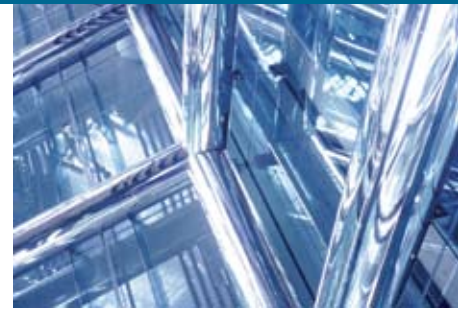


ClientAlert

Bank Finance

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A higher standard of financial prudence and responsibility for banks – Singapore Court of Appeal dismisses claims of defrauded banks



Overview

In *Skandinaviska Enskilda Banken AB (Publ), Singapore Branch v Asia Pacific Breweries (Singapore) Pte Ltd [2011] SGCA 22*, two international banks brought civil proceedings against Asia Pacific Breweries (Singapore) Pte Ltd ("**APBS**") for fraudulent acts perpetrated by APBS's employee over a period of four years. The Singapore Court of Appeal ("**CA**") dismissed all the claims of the defrauded banks largely on the basis that they had failed to comply with their own due diligence procedures prior to granting the loans in question.

The CA's decision represents an important precedent which considers the issues of agency law, vicarious liability, negligence and restitution. More importantly, it serves as a critical reminder to foreign and local banks that there is no substitute for robust due diligence and internal risk assessment procedures.

Summary of the key facts

Chia Teck Leng ("**Chia**") was the finance manager of APBS, a blue-chip company well-known in the region. For more than four years, Chia deceived the Singapore branch offices of several international banks by using the name of APBS to obtain substantial loan facilities purportedly made to APBS. Chia forged board resolutions that suggested that APBS had approved the loans and authorized Chia to operate the funds in his sole name. Chia ultimately misappropriated the funds extended under the loan facilities.

When Chia's fraudulent acts were discovered in 2003, two of the defrauded banks brought court proceedings against APBS, namely Skandinaviska Enskilda Banken AB (Publ) ("**SEB**") and Bayerische Hypo-Und Vereinsbank Aktiengesellschaft ("**HVB**"; and together the "**Banks**"). The Singapore High Court ("**High Court**") dismissed all the claims and the Banks subsequently filed an appeal with the CA.

The issues

The Banks sought repayment of the misappropriated loans on the following grounds:

- (i) Chia had actual or ostensible authority to enter into the loan facilities on behalf of APBS and APBS was therefore liable to repay the outstanding loans and interest;
- (ii) APBS was vicariously liable for the fraud committed by Chia on the Banks;
- (iii) APBS breached the duty of care it owed HVB to have in place reasonable internal controls to prevent and detect fraud; and
- (iv) APBS was liable to make restitution to SEB in respect of the misappropriated funds.

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The CA's decision

(i) The agency issue

One of the issues before the CA was whether Chia had express or implied actual authority to approve an application for a loan and execute the documents necessary to give effect to the transaction. The Banks also claimed that APBS had held out Chia as having authority to represent to the Banks that APBS had accepted the facilities and that the forged board resolutions were genuine.

The CA held that Chia did not have actual authority to approve the loans. Further, the appointment of Chia as finance manager in itself did not amount to a representation by APBS of Chia's apparent authority to warrant the genuineness of the certified board resolutions or communicate APBS's board approval of the transaction. The CA observed that "*Chia was only a finance manager of one company in a large corporate group*" and that his position would carry with it "*less general authority than the position of a general manager, ... a finance director or a managing director*". The Banks therefore had no reason to assume that Chia had the authority to represent that APBS had accepted the loan facilities.

The CA noted that the senior management of APBS, including the APBS board, was also within easy reach of the Banks. The Banks' impression that the certified extracts of the board resolutions were genuine was a result of the Banks' narrow and limited verification of condition precedent documents.

(ii) Vicarious liability

The Banks further contended that APBS was vicariously liable for Chia's deceit (in forging the certified extracts of the board resolutions) and the tort of deceit was committed in the course of Chia's employment. The CA reviewed a series of English and Canadian precedents which applied the "*close connection*" test and agreed with the High Court that APBS should not be vicariously liable for Chia's fraudulent acts as those acts were not sufficiently connected to his employment. The CA added that whilst it could be argued that there was a functional connection between Chia's employment as APBS' finance manager and his fraudulent scheme, the connection was "*illusory*" and the reality was that Chia had very limited financial authority.

The CA emphasised that vicarious liability only comes into play when the law is unable, for practical reasons, to make the blameworthy party bear the financial costs of the tort. Vicarious liability can only be justified where the victim of the tort is not at fault, or is less at fault than the ultimate defendant. The CA noted that this was not the case here as Chia's fraud could have been prevented by the Banks taking very elementary precautions. Although APBS was careless in its lax supervision of Chia's activities, the Banks were themselves blameworthy for readily lending money to APBS at Chia's request without first complying with their own internal controls and without attempting to contact any of the directors at APBS.

(iii) Negligence

The CA also dismissed the claim of HVB against APBS for damages as a result of negligence. On the facts of the case, the relationship between APBS and HVB was not sufficiently proximate to create a duty of care. The CA also found that APBS did not assume any responsibility to HVB in relation to its internal controls and supervision of Chia. The CA noted that even if APBS did owe HVB a duty of care, the proximate cause of HVB's loss was HVB's own negligence in believing the representations made by Chia in relation to the HVB facility and in readily accepting as genuine the forged APBS board resolution. All HVB had to do to prevent the fraud was to comply with its own due diligence procedures and verify the signatures of the directors. The CA further noted that on the facts, there was no compelling reason why the doctrines of vicarious liability and negligence should arrive at different conclusions.

(iv) Restitution

SEB had an alternative claim in restitution against APBS with respect to the sums which SEB, allegedly, paid into APBS' account with OCBC bank under a mistake. APBS denied liability in respect of all claims and brought a counter claim in restitution for knowing and dishonest assistance against SEB.

The CA decided that APBS was not unjustly enriched at SEB's expense and therefore the claim in restitution was unsustainable. However the claim was partly allowed in respect of certain sums (S\$347,671.23) that were transferred to APBS' OCBC bank account to give the appearance of interest on deposits. As there was no such deposit, the ground of total failure of consideration was made out and SEB's claim in this respect was allowed.

Comments

The CA, in dismissing the Banks' appeals, conducted a rigorous analysis of the facts and an extensive review of applicable precedents across the Common Law world. The CA was careful not to create a precedent that would encourage banks to take "*only minimal precautions against fraud*" when dealing with employees holding "*grand-sounding positions*". The CA observed that in view of the "*vital role of banks in our economy, there is every reason for the law to hold them to a higher standard of financial prudence and responsibility – especially in relation to fraud prevention*".

The CA consistently referred to the Banks' unquestioning reliance on Chia and their failure to conduct independent checks to verify his statements, despite the fact that it would have been easy for them to do so. The case serves as a timely reminder to all banks that it is crucial to have in place internal processes to ensure that loans are properly approved by authorised persons within the institution and that proper checks are carried out on condition precedent documents. In addition, there should also be internal mechanisms to identify not just credit risk but the risk of fraud as well. As noted by the CA, it is important for institutions to have "*adequate management structures in place for hiring honest and trustworthy staff*" and it is not the role of the courts to shield such institutions from losses should they be defrauded.

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