was designed by  
p.92 1.10-20 Mr. T.N. Su, ("Su") its chief accountant  
p.220 1.10-20 employed in early 1958. He obtained his  
qualification in China. That system remained  
p.97 1.18-20 unchanged until after May 1978 when Leung's  
p.152 1.10 frauds were discovered. This was  
notwithstanding that Tai Hing had developed  
into a medium sized and reasonably successful  
p.569 1.23-30 textile company with turnover reaching a  
p.417 1.27-33 figure of over HK\$160 million and making  
Part II p.1-3 profits every year except for 1977-8. It had  
p.95 1.36 a number of divisions: Spinning, Weaving,  
Part II p.1 Dyeing and Finishing, Garments (closed in  
p.94 1.7-39 March or April 1976) Texturising (closed at  
p.95 1.1-10 the end of 1978 or early 1979) and Knitting.

p.570 1.15-16 8. In September 1957 and November 1961 Tai  
p.570 1.29 Hing opened current accounts with Chekiang  
and Tokyo respectively.

p.171 9. In November 1962 Tai Hing opened a  
current account with LCH. By its letter of  
Part II p.22 8th November 1962 Tai Hing requested LCH to  
open a current account subject to the Rules  
and Regulations for the conduct of such  
accounts which it had received. Pursuant to  
such request, LCH opened Tai Hing's current

account. Its authorised signatories were  
Chen alone or two of a number of nominated  
p.94 1.20 signatories which from 1st March 1978  
included Leung. The LCH account was used by  
the spinning and weaving divisions.

Part II p.26 10. Clause 13 of the Rules and Regulations  
provided:

"13. A statement of the customer's  
account will be rendered once a month.  
Customers are desired (1) to examine all  
entries in the statement of account and  
to report at once to the Bank any error  
found therein, (2) to return the  
confirmation slip duly signed. In the  
absence of any objection to the  
statement within seven days after its  
receipt by the customer, the account  
shall be deemed to have been  
confirmed."

11. Pursuant to the Rules and Regulations,  
LCH sent monthly statements to Tai Hing.  
p.548 1.5-27 This would be done within a few days after  
the end of the month, on the day after the  
Part II p.61 date shown on the statement. Each statement  
stated that any exception error or change of  
Part II p.62 address should be promptly advised to the

bank and on its back each statement had a  
p.553 1.10-20 reconciliation of account form. LCH expected  
every customer on receipt of the statement to  
do a reconciliation checking all entries in  
the statement and to notify the bank of any  
errors. The form was to facilitate this  
exercise by the customer. Tai Hing did not  
send confirmation of any bank statement to  
LCH.

p.96 1.40 12. In 1968 Mr. Y.D. Wang ("Wang") who had  
no professional qualification was employed as  
p.97 1.1-2 chief accountant in place of Su who was  
promoted to office manager and director. On  
p.97 1.17-19 Su's death in June 1971, Wang became the  
p.97 1.6-8 office manager as well, carrying out both  
jobs and thus having a considerable burden of  
p.195 1.10-33 responsibility. He was later made a  
p.96 1.31-35 director. By the beginning of the 1970's  
Wang had about seven accounting staff under  
him. None had any professional  
p.220 1.26-27 qualification.

13. In October 1972 Tai Hing advertised for  
an assistant accountant. Leung aged 32 with  
p.97 1.20-33 no professional qualification was employed  
p.98 1.1-20 after Chen checked with one referee. He

p.94 1.30-40 was assigned to take care of the accounts of the garments and texturising divisions. The former used the account at the Dah Sing Bank and later at Chekiang. The latter used the p.95 1.1-10 account at Tokyo.

p.571 1.35-46 14. Leung was dishonest. From December 1972, shortly after his employment began he started stealing from Tai Hing. He opened bank accounts in names similar to those of real suppliers. Leung persuaded Chen to sign cheques by showing him forged documents which appeared to support the transactions. Sometimes the words "or bearer" had not been struck out on cheques issued by Chen. Leung simply endorsed them in his name and received payment. In this way he stole over HK\$300,000 from Tai Hing's Dah Sing Bank account between 4th December 1972 and 31st January 1974.

p.572 1.1-11 15. Leung then began to forge Chen's p.572 1.20-40 signature on cheques. He forged Chen's signature on 104 cheques involving p.573 1.38-40 HK\$790,842-89 on the Tokyo account between 30th January 1975 and 1st February 1978, on some 136 cheques involving over HK\$1.7



million on the Chekiang account from November 1974 to January 1978 and on 54 cheques involving just over HK\$3 million on the LCH account from November 1977 to March 1978.

p.574 1.1-5 His defalcations remained undetected for over five years involving approximately 500 cheques with a face value of approximately HK\$7 million of which about 300 bore forged signatures and had a face value of more than HK\$5 million.

p.572 1.20-25 16. The forgeries on the LCH account began  
p.99 1.25-30 in November 1977. At that time Wang fell ill and retired on 3rd December 1977 and Leung

p.216 1.1-5 assumed control of the LCH account in his place. The first forged cheque dated 5th November 1977 was for HK\$50,000. It was

Part II debited on 12th December 1977. This debit

p.46-7 together with debits for five further forged cheques were shown on the monthly statement for December 1977. This consisting of three pages dated 3rd January 1978 was sent to

p.548 1.25 Tai Hing on the next day. 48 further cheques were debited as shown on the monthly

Part II statements for January, February, March and  
p.48-60 April 1978.

p.100 1.10-20 17. With the departure of Wang, Mr. Liu ("Liu") joined as chief accountant on 1st January 1978. He did not take on the additional responsibility of office manager. This was discharged by Mr. A.C. Lo ("A.C.Lo")  
p.99 1.13 from 1st February 1978. On 1st March 1978  
p.36 1.22-30. Leung was promoted to deputy accountant and  
p.49 1.19-23 became a nominated co-signatory to the LCH account.

p.100 1.31-35 18. On 1st May 1978 A.C.Lo reported to Chen  
p.101 1.1-17 irregularities in the LCH account. These  
p.173 1.38-40 were revealed when he carried out a bank  
p.174 reconciliation on the monthly statement for  
p.176 1.14-35 March 1978. On the next day, Chen and his  
p.177 assistant one Lau, visited LCH. At their  
p.548 1.28-36 request, they were shown the originals of  
p.549 various cheques recently debited. Chen  
p.550 concluded that his signature thereon was  
forged. LCH and Chen then agreed that  
whenever a cheque drawn on Tai Hing's account  
was presented for payment, LCH would  
immediately telephone Lau to check its  
authenticity. Although this arrangement was  
suggested by Chen, LCH would have suggested  
it in any event.

p.574 19. Leung's fraud and forgeries took place  
p.575 1.1-12 over some five years in the context of a  
p.436 1.27-34 defective system of internal control which  
p.497 1.8-19 was inadequate for any company whether  
p.519 1.3-12 English or Chinese. This was acknowledged in  
p.574 1.9-11 cross-examination by both Tai Hing's own  
p.574 1.26-31 auditor and its expert witness. A  
p.432 1.8-36 reasonable system should have as one of its  
p.433 1.1-13 functions the prevention and early detection  
p.494 1.31-34 of fraud. Tai Hing's system did not and was  
p.495 1.1-10 not designed to discharge this function at  
all. There was no proper division of  
p.574 1.16-40 functions which is a fundamental requirement  
of a proper system. The accounts clerk  
p.433 1.14-35 responsible for a particular division had  
p.434 almost total control both of the receipts and  
p.435 the payments side of the accounts. He handled  
p.436 1.1-34 incoming cheques, recorded receipts and,  
p.483 1.40-44 subject to being able to produce supporting  
p.484 1.1 vouchers, made and recorded payments. To  
p.495 1.11-37 have a proper division of functions would not  
p.496 1.1-33 have involved the employment of any extra  
p.499 1.3-12 staff. This was demonstrated by subsequent  
p.517 1.3-31 improvements introduced by Tai Hing which  
p.515 1.14-34 achieved proper segregation of duties without  
p.530 1.2-20 any increase in staff.

p.574 1.41-50 20. Given the absence of a proper division  
p.575 1.1-12 of functions, it was essential that there  
p.444 1.7-39 be a high degree of supervision. There was  
p.445 none. In particular, there was a total  
p.446 failure to check or supervise Leung's  
p.447 reconciliation of the monthly bank  
p.448 1.1-6 statements. A proper bank reconciliation is  
p.442 1.32-38 an essential part of any system. It would  
p.447 1.28.31 have taken half a day to prepare, involving a  
p.503 1.29-36 line by line comparison of the monthly bank  
p.504 1.1-30 statement with the daily bank journal and  
p.447 1.32-34 finding explanations for the discrepant  
p.506 1.1-5 items. Review by a supervisor would have  
1.33-35 taken about half a day. Upon some  
peculiarity or irregularity being observed  
further investigation might take another half  
p.507 1.1-5 day so that forged cheques debited that month  
1.18-38 would have been detected in 2 to 3 days from  
p.508 1.1-9 receipt of the statement. A proper bank  
p.443 1.4-13 reconciliation should have been done by a  
p.503 1.8-20 person other than one of those involved in  
the receipts and payments functions for that  
account and then reviewed by a senior  
p.443 1.24-35 officer. The carrying out of proper bank  
p.446 1.1-6 reconciliations would not have involved the  
p.449 1.1-9 employment of any extra staff.

21. Assuming that Tai Hing owed to LCH, Chekiang and Tokyo a duty to take reasonable care to prevent cheques purportedly drawn on its account but not representing its true orders being presented to them respectively for payment ("the wider duty"), the Judge accepted that the standard of care which Tai Hing was required to take was one involving such precautions as a reasonable customer in his position would take to prevent such cheques being presented to his bank for payment. The Judge found on the facts that:

(a) Tai Hing was in breach of such duty in failing to take steps to prevent and uncover any forgeries.

(b) Such breaches caused damage to LCH, Chekiang and Tokyo for which Tai Hing was liable. Such damage was sufficient to extinguish Tai Hing's respective claims against them. Accordingly such breaches constituted a good defence to those claims.

22. Assuming that Tai Hing owed to LCH, Chekiang and Tokyo a duty to take reasonable

p.584 1.6-19

care to check its monthly statement when received from those Banks and to notify them of any items debited thereto which were not or might have been authorised by them, ("the narrower duty") the Judge accepted that the standard of care that Tai Hing was required to take was one involving such precautions as a reasonable customer in his position would take to enable him to notify the bank of any items therefrom which were not or may not have been authorised by him. The Judge found on the facts that :

(a) Tai Hing was in breach of such duty to take steps for this purpose, in particular to check bank statement reconciliations.

(b) Such breaches caused damage to LCH, Chekiang and Tokyo for which Tai Hing was liable. Such damage was sufficient to extinguish Tai Hing's respective claims against them. Accordingly such breaches constituted a good defence to those claims.

p.600-601

23. Such findings on the facts were not challenged by Tai Hing in the Court of Appeal.

Issues

24. The issues in this appeal are :

(a) whether clause 13 of the Rules and Regulations governing the account provides a complete defence to LCH.

(b) whether the wider or narrower duty should be implied into the contract between Tai Hing and LCH.

(c) whether Tai Hing owed to LCH the wider or narrower duty in tort.

(d) whether Tai Hing is estopped by its negligence and/or its representations from asserting that its account had been wrongly debited with the amounts of the forged cheques.

Clause 13

Part II p.26 25. It is clear on the facts that LCH's Rules and Regulations for current accounts formed part of the contract between Tai Hing and LCH. The offer of Tai Hing, accepted by LCH by opening the current account, was made "subject to your Rules and Regulations" p.171  
Part II p.22 which Tai Hing had seen. The Judge so held p.587 1.2-19 and was affirmed by the Court of Appeal. The p.630 1.12-20 question is what upon its true construction p.638 1.30-36 is the legal effect of clause 13. p.659 1.14-15

26. Clause 13 must be given its ordinary meaning. LCH submits that its meaning is plain. "Any error found" in the monthly statement means what it says. There is no context from which to restrict those words to errors arising from some causes but not others. In the absence of any objection by Tai Hing to the monthly statements containing debits for forged cheques within 7 days after receipt or at all, that account was "deemed to have been confirmed".

27. If an account containing an "error found therein" is in fact confirmed by the customer, the result would be that the customer could not sue the bank because the customer releases its claim against the bank in consideration of the bank releasing its claim against third parties. The last sentence of clause 13 is a contractual provision deeming the same consequences as would have followed if the customer had confirmed the statement.

28. Accordingly clause 13 provides a complete defence to LCH as Cons V-P held.



p.634 1.18-27 LCH submits that the Judge, and Hunter J  
p.590 1.19-27 (with whom Fuad JA agreed) were wrong in  
p.659 1.14-25 holding that clause 13 was not sufficiently  
p.638 1.30-36 clear to cover entries relating to forged  
cheques.

Implied term

29. The Court of Appeal held in effect that  
p.622 1.37-41 the wider duty including the narrower duty  
p.638 1.30-36 should be implied into the contract between  
p.659 1.4-10 Tai Hing and LCH, reversing the Judge who  
p.581 1.6 held against the implication of the wider  
p.582 1.1-5 and narrower duty.  
p.584 1.28-34

30. LCH submits that the wider or narrower  
duty ought to be implied into the contract  
because :

- (a) it is necessarily incidental to the  
legal relationship of banker and customer.
- (b) it is necessary to give that  
relationship business efficacy or is an  
obvious inference from the express and other  
implied terms.

31. The principle that the Court ought to  
imply a term into a contract because it is  
necessarily incidental to and arises out of

the legal relationship of the parties was set out and discussed in the decision of the House of Lords in Liverpool Corporation v. Irwin [1977] AC 239 at 254A-255C (Lord Wilberforce) at 257H-258E (Lord Cross), at 266G-268B (Lord Edmund-Davies), at 270B-C (Lord Fraser) and the earlier decision of the House of Lords in Lister v. Romford Ice and Cold Storage Co. Ltd. [1957] AC 555 at 576-579 (Viscount Simonds) and at 594 (Lord Tucker).

p.619 1.17-40 32. As Cons V-P and Hunter J held (and Fuad  
p.620 JA agreed with both), the Courts have by the  
p.621 application of this principle implied a  
p.622 1.1-10 number of now well-recognised obligations as  
p.646 1.32-44 necessary incidents of the banker and  
p.647-649 customer relationship. In doing so, the  
p.650 1.1-25 Courts have in some instances relied on the  
obligation concerned as mutual or reciprocal  
to an obligation of the other party. The  
following judgments apply or can be read to  
be applying this principle :

(a) London Joint Stock Bank v. Macmillan [1918] AC 777 (House of Lords) at 789-790 (Lord Finlay) 814 (Viscount Haldane) 824 (Lord Shaw) 829 (Lord

Parmour). It was held that the customer has a duty to use reasonable care in drawing his cheques so as to preclude fraudulent alterations. Such duty was recognised to be reciprocal to the banker's duty to pay such cheques on demand.

(b) Joachimson v. Swiss Bank Corporation [1921] 3 KB 110 at 119-120 (Bankes LJ) 125 (Warrington LJ) though Atkin LJ at 129 approached the implication on the basis of the parties' presumed intention. It was held that the customer's balance with his banker is repayable only on demand, the banker not being able to close the account without notice.

(c) Hilton v. Westminster Bank (1926) 135 L.T. 358 the same Court of Appeal as in the Joachimson case held on the facts that the bank was in breach of duty in paying a cheque because it should have been satisfied that the customer had effectively countermanded it or because the bank should have made some inquiry before payment. Bankes LJ at 358 said that the contractual relationship of

banker and customer involves "the duty on the bank to take reasonable care in the carrying out for its customer of its customer's business". Atkin LJ at 362 said that "it is the duty of the bank arising out of the contract to exercise reasonable care and skill in dealing with the communications which the customer sends to them in relation to his banking business".

(d) Greenwood v. Martins Bank [1932] 1 KB 371 (Court of Appeal) at 381 (Scrutton LJ) at 388 (Greer LJ) and at 390 (Romer LJ). It was held that banker and customer are under a mutual and continuing duty to use reasonable care to ensure the proper working of the account so that each must inform the other about known forgeries. In the House of Lords [1933] AC 51 at 57-8 Lord Tomlin said that the existence of a duty on the customer's part to disclose to the bank his knowledge of known forgeries was rightly admitted.

(e) Lloyds Bank v. Brooke (1950) 6 Legal Decisions affecting Bankers 161 (Lynskey J). It was held that a banker

owes a duty of care to its customer in relation to the preparation of its customer's statements.

(f) Selangor United Rubber Estates Limited v. Craddock [1968] 1 WLR 1555 (Ungoed-Thomas J) at 1607-1609. It was held that the bank's obligation is not merely to pay on demand but that it also owes its customer a duty to take reasonable care to ascertain that the cheque presented for payment represented the customer's true intentions and instructions. In confirming this decision in Karak Rubber Estates Ltd. v. Burden [1972] 1 WLR 602 at 620-630, Brightman J (as he then was) based the implication both on the above principle and on the parties "presumed" intention.

33. LCH submits that the wider or narrower duty should be implied into the contract because it is necessarily incidental to the legal relationship of banker and customer between LCH and Tai Hing. Even if the bank's obligation was only to pay on demand, such implication is necessary as the customer has

p.622 1.34-41 as great an interest as his banker has in the proper working of the account. As Cons VP noted, in modern business conditions, it cannot be feasible for banks to subject each and every cheque to examination and comparison with specimen signatures. But since 1968 it has been recognised that the bank's duty goes further. As an incident of the banker and customer relationship, it owes its customer a duty to take reasonable care to ascertain that the cheque presented for payment represented the customer's true intentions and instructions. That being so, the Court ought to imply as equally necessary the mutual or reciprocal obligation of the customer in the form of the wider or narrower duty as an incident of that legal relationship.

34. The implication of the wider or narrower duty as necessarily incidental to the relationship follows from the duty recognised by the House of Lords in the Macmillan decision. The customer is under a duty to use reasonable care in drawing his cheques so as to preclude fraudulent alterations and there is "no rational stopping place" between that point and holding him to be under a duty

to take the precautions contemplated by the wider or narrower duty.

35. Accordingly, LCH submits that the Court of Appeal was right in implying the wider duty as a term of the contract. Cons V-P took a practical view of that which should necessarily be implied as or incidental to the Banker and Customer relationship. He held that failure to imply such a term would render the contract futile, inefficacious and absurd. Hunter J founded such implication upon the proximity created by the relationship of banker and customer and the mutual obligations arising thereunder. LCH submits that Hunter J in effect held such implication necessary to that relationship having regard to its proximity. Fuad JA agreed with both judgments.

p.622 1.20-41

p.650 1.7-25

1.28-39

p.638 1.30-36

36. Quite apart from the application of the principle of implying a term as necessarily incidental to the banker and customer relationship, LCH submits that the wider or narrower duty ought to be implied because it is necessary to give business efficacy or is an obvious inference from the express and

other implied terms. This basis is set out at Chitty on Contracts (25th ed.) paragraph 847. The parties must be presumed to have intended to contract on that basis.

37. The express and other implied terms in the contract upon which LCH relies for this purpose are as follows :

LCH undertook

(a) expressly to pay on demand cheques purporting to be drawn on behalf of Tai Hing provided that the same was signed in accordance with its mandate.

(b) expressly to render a statement once a month to Tai Hing.

(c) by implication to use reasonable care to ensure that such statement is accurate as established by Lloyds Bank v. Brooke.

(d) by implication to use reasonable care to ensure that a cheque drawn in accordance with Tai Hing's mandate represented its true intentions and instructions as established in Selangor United Rubber Estates v. Craddock.

(e) by implication to notify Tai Hing of known forgeries as established by



Greenwood v. Martins Bank.

Tai Hing undertook

(f) by implication to use reasonable care to draw cheques so as to prevent fraudulent alterations as established by the Macmillan decision.

(g) by implication to notify LCH of known forgeries as established by Greenwood v. Martins Bank.

38. LCH submits that the wider or narrower duty ought to be implied because it is necessary to give business efficacy to the contract; the contract would not be efficacious in a business sense without the elementary precautions which the wider or narrower duty oblige the customer to take. Further it is an obvious inference from the express or other implied terms; the parties must be presumed to have intended the customer to take such precautions. The officious bystander posing the question of the existence on the wider or narrower duty would have received the unhesitatingly affirmative answers from both parties.

p.581 1.3-17 39. LCH submits that the Judge and Cons V-P  
p.617 1.3-6 were wrong in declining to make the  
implication on this alternative  
basis. Hunter J held that the contractual  
duty formulation "owed little or nothing"  
to the presumed intention test and founded  
himself on the need to imply the relevant  
term as an incident of the relationship.

#### Tort

40. The principles for deciding whether a  
duty exists in tort were discussed by Lord  
Wilberforce in his speech in Anns v. Merton  
London Borough Council [1978] AC 728 at  
751G-752B.

"Through the trilogy of cases in this  
House - Donoghue v. Stevenson [1932]  
A.C. 562, Hedley Byrne & Co. Ltd. v.  
Heller & Partners Ltd. [1964] A.C. 465,  
and Dorset Yacht Co. Ltd. v. Home Office  
[1970] A.C. 1004, the position has now  
been reached that in order to establish  
that a duty of care arises in a  
particular situation, it is not  
necessary to bring the facts of that  
situation within those of previous  
situations in which a duty of care has  
been held to exist. Rather the question

has to be approached in two stages. First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter - in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any 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 or the damages to which a breach of it may give rise: see Dorset Yacht case [1970] A.C. 1004, per Lord Reid at p.1027."

41. These passages were quoted and applied by Lord Roskill in his speech in Junior Books Ltd. v. Veitchi Ltd. [1983] 1 AC 520 at 541F-542B. In Governors of the Peabody Donation Fund v. Sir Lindsay Parkinson & Co. Ltd. [1984] 3 WLR 953 delivered on 18th October

1984 when the present appeal was pending, the House of Lords (Lord Keith) at 960A-F said that the temptation of treating these passages as being themselves of a definitive character should be resisted. "The true question in each case is whether the particular defendant owed to the particular plaintiff a duty of care having the scope contended for, and whether he was in breach of that duty with consequent loss to the plaintiff. A relationship of proximity in Lord Atkin's sense must exist before any duty of care can arise but the scope of the duty must depend on all the circumstances. In determining whether or not a duty of care of a particular scope was incumbent upon a defendant, it is material to take into consideration whether it is just and reasonable that it should be so."

42. LCH submits that it is plain that there is a sufficient relationship of proximity between Tai Hing and LCH such that in the reasonable contemplation of Tai Hing, carelessness on its part in failing to take the elementary precautions requisite for an adequate system of internal control was likely to cause damage to LCH.

43. LCH submits that in all the circumstances Tai Hing owed LCH the wider or narrower duty. It is clearly just and reasonable that such duties should be imposed or found. The following considerations are of particular importance:-

(a) It is well known that unsupervised employees may commit fraud against their employers if left in uncontrolled charge of the employers' cheque books and bank statements.

(b) Since it is clear that a bank must re-credit a customer's account to the extent of any debit entered against a forged cheque, banks will unreasonably be exposed to liability unless the customer is required to take reasonable precautions to prevent or detect forgery.

(c) A bank has no power to interfere with its customer's business and is totally at risk in the face of the fraudulent employee in whom the customer has elected to put his trust.

(d) The duty sought to be imposed on the customer is modest in range and weight when compared with the consequences to a bank of its customer being free to act in disregard of all ordinary requirements of business prudence in dealing with its financial affairs.

Both banker and customer have a mutual interest to ensure the proper working of the account. The bank owes the customer the mutual or reciprocal duty to take reasonable care to ascertain that the cheque presented for payment represents the customer's true intentions and instructions as held in the Selangor case. Further the customer as an incident of the relationship is under a duty to use reasonable care to draw cheques so as to prevent fraudulent alterations as held in the Macmillan case and there is "no rational stopping place" between that point and the customer being obliged to take the precautions involved in the wider or narrower duty.

44. In LCH's submission, there are no considerations which ought to negative or to

reduce or limit the scope of the wider or narrow duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.

45. The fact that the challenged debits are the result of forgeries committed by Leung does not in LCH's submission affect tortious liability. A high degree of foreseeability that damage would occur is usually required where it is sought to make a person liable for the acts of an independent third party in circumstances where there is a special relationship between them imposing on the person concerned a duty to exercise control over the third party causing damage. But this principle relates to causation and remoteness and as Hunter J pointed out, the Judge's adverse findings against Tai Hing in favour of the banks in this respect were not challenged. Even if they had been, as Hunter J held, this principle has no application to a servant whose work and working environment is under his master's control and Leung could not be regarded as an independent third party within the principle. Further, even if the

p.643 1.31-33

p.643 1.33-37

p.644 1.1-3

p.652 1.23-27

p.643 1.33-37 principal were applicable, a special  
p.644 1.1-3 relationship existed and the required high  
p.625 1.25-29 degree of foreseeability was present as Cons  
p.625 1.30-38 V-P held. Tai Hing could have controlled  
p.626 1.1-22 Leung either directly or by the introduction  
of an adequate system of supervision or  
internal control and LCH's position was one  
of danger, being peculiarly likely to suffer  
from Leung's misbehaviour. As in the  
Macmillan case, where the duty was found to  
take precautions against the very sort of  
thing which happened, that which in fact  
happened must be regarded as expected and  
highly foreseeable. In the Macmillan case,  
Lord Finlay pointed out at 789-790 that if a  
cheque is drawn in such a way as to  
facilitate or almost to invite an increase in  
the amount by forgery if the cheque should  
get into the hands of a dishonest person,  
forgery is not a remote consequence of  
negligence of this description. So, in the  
present case, the lack of elementary  
precautions in breach of the wider or  
narrower duty was to invite fraud and forgery  
by a dishonest person and forgery is  
similarly not a remote consequence of such  
negligence. In this regard, this case and  
the Macmillan case are indistinguishable.



46. Cons V-P and Hunter J (with both of whom  
p.627 1.30-46 Fuad JA agreed) held, in LCH's submission  
p.659 1.4-6 correctly, that the wider duty (including the  
p.638 1.30-36 narrower duty) was owed by Tai Hing to LCH in  
tort, reversing the Judge.

47. The question whether the wider or  
narrower duty is owed in tort is a separate  
question from whether such duty is owed in  
contract. The tests for determining the  
respective questions are different. On a  
given set of facts, both the contractual and  
tortious duties may be held to exist and the  
existence of a contractual duty of care does  
not necessarily exclude a comparable duty of  
care in tort as was held in Midland Bank  
Trust Co. Ltd. v. Hett Stubbs Kemp [1979] Ch.  
384 [Oliver J as he then was]. On the facts,  
the contractual duty may be held to exist but  
not the tortious duty or the tortious duty  
may be held to exist but not the contractual  
duty. LCH submits that if the facts are such  
as to give rise to a duty of care in tort,  
the absence of a contractual duty has no  
bearing on the matter. The existence of the  
contract is part of the factual picture only  
though an express term therein can exclude or  
limit the liability in tort.

48. In LCH's submission, the Judge was wrong  
p.583 1.39-43 in concluding that as there was no  
p.584 1.1-4 contractual duty, there could be no duty in  
tort. Cons V-P held that in principle a duty  
p.623 1.19-27 in tort can exist in the absence of a  
contractual duty in respect of conduct which  
although it would or may not have occurred  
without the existence of the contract is  
otherwise independent of it but not in  
respect of acts and omissions in the actual  
performance of the contract itself. LCH  
submits that this approach without the  
qualification concerning the latter kind of  
p.650 1.20-25 conduct is correct. Hunter J applied the  
same test of proximity to the separate  
questions of the existence of a duty in  
contract and in tort. As LCH has submitted,  
the tests for the separate questions are  
different.

American and Canadian authorities

49. Support for the wider or narrower duty  
can be found in the following American and  
Canadian authorities. In support of the  
wider duty:

- (a) Screenland Magazine Inc. v.  
National City Bank of New York (1943) 42

New York Supplement 2d Series 286  
(Justice Shientag of the Supreme Court,  
New York County).

(b) Canadian Pacific Hotels Ltd. v.  
Bank of Montreal (1981) 122 DLR (3d) 519  
Montgomery J in the Ontario High Court  
of Justice following the dissenting  
judgment of Laskin J in the Supreme  
Court of Canada in Arrow Transfer Co. v.  
Royal Bank of Canada (1972) 27 DLR (3d)  
81 at 101-103. Montgomery J was upheld  
by the Ontario Court of Appeal (Jessup  
JA and Houlden JA with Lacourciere JA  
dissenting) (1982) 139 DLR (3d) 575.  
Leave to appeal to the Supreme Court of  
Canada was granted on 1st November  
1982.

In support of the narrower duty are the  
following authorities in addition to those  
above:

(c) Leather Manufacturers' Bank v.  
Morgan (1886) 117 U.S. 96.

(d) Critten v. The Chemical National  
Bank (1902) 171 N.Y. 219.

(e) Morgan v. U.S. Mortgage & Trust Co.  
(1913) 208 NY 21.

(f) Potts & Co. Inc. v. Lafayette  
National Bank (1935) 269 NY 191.

(g) Thomson v. New York Trust Co. (1944)  
292 NY 58.

Authorities against

50. (a) The extempore observations of Lord Esher M.R. in Chatterton v. London and County Bank The Miller (newspaper) 3rd November 1980 were to the effect that a customer was not bound to look at his pass-book.

(b) In Lewes Sanitary Steam Laundry Co. Ltd. v. Barclay and Co. Ltd. (1906) 95 L.T. 444, Kennedy, J held that it was not enough for a bank to show that a customer's carelessness had enabled a fraud to be committed.

(c) In Walker v. Manchester and Liverpool District Banking Co. Ltd. (1913) 108 L.T. 728, Channell J. rejected the bank's defence of negligence as non causative.

(d) In Kepitigalla Rubber Estates v. National Bank of India Ltd. [1909] 2 KB 1010 Bray J decided against widening the customer's duty beyond that relating to the issue of the mandate.

(e) In the Macmillan decision in 1918, Lord Finlay (at 795 and 801) and Viscount Haldane (at 816) referred to Kepitigalla.

(f) In Wealdon Woodlands (Kent) Ltd. v. National Westminster Bank an unreported decision in March 1983, McNeill J followed Kepitigalla.

(g) In National Bank of New Zealand v. Walpole and Patterson [1975] 2 NZLR 7, the New Zealand Court of Appeal also decided against widening the customer's duty beyond that relating to the issue of the mandate. This decision was followed at first instance in Hong Kong in 1979 in Asien-Pazifik Merchant Finance Limited v. Shanghai Commercial Bank Limited reported in [1982] HKLR 273.

51. These authorities have at most only persuasive effect in Hong Kong. In LCH's submission, they are of doubtful assistance. First, the argument that the wider or narrower duty should be implied in the contract as necessarily incidental to the banker and customer relationship was not considered. Second the argument based on tort was not considered in Kepitigalla. It was adverted to in Walpole. But the more recent statements of principle on tortious duty must now be applied. Third, as Hunter J pointed out, the references to Kepitigalla in Macmillan should not in their context be read as approving Bray J's rejection of any widening of the duty. They were dealing with

p.643 1.13-18

causation and remoteness. Fourth, as  
p.643 1.19-21 Hunter J held, the New Zealand Court of  
Appeal was accordingly wrong in Walpole in  
p.656 1.11-16 considering that the Macmillan decision was  
an authority for not widening the duty.  
p.627 1.9-12 Fifth, as Cons V-P and Hunter J accepted,  
p.639 1.33-39 Kepitigalla and the older cases were  
p.643 1.13-21 bedevilled by outmoded concepts of causation  
and remoteness based on proximate cause and  
natural or direct consequence which have been  
replaced by the foreseeability test.  
p.655 1.14-41 Sixth, as discussed by Hunter J, the  
p.656 1.1-10 reasons relied on by Bray J in Kepitigalla  
are not sufficient to justify the Court in  
holding against the wider or narrower duty in  
modern business conditions.

52. Finally, these cases overlooked an  
earlier line of English cases which  
specifically imposed an obligation on the  
customer to examine his pass-book. In  
Devaynes' v Noble (1816) 1 Mer. 529 the  
custom of bankers was set out in a report  
prepared by the Master and included the  
assertion that the silence of the customer  
when returning a pass-book was regarded as an  
admission that the entries were correct. The

same principle was applied to passage accounts. Sir William Grant M.R. at p. 610 stated: "... the report states that the silence of the customer after the receipt of his banking account is regarded as an admission of its being correct. Both debtor and creditor must, therefore, be considered as having concurred in the appropriation." In Ex.p.Randleson (1833) 2 Deac & Ch. Sir J. Cross said at p. 541: "With regard to the pass book it may be observed that bankers make up these books every year, in order to satisfy their customers of the state of their accounts with them. The only inference, therefore, that can be drawn of any entry in the pass book is that the customer, by keeping the book, admits the statement in it to be correct." In Blackburn Building Society v. Cunliffe Brooks & Co. (1882) 22 Ch. D. 61 at pp. 71-2, Lord Selborne referred to "the doctrine that a pass book passing to and fro is evidence of a stated and settled account." Although the 'settled account' argument failed at first instance and in the court of Appeal in Vagliano Brothers v. Bank of England, (1889) 22 QBD 103, 23 Q.B.D. 243

(C.A.), (reversed by House of Lords on other grounds at (1891) AC 107), Devaynes v. Noble was not cited. In the House of Lords in Vagliano, Lord Halsbury L.C. in the speech at p.116 asked: "Was not the customer bound to know the contents of his own pass book?"

p.622 1.42-47 53. LCH submits that the Court of Appeal of  
p.623 1.1-7 Hong Kong was right in concluding that these  
p.643 1.13-22 authorities do not inhibit their conclusion  
p.655 1.5-41 that the customer owes the bank in contract  
p.656 1.1-21 and/or in tort the wider duty (including the  
narrower duty).

#### Estoppel

54. As the Court of Appeal held, reversing  
p.637 1.29-32 the Judge, that Tai Hing is estopped by  
p.638 1.30-36 negligence from asserting that its account  
p.659 1.38-39 had been wrongly debited with the amounts of  
the forged cheques. It owed to LCH the wider  
or narrower duty. Its conduct amounted to  
the requisite representation to LCH which was  
intended to be and was acted upon by LCH to  
its detriment.

55. Even if Tai Hing did not owe any duty to  
p.593 1.24-40 LCH, LCH submits that the Judge was right in  
p.594 1.1 deciding that Clause 13 coupled with the



absence of any objection amounted to a representation that the monthly statements were correct. The word "deemed" is used to give rise to a legal consequence and cannot be read as merely precatory.

56. Clause 13, representing as it does the intention of the Parties, must have been intended by Tai Hing to be acted upon by LCH because otherwise there would have been no purpose in including it. That LCH acted upon it to its detriment is an obvious and correct inference to draw from the facts as to what happened in early May 1978 when the forgeries were discovered. At that time an arrangement was made protecting LCH from the risk of forged cheques. Moreover as stated in evidence LCH expected every customer on receipt of the monthly statement to do a reconciliation.

p.595 1.1-2 57. LCH submits that the Judge was right in holding that such representation gave rise to an estoppel, the other elements of the estoppel being present. The Court of Appeal did not rule on this estoppel.

p.595 1.2-14 58. The Judge however limited the effect of the estoppel in LCH's case to forged cheques paid after the December 1977 monthly statement (showing the debit of the first six forged cheques) was received. He did so on the ground that the chances of recovering from Leung were not diminished substantially between November 1977 and May 1978 and that this head of prejudice was therefore not present in the case of LCH in addition to the prejudice common to all three banks of continuing to operate the account and exposing themselves to the risk of paying out on forged cheques. LCH submits that the Judge was wrong in this regard. The prejudice suffered by LCH which also applied to the other two banks was sufficient to preclude recovery. In any event the chances of recovering from Leung did materially diminish between November 1977 and May 1978. During this period he forged cheques amounting to well over \$3 million and as the amount of Leung's liabilities materially increased, the chances of recovery from him materially diminished.

p.663 59. On 14th February 1984 the Court of

provisional leave to appeal to Her Majesty in Council. Final leave was granted on 27th July 1984.

60. LCH submits that this appeal should be dismissed with costs for the following amongst other:

REASONS

1. BECAUSE, Rule 13 of the Rules and Regulations governing Tai Hing's account with LCH provides a complete defence to LCH.
2. BECAUSE, the wider and/or narrower duty should be implied into the contract between Tai Hing and LCH.
3. BECAUSE, Tai Hing owed to LCH the wider and/or narrower duty.
4. BECAUSE, Tai Hing is estopped by its negligence and/or its representations from asserting that its account had been wrongly debited with the amounts of the forged cheques.
5. BECAUSE, the Judgment of the Judge on estoppel by representation (save in the respect referred to in paragraph 58) was right.

6. BECAUSE, the Judgments of the Court of Appeal save in the respects expressly referred to above were right.

*Order made*